IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
WESTERN DIVISION
5:11-CV-00463-D

BRAD HABERLAND, derivatively on behalf of DEX ONE CORPORATION,	)
Plaintiff,	)
v.	)
JONATHAN B. BULKELEY, EUGENE I. DAVIS, RICHARD L. KUERSTEINER, W. KIRK LIDDELL, MARK A. MCEACHEN, ALFRED T. MOCKETT, ALAN F. SCHULTZ, STEVEN M. BLONDY, GEORGE F. BEDNARZ, MARK W. HIANIK, SEAN W. GREENE, and DAVID C. SWANSON,	)
Defendants,	)
and	)
DEX ONE CORPORATION,	)
Nominal Defendant.	)

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS
(Fed. R. Civ. P. 23.1(b) and 12(b)(6))

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MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS

Defendants Jonathan B. Bulkeley, Eugene I. Davis, Richard L. Kuersteiner, W. Kirk Liddell, Mark A. McEachen, Alfred T. Mockett, Alan F. Schultz, Steven M. Blondy, George F. Bednarz, Mark W. Hianik, Sean W. Greene, and David C. Swanson (the "Individual Defendants") and Nominal Defendant Dex One Corporation ("Dex One" or "the Company") (collectively, "Defendants") move the Court to dismiss Plaintiff's shareholder derivative Complaint challenging the Company's 2010 executive compensation for three independent reasons. First, the Complaint must be dismissed under Federal Rule of Civil Procedure 23.1(b)(3) because Plaintiff neither made demand of the Company's Board of Directors nor adequately alleges that such demand was futile. Second, the Complaint must be dismissed under Federal Rule of Civil Procedure 12(b)(6) because Plaintiff's conclusory allegations fail to rebut the presumptions of the business judgment rule, and thus fail to state claims for breach of fiduciary duty and unjust enrichment. Third, the Complaint must be dismissed, in whole or in part, because Plaintiff, who acquired Dex One stock after the Company emerged from bankruptcy, cannot, as a matter of law, challenge decisions that (i) pre-dated his stock ownership and (ii) were reviewed, approved, and confirmed by the United States Bankruptcy Court for the District of Delaware. For each of these reasons, Defendants respectfully request that this Court enter an Order dismissing Plaintiff's Complaint with prejudice.

NATURE OF THE CASE

This is one of several shareholder derivative actions recently filed based on the so-called "say on pay" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (the "Dodd-Frank Act"). The Dodd-Frank Act, passed in 2010, requires publicly traded companies to submit executive compensation programs for a non-

binding vote of the shareholders at least once every three years. 15 U.S.C. § 78n-1(a). Congress spoke with great clarity in the statute regarding what this shareholder "say on pay" vote does, and does not, mean. Specifically, the statute provides that (i) the vote "shall not be binding" on the company's board of directors, (ii) the vote "may not be construed . . . to create or imply any change to the fiduciary duties" of the company's board, and (iii) the vote "may not be construed . . . to create or imply any additional fiduciary duties" for the board. 15 U.S.C. § 78n-1(c). Despite this clear and unambiguous language, a handful of actions like this one have been filed, claiming that a negative "say on pay" vote somehow means that the board of directors breached its fiduciary duties. As of the date of the filing of this Motion, the only other court to decide a motion to dismiss based on Delaware law, which is applicable here, granted the motion and dismissed virtually identical "say on pay" claims. *Teamsters Local 237 Additional Sec. Benefit Fund ex rel Beazer Homes USA, Inc. v. McCarthy*, No. 2011-cv-197841 (Sup. Ct. Fulton County, Ga. Sept. 16, 2011) (attached as **Ex. 1**).[1] The outcome here should be no different.

STATEMENT OF RELEVANT FACTS

Plaintiff Brad Haberland claims to have been a Dex One shareholder from 2010 to the present.[2] (Compl. ¶¶ 1, 19 (Docket No. 1).) Nominal Defendant Dex One is a Delaware corporation headquartered in Cary, North Carolina. (Compl. ¶ 20.) The Individual Defendants

[1] As of the date of this filing, one other court has decided a motion to dismiss in a "say on pay" case. *NECA-IBEW Pension Fund ex rel. Cincinnati Bell, Inc. v. Cox*, No. 1:11-cv-451, 2011 WL 4383368 (S.D. Ohio Sept. 20, 2011) (attached as **Ex. 2**). In that case, the court denied the motion to dismiss, but based its decision on Ohio law, and diverged in key respects from the Delaware legal principles that govern here. *See infra* Part I.B.

[2] For purposes of this motion only, Defendants recite the facts as they are alleged in Plaintiff's Complaint. Defendants reserve the right to deny Plaintiff's allegations in subsequent responsive pleadings, if necessary.

include all seven of the Company's current directors and six current or former Company executives.[3] (Compl. ¶¶ 21-32.)

Dex One, which was previously known as R.H. Donnelley Corporation ("RHD"), was traded publically on the New York Stock Exchange ("NYSE") beginning in 1998. (Compl. ¶ 3.) On December 31, 2008, the NYSE suspended trading of RHD shares because it no longer met the NYSE's continued listing standards. (Compl. ¶ 3.) The Company subsequently filed Chapter 11 bankruptcy on May 28, 2009. (Compl. ¶ 46.) On January 12, 2010, the Bankruptcy Court approved and confirmed the Company's Plan of Reorganization. (Dex One Corp. Proxy Statement at 13 (Mar. 17, 2011) ("Proxy") (attached as **Ex. 3**).)[4] The Company successfully emerged from bankruptcy as Dex One Corporation on January 29, 2010 (Proxy at 13), pursuant to the terms of the Bankruptcy Court's Confirmation Order. *In re R.H. Donnelley Corp.*, No. 09-11833 (Bankr. D. Del. Jan. 12, 2010) ("Confirmation Order") (attached as **Ex. 4**).[5] On February 1, 2010, the NYSE began trading shares of Dex One stock. (Compl. ¶ 47.)

The 2010 executive compensation program challenged by Plaintiff was, in substantial part, reviewed, approved, and confirmed by the Bankruptcy Court. The Company's 2010 executive compensation plan includes the following elements: base salaries, bonuses awarded

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[3] Defendant Alfred Mockett, who is a director and the current President and CEO of the Company, is included in both categories. (Compl. ¶ 26.)

[4] In deciding a motion to dismiss, a court may consider documents relied upon in the complaint. *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 618 (4th Cir. 1999); *New Beckley Mining Corp. v. Int'l Union, United Mine Workers*, 18 F.3d 1161, 1164 (4th Cir. 1994). Plaintiff repeatedly cites and relies upon the Proxy in his Complaint. (*E.g.*, Compl. ¶¶ 6, 10, 36-37, 51, 56-58, 89, 94.) Accordingly, it is appropriate for the Court to consider the Proxy in ruling upon this Motion to Dismiss.

[5] A court may take judicial notice of judicial records in a bankruptcy proceeding. *Capparelli v. AmeriFirst Home Imp. Fin. Co.*, 535 F. Supp. 2d 554, 559 n.3 (E.D.N.C. 2008) (Dever, J.). Additionally, in deciding a motion to dismiss based on res judicata, courts may take judicial notice of facts from prior judicial proceedings. *Q Int'l Courier Inc. v. Smoak*, 441 F.3d 214, 216 (4th Cir. 2006) (citing *Andrews v. Daw*, 201 F.3d 521, 524 n.1 (4th Cir. 2000)). Accordingly, it is appropriate for the Court to consider the Confirmation Order and related Bankruptcy Court filings in ruling upon this Motion to Dismiss.

pursuant to the 2009 Long-Term Incentive Program, stock awards, option awards in the form of stock options and stock appreciation rights ("SARs"),[6] non-equity incentive plan compensation pursuant to the Annual Incentive Plan, and miscellaneous compensation. (Proxy at 22-23.) Plaintiff's vague challenges to the Company's "2010 executive compensation" appear to encompass each of these elements. (Compl. ¶ 53 & n.3.) However, in the Confirmation Order, the Bankruptcy Court expressly addresses and approves the following elements of 2010 executive compensation:

- The base salaries (Confirmation Order at 12,[7] 42-44.)
- The SARs that were issued following the Company's emergence from bankruptcy (Confirmation Order at 12,[8] 42-44.)
- The employment agreements of Defendants Blondy and Swanson (Confirmation Order at 12, 42-44; Approved Plan List at 22.)

Additionally, the Bankruptcy Court approved the following executive compensation plans, pursuant to which elements of the 2010 executive compensation were later awarded:

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[6] As discussed further in Part I.C.3, all such 2010 stock options and stock appreciation rights are presently worthless because the Company's share price is significantly below the relevant exercise price or base price. (*See* Proxy at 24.)

[7] The Confirmation Order incorporates and approves the "Employment and Retirement Benefit Agreements," which the Plan of Reorganization defines to include all contracts, agreements, and programs listed in "Exhibit C to the Noteholders Plan Term Sheet." (Confirmation Order, Exhibit A, at 11 ("Plan of Reorganization").) This Exhibit C expressly includes "Current Base Salaries," the "2009 Annual Incentive Plan," and the "2009 Long-Term Incentive Plan for Executives." (Noteholders Plan Term Sheet, Exhibit C, at 22 ("Approved Plan List") (attached in excerpted form as **Ex. 5**).) This document is Exhibit C to the Noteholders Plan Term Sheet, which is Exhibit A to the Noteholder Support Agreement, which in turn is Exhibit C to the Disclosure Statement for the Joint Plan of Reorganization. (*See* Ex. 5 (containing the initial pages of the Disclosure Statement and Exhibit C thereto).)

[8] The Confirmation Order incorporates and approves the "MIP Documents," which are defined to include the "Addendum to R.H. Donnelley Corporation Equity Incentive Plan" and the "Stock Appreciation Right Agreement." (Confirmation Order at 6-7.) The Addendum requires that the Company issue stock appreciation rights to certain executives following the Company's emergence from bankruptcy. (Addendum to Dex One Corporation Equity Incentive Plan ("Addendum") (attached in excerpted form as **Ex. 6**).) The MIP Documents, which include the Addendum, are Exhibit 5.10 to the Plan Supplement Documents. (*See* Ex. 6 (containing the initial pages of the Plan Supplement Documents and Exhibit 5.10 thereto).)

- The 2009 Long-Term Incentive Plan (Confirmation Order at 12, 42-44; Approved Plan List at 22.)
- The 2009 Annual Incentive Plan (Confirmation Order at 12, 42-44; Approved Plan List at 22.)

In March 2011, the Company filed the Proxy with the Securities and Exchange Commission ("SEC") and distributed it to Dex One shareholders. (Compl. ¶ 6.) The Proxy included a proposed advisory (non-binding) resolution approving the Board's 2010 executive compensation program, as required by the Dodd-Frank Act's "say on pay" provisions. (Compl. ¶ 10; Proxy at 35-36.) The Board recommended that shareholders vote in favor of this proposal. (Compl. ¶ 10.) On May 3, 2011, however, a slight majority of the voting shares (52 percent) voted against this proposal. (Compl. ¶ 11.)

Plaintiff commenced this shareholder derivative suit on September 1, 2011. In the Complaint, Plaintiff asserts claims for breach of fiduciary duty and unjust enrichment. In short, Plaintiff contends that the Company's 2010 executive compensation was excessive and unwarranted in light of the Company's 2009 bankruptcy, the suspension of trading in its shares on the NYSE, and the decline in its share price. (Compl. ¶¶ 13-15.) Plaintiff makes no mention of the Bankruptcy Court's approval of significant aspects of the 2010 compensation program, and instead claims that the Individual Defendants breached their fiduciary duties to the Company by (i) making misrepresentations concerning the 2010 executive compensation (First Cause of Action), (ii) increasing executive compensation in violation of an alleged "pay for performance" policy (Second Cause of Action), and (iii) failing to respond to the negative shareholder vote on executive compensation (Third Cause of Action). Additionally, Plaintiff claims that the Individual Defendants were unjustly enriched by this executive compensation (Fourth Cause of Action).

Plaintiff chose not to make a pre-suit demand that the Board assert these claims for the Company. Instead, Plaintiff contends that demand is excused because it would have been futile. (Compl. ¶¶ 74-81.) In this regard, Plaintiff offers no specific factual allegations supporting the contention that a majority of the Company's directors are interested or otherwise unable to exercise their business judgment. Rather, Plaintiff offers only conclusory claims that "a majority of the Board is interested because there is a substantial likelihood that they will be held liable for their conduct," or because they are members of the Compensation Committee whose decisions are challenged by Plaintiff. (Compl. ¶¶ 75, 77, 79, 81.) Plaintiff also claims that "there is doubt" that the Board's decisions concerning 2010 executive compensation constituted a valid exercise of business judgment, given the Company's 2009 bankruptcy, the suspension of trading in its shares on the NYSE, and the decline in its stock price. (Compl. ¶¶ 74, 76.)

Even taking Plaintiff's allegations as true, for purposes of this Motion, Plaintiff's Complaint must be dismissed, as a matter of law, for the following reasons.

ARGUMENT

I. PLAINTIFF'S CLAIMS MUST BE DISMISSED FOR FAILURE TO MAKE DEMAND OR SUFFICIENTLY ALLEGE DEMAND FUTILITY.

A. Legal Standard

1. Choice of Law

Under Rule 23.1 of the Federal Rules of Civil Procedure, a shareholder derivative complaint must "state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority . . . and (B) the reasons for not obtaining the action or not making the effort." FED. R. CIV. P. 23.1(b)(3). This rule contemplates a pre-suit demand requirement, but does not establish the scope and nature of that requirement. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96 (1991). The Supreme Court has held that the demand

requirement for shareholder derivative suits is a matter of substance, not procedure. *Id.* at 96-97. In diversity cases, federal courts apply the conflict of law principles of the state in which they are located to determine which state's law governs. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496-97 (1941). Accordingly, questions concerning the scope and nature of the demand required (including when demand will be deemed futile) are determined based on state law. *E.g.*, *Kanter v. Barella*, 489 F.3d 170, 176 (3d Cir. 2007).

Under North Carolina law, the substantive law governing a corporation's internal affairs is determined by its state of incorporation. *See Bluebird Corp. v. Aubin*, 188 N.C. App. 671, 680-81, 657 S.E.2d 55, 63 (2008) (recognizing the internal affairs doctrine). Moreover, the North Carolina Business Corporation Act provides that in any derivative proceeding brought in the right of a foreign corporation, shareholder standing and demand futility are governed by the law of the state of incorporation. N.C. Gen. Stat. § 55-7-47. Here, since Dex One is a Delaware corporation, Delaware substantive law governs the scope and nature of the demand requirement and the breach of fiduciary duty standard.

2. Demand Futility Standard

Under Delaware law, a shareholder must make a demand before filing a derivative suit unless doing so would be futile. The demand requirement "is a recognition of the fundamental precept that directors manage the business and affairs of corporations." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244, 253-54 (Del. 2000).

Since directors are charged with managing the corporation's business, "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." *Aronson*, 473

A.2d at 808. As the Delaware Chancery Court explained in its most recent decision dismissing a challenge to executive compensation, "[d]emand is required because '[t]he decision whether to initiate or pursue a lawsuit on behalf of the corporation is generally within the power and responsibility of the board of directors.'" *In re Goldman Sachs Group, Inc.*, Civ.A. 5215-VCG, 2011 WL 4826104, at *6 (Del. Ch. Oct. 12, 2011) (attached as **Ex. 7**) (quoting *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009)). Specifically, the *Aronson* test provides that demand is only excused in a case like this if the complaint includes particularized factual allegations that either (1) create a reasonable doubt that a majority of the directors were disinterested and independent when the action was filed or (2) create a reasonable doubt that the challenged decision was otherwise the product of a valid exercise of business judgment. *Brehm*, 746 A.2d at 256-57 (citing *Aronson*, 473 A.2d at 811). In determining whether demand was futile, courts consider only the allegations of the complaint. *Spiegel v. Buntrock*, 571 A.2d 767, 774 (Del. 1990); *Aronson*, 473 A.2d at 808. Under either inquiry, the plaintiff bears the burden of rebutting the business judgment rule presumption that the directors acted on an informed basis, in good faith, and in the honest belief that the decision made was in the company's best interests. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048-49 (Del. 2004); *Aronson*, 473 A.2d at 812.

B. Plaintiff Has Not Alleged Particularized Facts That Raise a Reasonable Doubt About Whether a Majority of the Company's Directors Are Disinterested and Independent.

To satisfy the first prong of the *Aronson* test, a plaintiff must allege particularized facts that raise a reasonable doubt about whether a majority of the directors are disinterested and independent. Plaintiff's Complaint fails to make this showing.

A director is considered interested when that director "either has received, or is entitled to receive, a personal financial benefit from the transaction which is not equally shared by the stockholders." *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984), *overruled in part on other grounds by Brehm*, 746 A.2d at 253-54. A director lacks independence when that director is unable to make a decision "based on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Aronson*, 473 A.2d at 816.

Delaware courts have repeatedly rejected the argument, relied upon by Plaintiff here, that directors are interested simply because they approved the challenged transaction. "[M]ere directorial approval of a transaction, absent particularized facts supporting a breach of fiduciary duty claim, or otherwise establishing the lack of independence or disinterestedness of a majority of the directors, is insufficient to excuse demand." *Aronson*, 473 A.2d at 817; *see also Brehm*, 746 A.2d at 257 n.34; *Pogostin v. Rice*, 480 A.2d at 625.[9] Similarly, "the fact that all directors are named as defendants in a derivative complaint is not determinative of their lack of independence." *Spiegel*, 571 at 774 n.14; *see also Brehm*, 746 A.2d at 257 n.34; *Pogostin*, 480 A.2d at 625; *Aronson*, 473 A.2d at 818. Additionally, "the mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." *Aronson*, 473 A.2d at 815. The threat of personal liability only excuses demand in "rare cases" where the board's decision is "so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists." *Id.*; *In re Citigroup*, 964 A.2d at 121.

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[9] Delaware law on this issue is completely different than Ohio law as applied by the court in the *NECA-IBEW* case. In that case, the court concluded that demand was futile primarily because "[t]he director defendants are the very same people who approved the pay hikes and bonuses, and plaintiff has named all directors who approved the compensation as defendants," two demand futility rationales Delaware courts have repeatedly rejected. *NECA-IBEW*, 2011 WL 4383368, at *4.

Here, Plaintiff does not plead any facts that call into question the independence or disinterestedness of the Company's six outside directors. Plaintiff questions the independence of Defendant Mockett (Compl. ¶ 78), who serves as a director and as the Company's President and CEO, and who the Company identified in the Proxy as not independent for that reason. (Proxy at 8.) Yet Plaintiff does not even mention, much less challenge, the Board's unanimous determination that all other directors – Defendants Bulkeley, Davis, Kuersteiner, Liddell, McEachen, and Schultz – "qualify as independent directors within the meaning of all applicable laws and regulations." (Proxy at 8.) Plaintiff does not allege that any of these six directors received personal financial benefit from the challenged executive compensation or were subject to the dominion and control of Defendant Mockett (or any other person who benefitted from the challenged compensation). Accordingly, Plaintiff has not raised any reasonable doubt concerning the independence of a majority of the Company's directors.

Moreover, Plaintiff's allegations that a majority of the Company's directors are interested rely solely on arguments that have been repeatedly rejected by courts applying Delaware law. *See supra* pp. 9-10. Plaintiff makes conclusory allegations that demand was futile because the directors face a "substantial likelihood of liability." But the Complaint's conclusory assertion that "a majority of the Board either was at fault for the misconduct described herein and/or is liable for the misconduct described herein" (Compl. ¶ 81) is unavailing. As discussed above, Delaware courts have squarely rejected the argument that demand futility exists simply because the directors approved the challenged transaction or are named as defendants. *Aronson*, 473 A.2d at 817-18. Furthermore, Plaintiff's factual allegations regarding breach of fiduciary duty, even if taken as true for purposes of this Motion, do not establish the type of egregious conduct required to show a substantial likelihood of liability. *Cf. Ryan v. Gifford*, 918 A.2d 341, 355-56

(Del. Ch. 2007) (holding that directors faced a substantial likelihood of liability where those directors allegedly either approved or accepted backdated stock options in violation of a shareholder-approved stock option plan and made intentionally fraudulent public disclosures concerning their compliance with that plan). At best, they show no more than a "mere threat" of liability, which does not render demand futile under Delaware law. *Aronson*, 473 A.2d at 815.

This is particularly true where, as here, the Company's Certificate of Incorporation contains provisions that exculpate the Company's directors from liability for monetary damages for breach of fiduciary duty to the maximum extent permitted by law. (Dex One Corp., Certificate of Incorporation, at 4 (attached as **Ex. 8**).)[10] The Delaware Supreme Court has held that such exculpatory provisions militate against finding a substantial likelihood of liability: "Where directors are contractually or otherwise exculpated from liability for certain conduct, 'then a serious threat of liability may only be found to exist if the plaintiff pleads a non-exculpated claim against the directors based on particularized facts.'" *Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008) (holding that plaintiff's factual allegations were insufficient to establish demand futility in light of exculpatory provision) (quoting *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003)); *see also In re Citigroup*, 964 A.2d at 121 (dismissing breach of fiduciary duty claims in light of exculpatory provisions because plaintiff did not plead particularized facts establishing non-exculpable conduct); *In re Goldman Sachs*, 2011 WL 4826104, at *18 ("The

[10] Delaware courts consider such exculpatory provisions in determining whether demand was futile. *E.g.*, *Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008); *In re Citigroup*, 964 A.2d 106, 121 (Del. Ch. 2009). The Company's Certificate of Incorporation has been filed with the Delaware Secretary of State, was filed with the Bankruptcy Court, was filed with the SEC, and is publically available. Accordingly, this Court may take judicial notice of the Certificate of Incorporation in deciding this Motion to Dismiss. FED. R. EVID. 201(b)(2), (d); *In re PEC Solutions, Inc. Sec. Litig.*, 418 F.3d 379 (4th Cir. 2005) (taking judicial notice of documents publically filed with the SEC to affirm dismissal under Rule 12(b)(6)).

likelihood of directors' liability is significantly lessened where, as here, the corporate charter exculpates the directors from liability to the extent authorized by 8 Del. C. § 102(b)(7).").[11]

In sum, Plaintiff's conclusory allegations do not create any reasonable doubt about whether a majority of the Board was disinterested and independent when this action was filed.

C. Plaintiff Has Not Alleged Particularized Facts That Raise a Reasonable Doubt That the Challenged Decisions Were the Product of a Valid Exercise of Business Judgment.

Plaintiff has also failed to allege particularized facts that raise a reasonable doubt concerning whether the challenged compensation decisions were valid exercises of the Board's business judgment. "A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson*, 473 A.2d at 811 (citing 8 Del. Code § 141(a)). Under the business judgment rule, a company's directors are presumed to have "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Id.* at 812.

It is well-settled under Delaware law that decisions regarding executive compensation are squarely within the business judgment of a company's board. *See Brehm*, 746 A.2d at 262 n.56 (stating that "directors have the power, authority and wide discretion to make decisions on executive compensation" (citing 8 Del. Code § 122(5)); *In re Goldman Sachs*, 2011 WL 4826104, at *14 (describing setting employee compensation as "a core function of a board of directors exercising its business judgment"). The Delaware General Corporation Law explicitly

[11] The Bankruptcy Court's Confirmation Order and Plan of Reorganization also contain comprehensive exculpatory provisions that, among other things, exculpate the Company's directors from liability for claims arising after the Company entered bankruptcy, including claims arising from the implementation of the Plan of Reorganization. (Confirmation Order at 79-80; Plan of Reorganization at 16, 18-19, 85.) These exculpatory provisions further diminish any threat of personal liability for the Company's directors.

grants corporations the power to "[a]ppoint such officers and agents as the business of the corporation requires and to pay or otherwise provide for them suitable compensation" and to "pay pensions and establish and carry out pension, profit sharing, stock option, stock purchase, stock bonus, retirement, benefit, incentive and compensation plans, trusts and provisions for any or all of its directors, officers and employees." 8 Del. Code § 122(5), (15). Accordingly, "the size and structure of executive compensation are inherently matters of judgment." *Brehm*, 746 A.2d at 263. "If an independent and informed board, acting in good faith, determines that the services of a particular individual warrant large amounts of money, whether in the form of current salary or severance provisions, the board has made a business judgment." *Grimes v. Donald*, 673 A.2d 1207, 1215 (Del. 1996), *overruled in part on other grounds by Brehm*, 746 A.2d at 253-54.

A board's judgments concerning executive compensation are entitled to protection under the business judgment rule "unless the facts show that such amounts, compared with the services to be received in exchange, constitute waste or could not otherwise be the product of a valid exercise of business judgment." *Id.* Under Delaware law, waste is shown only when there is "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Brehm*, 746 A.2d at 263 (quoting *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997)). Consequently, "when dealing with a board's decision on executive compensation, its substantive decision is entitled to great deference." *Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, Civ.A. 20228-NC, 2004 WL 1949290, at *17 (Del. Ch. Aug. 24, 2004) (attached as **Ex. 9**); *see also White v. Panic*, 783 A.2d 543, 553 n.35 (Del. 2001) (recognizing a board's "broad

discretion to set executive compensation"); *Aronson*, 473 A.2d at 817 (recognizing directors' "broad corporate power to fix the compensation of officers").

In challenging the Board's business judgments concerning the 2010 executive compensation, Plaintiff focuses on three issues: (i) allegedly misleading statements; (ii) the negative "say on pay" vote that occurred in May 2011; and (iii) a statement Plaintiff describes as the Company's "pay for performance" policy. These allegations in no way rebut the presumptions of the business judgment rule.

1. Allegedly Misleading Statements

The Complaint alleges that Defendants "failed to disclose material information and or/made material misrepresentations to shareholders regarding Dex's 2010 executive compensation scheme." (Compl. ¶ 84.) Although Plaintiff speaks of "numerous misrepresentations" (Compl. ¶ 86), he ultimately identifies only two, both from the Proxy. The first alleged misrepresentation is that "the Board stated that their pay for performance policy 'align[ed] executive pay with performance, both annual and long-term.'" (Compl. ¶ 89.) The second is that "the Board stated that another 'objective' is to 'strongly link the interests of executives to those of the Company's shareholders.'" (Compl. ¶ 89 (emphasis omitted).) Plaintiff contends that these statements are "false and misleading" in relation to the Company's 2010 executive compensation. As to the purported failure to disclose, the only undisclosed "fact" Plaintiff identifies is that "the Company was overpaying its directors, officers and employees via compensation plans premised on an illusory 'pay for performance' executive compensation scheme." (Compl. ¶ 88.)

These allegations strain credulity. The two purported "misrepresentations" are taken from a list of six different "executive compensation objectives" found in the executive summary

of the Proxy's Compensation Discussion and Analysis section. (Proxy at 13.) Even taken on their own, it is difficult to understand how such non-specific statements could be misleading. In context, these statements are immediately followed by twenty-one (21) pages of detailed information about the Company's executive compensation. (Proxy at 13-34.) These aspirational "executive compensation objectives" cannot be considered false and misleading statements given the detailed financial information and analysis contained in the Proxy. Moreover, Plaintiff has not identified any way in which the Company violated these two objectives. *See Teamsters Local 237*, slip op. at 16 (dismissing "say on pay" derivative claims alleging misrepresentations concerning executive compensation policies in a proxy statement because plaintiffs identified "no facts whatsoever suggesting that any specific statements contained therein misrepresented the Company's policies with respect to executive compensation or that the challenged 2010 executive compensation 'violated' those policies").

Additionally, Plaintiff has not identified any financial information that the Company failed to disclose concerning its 2010 executive compensation. Plaintiff's allegation that the Company failed to disclose that the executive compensation was excessive is not a fact, but an opinion. *See Teamsters Local 237*, slip op. at 14-15 ("The allegation that the challenged executive compensation was 'excessively large and irrational,' however, does not identify any undisclosed material *fact*, but rather states an unsupported conclusion.").

Most notably, Plaintiff's own allegations undermine any suggestion that he was misled. The Complaint relies heavily (and perhaps exclusively) on the Proxy for information about the 2010 executive compensation. (*Compare* Compl. ¶ 53 (compensation chart) *with* Proxy at 22 (compensation chart).) In addition, Plaintiff repeatedly cites the negative shareholder vote as evidence supporting his claims. As the Complaint describes, this vote was in response to the

2010 executive compensation decisions described in the Proxy. (Compl. ¶¶ 53, 56-57.) Thus, on the one hand, Plaintiff contends that the 2010 executive compensation disclosed in the Proxy is excessive and unwarranted; on the other hand, Plaintiff claims that the very same Proxy misled him and failed to disclose material information about the allegedly excessive nature of the compensation. Plaintiff cannot have it both ways.

In sum, Plaintiff has not identified a single misleading statement or undisclosed material fact. Instead, Plaintiff simply disagrees with the Board's decisions concerning executive compensation, which are explained at length in the Proxy. Plaintiff's allegations concerning misrepresentations and nondisclosure, which are wholly refuted by even a cursory examination of the Proxy, do not raise any reasonable doubt concerning whether the Board validly exercised its business judgment with respect to the 2010 executive compensation.

2. Advisory Shareholder Vote

In 2010, Congress enacted the Dodd-Frank Act, which, among other things, requires that publicly held corporations hold a non-binding vote concerning executive compensation at least once every three years. 15 U.S.C. § 78n-1(a). Plaintiff contends that the result of the Company's May 2011 "say on pay" vote shows that the Board breached its fiduciary duties. (Compl. ¶¶ 13, 65-66, 80, 101.) The statute itself, however, squarely rejects this argument. Instead, it requires that an advisory shareholder vote be construed as follows:

> **(c) Rule of construction**
> The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed--
> **(1)** as overruling a decision by such issuer or board of directors;
> **(2)** to create or imply any change to the fiduciary duties of such issuer or board of directors; [or]
> **(3)** to create or imply any additional fiduciary duties for such issuer or board of directors

15 U.S.C. § 78n-1(c).

Undeterred by the clear and unambiguous language of the statute upon which he relies, Plaintiff offers the shareholder vote as his primary evidence that the Board has breached its fiduciary duties. (Compl. ¶¶ 13, 65-66, 80, 101.) Moreover, Plaintiff contends that the shareholder vote created an additional fiduciary duty for the Board—a duty to respond. Indeed, Plaintiff's Third Cause of Action is entirely premised on this invented duty. (Compl. ¶¶ 99-105.) These contentions are baseless—the statute expressly disclaims the creation of any new fiduciary duty.

Even as evidence of shareholder sentiment, this "say on pay" vote provides little information other than that a slim majority of the voting shareholders (52 percent) voted against approving, on an advisory basis, the executive compensation described in the Proxy. The result does not reveal the nature and extent of the shareholders' disapproval. For example, it provides no information about what specific aspects of the executive compensation each disapproving shareholder questions, particularly given the fact that the Proxy describes compensation over multiple years. (Proxy at 22; *see also* Proxy at 36 ("This vote is not intended to address any specific item of compensation, but rather the overall compensation of our NEOs and the philosophy, policies and practices described in this Proxy Statement.").)

At present, only one court has decided a "say on pay" shareholder derivative suit under Delaware law. *See generally Teamsters Local 237*. In *Teamsters*, which closely resembles this case, the court dismissed the plaintiff's breach of fiduciary duty and unjust enrichment claims for (i) failure to allege contemporaneous stock ownership; (ii) failure to adequately allege demand futility; and (iii) failure to state a claim upon which relief could be granted. The court rejected the argument that a negative "say on pay" vote could rebut the presumption that prior executive compensation decisions were valid business judgments, noting that "the outcome of the vote,

which was not known when the challenged decisions were made, does not suggest that . . . the directors failed to act on an informed basis, in good faith, and in the honest belief that the decisions were in [the corporation's] best interests." *Id.* at 10-11. Furthermore, the court rejected the contention that the "say on pay" vote was relevant evidence in determining whether the plaintiffs had rebutted the presumptions of the business judgment rule. *Id.* at 12.

In this case, the "say on pay" vote is irrelevant to Plaintiff's claims concerning the Company's 2010 executive compensation. First, every aspect of that compensation was determined before the advisory vote ever occurred in May 2011. While Plaintiff criticizes the Board because it "has not rescinded 2010 executive compensation" and has failed to "amend or alter 2010 executive compensation," Plaintiff does not explain how he expected the Board to change the 2010 executive compensation after the fact in May of 2011. (Compl. ¶¶ 12, 101.) Second, the argument that this advisory vote imposes a new duty to respond is entirely contrary to governing federal law, which expressly disclaims creation of any new duty. Third, this advisory vote does not change the fundamental balance of power between the directors and shareholders of a Delaware corporation—directors, not shareholders, are charged with managing the corporation's affairs. Consequently, this advisory vote does nothing to undermine the presumptions of the business judgment rule.

3. Pay for Performance

Plaintiff relies heavily on what he describes as the Company's "pay for performance" policy, repeatedly invoking this alleged policy as though it is a detailed edict the Board has somehow violated. (*See, e.g.*, Compl. ¶¶ 6-11, 13, 36-37, 49-52, 54, 56, 66, 68, 74-77, 79, 88-89, 94.) In reality, however, the single phrase Plaintiff relies on ("align executive pay with performance, both annual and long-term") is merely one of six different executive compensation

objectives identified in the Proxy. (Proxy at 13.) Plaintiff concludes that this purported policy means that "the Company's executives should receive superior compensation only if they create 'annual and long-term' performance for Dex stock holders, and they should receive less compensation when they do not." (Compl. ¶ 7.) Based on this interpretation, Plaintiff contends that the Board's decisions concerning 2010 executive compensation violate this policy (as interpreted and augmented by Plaintiff).

Plaintiff's attempt to elevate this compensation objective above the other compensation objectives described in the Proxy usurps the Board's role. The Company's directors, not Plaintiff, are responsible for defining and implementing whatever executive compensation objectives they select. Additionally, Plaintiff's attempt to equate "performance" solely with share price grossly mischaracterizes this executive compensation objective. The Company has explained that it considers a variety of metrics in evaluating performance and setting compensation. For example, the Proxy states that "an executive officer's total direct compensation is based upon the Company's performance <u>as well as the performance of the individual officer</u>." (Proxy at 16 (emphasis added).) Similarly, the Proxy explains how bonuses under the Annual Incentive Plan are tied to specific performance metrics. (Proxy at 16-17.) These metrics include various measures described as Ad Sales Growth, EBITDA, Free Cash Flow, and Line of Sight. (Proxy at 17.) The Proxy also explains that the Long-Term Incentive Plan provides incentives based on performance measures related to the Company's free cash flow. (Proxy at 18.) Plaintiff has alleged no facts showing that the Board violated a "pay for

performance" policy, and his allegations concerning the "pay for performance" policy do not rebut the presumptions of the business judgment rule.[12]

Plaintiff not only grossly mischaracterizes this executive compensation objective, but also completely ignores the Proxy's information concerning how the Company has met this objective. For example, the Proxy explains that the Long-Term Incentive Plan provided for earlier payment for achieving a restructuring of the Company's indebtedness and liabilities. (Proxy at 18.) Additionally, the Company's use of stock appreciation rights and stock options, the value of which varies with the Company's share price, demonstrates that executive compensation is in fact tied to share price. (Proxy at 22, 24.) Indeed, accepting as true the Complaint's allegations concerning the Company's share price, it is evident that all stock options and stock appreciation rights awarded in 2010 are of absolutely no value as of the end of 2010 and the September 2011 filing of Plaintiff's Complaint because their exercise prices or base prices far exceeded the Company's share price as of those dates. (Proxy at 24 (showing base/exercise prices ranging from $9.75 per share to $28.68 per share); Compl. ¶ 5 (stating that the Company's share price was $7.46 per share at the end of 2010 and $1.25 per share when the Complaint was filed).) This demonstrates that a substantial portion of the 2010 executive compensation about which Plaintiff complains is directly tied to the Company's share price, as Plaintiff contends it should be.[13]

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[12] The Bankruptcy Court's decision approving specific elements of the 2010 executive compensation (including base salaries and the SARs granted upon emergence from bankruptcy) and approving certain executive compensation plans in accordance with which other elements of the 2010 executive compensation were determined (including the 2009 Long-Term Incentive Plan and the 2009 Annual Incentive Plan) as "valid, proper and reasonable under the circumstances" (Confirmation Order at 12) further refutes Plaintiff's argument that the Board's decision to award that compensation was somehow outside the boundaries of valid business judgment.

[13] This compensation constitutes a substantial portion (valued at more than $6.6 million) of the 2010 executive compensation Plaintiff challenges. (Proxy at 24; Compl. ¶ 53.)

Taken together, these aspects of the Company's 2010 executive compensation demonstrate that the Company does "align executive pay with performance." The fact that Plaintiff disagrees with how the Board has implemented this particular executive compensation objective does not raise any reasonable doubt concerning whether the Board has engaged in a valid exercise of business judgment. *See In re Goldman Sachs*, 2011 WL 4826104, at *14 (concluding that demand was not futile where plaintiff simply disagreed with the board's choice of performance metrics in setting executive compensation). Plaintiff's allegations, which mischaracterize the Company's compensation policies and ignore the Company's actions implementing those policies, do not raise any reasonable doubt about whether the Board validly exercised its business judgment with respect to the 2010 executive compensation.

Delaware law requires that Plaintiff establish "reasonable doubt" concerning whether the directors are independent and not interested or whether the challenged transaction was a valid exercise of business judgment. Plaintiff never asserts that his factual allegations raise any reasonable doubt. Instead, Plaintiff reiterates that "[t]here is doubt" that the challenged decisions constitute protected business judgments (Compl. ¶¶ 74, 76, 80), and that the facts alleged "raise doubt" (Compl. ¶¶ 74-77). While Plaintiff may harbor idiosyncratic doubts about the Board's decisions, none of his particularized factual allegations raise any reasonable doubt concerning whether the challenged decisions were protected business judgments. Furthermore, Plaintiff's repeated statements that the Individual Defendants breached their "fiduciary duties of candor, good faith, [and] loyalty" (*e.g.*, Compl. ¶ 36) are not factual allegations, and do not raise any reasonable doubt. In sum, Plaintiff has not alleged any particularized facts that show demand futility. Accordingly, Plaintiff is barred from asserting these shareholder derivative claims, and the Complaint must be dismissed.

II. PLAINTIFF'S CLAIMS MUST BE DISMISSED FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF COULD BE GRANTED.

A. Legal Standard

A motion to dismiss brought under Rule 12(b)(6) tests the legal sufficiency of the complaint. FED. R. CIV. P. 12(b)(6). Though a court considering a Rule 12(b)(6) motion must accept as true all well-pleaded allegations, the court need not accept legal conclusions stated in the complaint. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009). "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* On the contrary, to survive a motion to dismiss, a complaint must plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* If the complaint's well-pleaded factual allegations do not nudge the plaintiff's claims "across the line from conceivable to plausible," then the "complaint must be dismissed." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

B. Plaintiff Has Not Alleged Sufficient Facts To State a Plausible Claim for Relief in Light of the Business Judgment Rule.

In addition to the failure to sufficiently allege demand futility, Rule 12(b)(6) of the Federal Rules of Civil Procedure provides a separate and independent basis for dismissal of Plaintiff's claims. Plaintiff's breach of fiduciary duty claims cannot succeed unless he pleads sufficient facts to rebut the presumptions of the business judgment rule. *Teamsters Local 237*, slip op. at 19 ("Where a plaintiff fails to rebut the business judgment rule's presumptions, there is no basis for imposing liability on the directors." (citing *Brehm*, 746 A.2d at 266)). As discussed above in Part I.C, however, Plaintiff has not alleged any particularized facts that raise a reasonable doubt that the challenged decisions were a valid exercise of business judgment. For the same reasons, Plaintiff's factual allegations cannot support a "reasonable inference that the

defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. Accordingly, the First, Second, and Third Causes of Action must be dismissed for failure to state a claim upon which relief could be granted.[14]

C. Plaintiff Has Not Alleged a Plausible Unjust Enrichment Claim.

The unjust enrichment claim may be governed by North Carolina law or Delaware law, but the outcome – dismissal for failure to state a claim – is the same under either. Under Delaware law, unjust enrichment is "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." *Nemec v. Shrader*, 991 A.2d 1120, 1130 (Del. 2010). Likewise, under North Carolina law, to recover for unjust enrichment, "a party must prove that it conferred a benefit on another party, that the other party consciously accepted the benefit, and that the benefit was not conferred gratuitously or by an interference in the affairs of the other party." *Southeastern Shelter Corp. v. BTU, Inc.*, 154 N.C. App. 321, 330, 572 S.E.2d 200, 206 (2002) (citing *Booe v. Shadrick*, 322 N.C. 567, 570, 369 S.E.2d 554, 556 (1988)).

As an initial matter, Plaintiff's unjust enrichment claim does not differentiate between Individual Defendants who receive executive compensation as officers of the Company and those who are only members of the Board. Plaintiff has not alleged that Defendants Bulkeley, Davis, Kuersteiner, Liddell, McEachen, or Schultz have received or will receive any of the challenged executive compensation. Accordingly, Plaintiff has not stated an unjust enrichment claim against these six defendants.

[14] Plaintiff's exceedingly generic allegations of "aiding and abetting" (Compl. ¶¶ 40-41) do not state a claim because Plaintiff's conclusory allegations fail to establish any primary wrongdoing, much less aiding and abetting thereof. The Complaint is entirely devoid of any substantive allegations concerning how any of the Individual Defendants aided or abetted any of the other Individual Defendants in any purported wrongdoing. Consequently, these generic statements about aiding and abetting do not state a legal claim. *See Teamsters Local 237*, slip op. at 20-22 (dismissing similarly "formulaic and conclusory allegations" of aiding and abetting for failure to state a claim).

Furthermore, regardless of which State's law applies, Plaintiff's unjust enrichment claim fails with respect to all of the challenged executive compensation because Plaintiff cannot show that the compensation was in fact unjust or unearned without rebutting the presumptions of the business judgment rule. Plaintiff has not alleged that the Individual Defendants received any compensation in excess of that duly approved by the Board. Additionally, Plaintiff has not alleged that the Individual Defendants failed to perform their duties as officers of the Company. Instead, Plaintiff asserts simply that "the Defendants will be and have been unjustly enriched at the expense of Dex, in the form of unjustified salaries, benefits, stock option grants and other emoluments of office." (Compl. ¶ 107.) Furthermore, Plaintiff alleges that "[a]ll the payments and benefits provided to the Defendants based upon or related to Defendants' executive compensation were unjustly awarded and at the expense of Dex, resulting in substantially unearned benefits." (Compl. ¶ 108.) These unsupported conclusions are simply a restated critique of the Board's compensation decisions, and the claim cannot survive as a matter of law for the same reasons that Plaintiff's breach of fiduciary duty claims fail. *See Teamsters Local 237*, slip op. at 22-23 (dismissing unjust enrichment claim because "Plaintiffs' conclusory allegation that the 2010 executive compensation was 'excessive' because [the Company] lost money during fiscal 2010 and the Company's stock price return alleged declined is simply not enough to state a claim for unjust enrichment").

Finally, under both Delaware and North Carolina law, unjust enrichment is a quasi-contract claim that does not permit recovery where a contract governs a party's right to recovery. *Res. Ventures, Inc. v. Res. Mgmt. Int'l, Inc.*, 42 F. Supp. 2d 423, 439 (D. Del. 1999) (citing *Wood v. Coastal States Gas Corp.*, 401 A.2d 932, 942 (Del. 1979)); *see also MCG Capital Corp. v. Maginn*, No. 4521-CC, 2010 WL 1782271, at *24 (Del. Ch. May 5, 2010) (attached as **Ex. 10**)

(dismissing unjust enrichment claims concerning executive compensation that was governed by employment agreements); *Southeastern Shelter Corp.*, 154 N.C. App. at 330-31. Here, executive compensation was paid pursuant to "employment agreements" and "other compensation arrangements" with executives. (Proxy at 25.) Additionally, as discussed in Part III, much of the 2010 executive compensation was paid pursuant to plans and agreements approved and confirmed by the Bankruptcy Court and incorporated into the Confirmation Order. Accordingly, Plaintiff's unjust enrichment claim also fails to the extent that it seeks recovery of executive compensation paid pursuant to employment agreements or other arrangements. (Proxy at 25-27.)

III. PLAINTIFF'S CLAIMS MUST BE DISMISSED TO THE EXTENT THAT THEY CHALLENGE DECISIONS THAT PREDATE PLAINTIFF'S STOCK OWNERSHIP AND THAT WERE APPROVED BY THE BANKRUPTCY COURT.

A. Plaintiff Has Not Adequately Alleged Contemporaneous Ownership.

Rule 23.1 of the Federal Rules of Civil Procedure requires that a shareholder derivative complaint "allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law." FED. R. CIV. P. 23.1(b)(1). Delaware's General Corporation Law imposes the same requirement. 8 Del. Code § 327 ("In any derivative suit . . . it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such

stockholder by operation of law.”).[15] A complaint that fails to allege contemporaneous ownership is subject to dismissal. *In re Bank of N.Y. Derivative Litig.*, 320 F.3d 291, 301 (2d Cir. 2003) (affirming dismissal and holding that “to invoke derivative standing pursuant to Federal Rule of Civil Procedure 23.1 . . . a plaintiff must have owned stock in the corporation before the core of the allegedly wrongful conduct transpired”); *Brambles*, 731 F. Supp. at 652 (dismissing a shareholder derivative complaint challenging a transaction that occurred before the plaintiff acquired stock). Moreover, a plaintiff cannot challenge a continuing wrong if the plaintiff acquired stock with knowledge of the purported wrongdoing. *Brambles*, 731 F. Supp. at 652.

In this case, the Complaint alleges only that Plaintiff is a “shareholder of Dex and has been continuously throughout the Relevant Period,” which Plaintiff defines as “2010 to the present.” (Compl. ¶¶ 1, 19.) This statement is insufficient to satisfy the contemporaneous ownership requirement. For example, this statement would be equally true if Plaintiff acquired Dex One stock on February 1, 2010 (the day the Company’s stock began trading on the NYSE following bankruptcy), or if Plaintiff acquired Dex One stock on December 31, 2010. Consequently, Plaintiff has failed to plead contemporaneous ownership with respect to any decision made during this period.

Furthermore, even if it could be assumed that the Plaintiff owned Dex One shares at the earliest possible point, that ownership could not have preceded the Company’s emergence from

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[15] It is not clear whether the contemporaneous ownership requirement is governed by federal or state law in diversity cases. *See McQuillen v. Nat’l Cash Register Co.*, 112 F.2d 877, 882 (4th Cir. 1940) (refraining from deciding which law applied because federal law and Maryland law did not diverge); CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, 7C FEDERAL PRACTICE AND PROCEDURE § 1829 (3d ed. 2007) (recognizing this uncertainty). There is no need to make the determination here, as federal law and Delaware law both support dismissal of Plaintiff’s claims in this action. *See Brambles USA, Inc. v. Blocker*, 731 F. Supp. 643, 648 n.8 (D. Del. 1990) (concluding that either federal law or Delaware law would support dismissal for lack of contemporaneous ownership).

bankruptcy on January 29, 2010, because all Dex One securities were issued upon that event.[16] (*See* Plan of Reorganization at 66-67.) As the Proxy explains, decisions regarding (i) the 2010 base salaries and (ii) the target annual incentive opportunities under the Annual Incentive Plan were made by the RHD pre-bankruptcy compensation committee, well before Plaintiff ever could have owned Dex One shares. (Proxy at 13.) Additionally, the Bankruptcy Court expressly approved plans and agreements pursuant to which certain elements of the 2010 executive compensation were awarded, including without limitation (i) the successful restructuring payments aggregating just over $6.6 million, pursuant to the 2009 Long-Term Incentive Program for Executive Officers, and (ii) the SARs that were issued upon the Company's emergence from bankruptcy. (Proxy at 18, 22; *see supra* pp. 4-5.)

In sum, the Bankruptcy Court's Confirmation Order, which necessarily predates Plaintiff's ownership of Dex One stock, expressly approves and incorporates the aspects of the 2010 executive compensation program described above. Accordingly, Plaintiff took ownership of his Dex One stock after these decisions were made and a matter of public record, and the contemporaneous ownership requirement bars Plaintiff's complaints about such prior decisions.[17]

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[16] While Plaintiff repeatedly alleges that the Company's stock "resumed trading on the NYSE" in February 2010 (*e.g.,* Compl. ¶¶ 36, 49, 74-77), Dex One stock was in fact not issued, much less traded, until the Company emerged from bankruptcy. (Plan of Reorganization at 66-67.) Accordingly, Plaintiff could not have been a "shareholder of Dex" (Comp. ¶ 19) prior to January 29, 2010.

[17] Rule 23.1 also requires that shareholder derivative complaints "be verified." FED. R. CIV. P. 23.1(b). A complaint that fails to comply with this requirement is subject to dismissal. *E.g.*, *Johnson v. Brandon Corp.*, 183 F.2d 444, 445 (4th Cir. 1950) (affirming dismissal of unverified shareholder derivative complaint). While the Complaint includes a signed verification page ambiguously titled "Dex One Corp. Verification," this verification is not notarized.

B. Plaintiff Is Barred from Challenging Executive Compensation Decisions That Were Approved by the Bankruptcy Court.

Under the Bankruptcy Code, a confirmed plan of reorganization binds all parties. 11 U.S.C. § 1141(a) ("[T]he provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor . . . .") Accordingly, "[a] bankruptcy court's order of confirmation is treated as a final judgment with res judicata effect," which means that "parties may be precluded from raising claims or issues that they could have or should have raised before confirmation of a bankruptcy plan." *In re Varat Enters., Inc.*, 81 F.3d 1310, 1315 (4th Cir. 1996).

Res judicata applies when three conditions are met: (i) "the prior judgment was final and on the merits, and rendered by a court of competent jurisdiction in accordance with the requirements of due process"; (ii) "the parties are identical, or in privity, in the two actions"; and (iii) "the claims in the second matter are based upon the same cause of action involved in the earlier proceeding." *Id.* In the bankruptcy context, res judicata means that once a plan of reorganization has been confirmed, both the debtor and creditors are barred from asserting rights that are inconsistent with its provisions. *Id.* at 1317; *see also In re Schepps Food Stores, Inc.*, 160 B.R. 792 (Bankr. S.D. Tex. 1993) (holding that res judicata barred a shareholder derivative suit based on conduct that occurred during bankruptcy as "an improper attempt to interfere with the confirmation order, reorganization process and plan of reorganization").

Here, Plaintiff seeks to assert derivative claims on behalf of the Company. Under principles of res judicata, however, the Company is barred from asserting claims that are inconsistent with the Confirmation Order. As discussed above, the Bankruptcy Court expressly approved two elements of the 2010 executive compensation, namely executive base salaries and

the SARs issued after the Company emerged from bankruptcy.[18] Res judicata would therefore bar any claim by or on behalf of the Company that sought to relitigate the Bankruptcy Court's approval of those elements. Plaintiff cannot assert shareholder derivative claims that the Company would be barred from asserting. Consequently, Plaintiff's claims must be dismissed to the extent that they challenge these elements of the 2010 executive compensation, which were addressed in the Bankruptcy Court proceeding and approved in the Confirmation Order.

C. Plaintiff's Claims Are Barred to the Extent They Were Released in the Bankruptcy Court's Confirmation Order.

Plaintiff is also barred from challenging executive compensation decisions that were made before the Company emerged from bankruptcy because the Company released those claims. In this derivative suit, Plaintiff purports to assert claims on behalf of the Company. The Confirmation Order and Plan of Reorganization, however, contain comprehensive release provisions under which, among other things, the Debtors and Reorganized Debtors and their Related Persons (including the Company and its shareholders) released all claims against the Released Parties (including the Company's "directors, officers, [and] employees") "that are or may be based in whole or part on any act, omission, transaction, event or other circumstance taking place or existing on or prior to the Effective date" (the date the Company emerged from bankruptcy). (Confirmation Order at 70-71; Plan of Reorganization at 5, 18-19, 81 (emphasis added).) As discussed above, the 2010 executive base salaries and the SARs issued pursuant to the Confirmation Order were established before the Company emerged from bankruptcy. Thus, Plaintiff's derivative claims related to this compensation have been released.

[18] The Proxy explains that there were "no changes to base salaries" from 2009 to 2010. (Proxy at 13.)

CONCLUSION

This shareholder derivative suit should be dismissed for three independent reasons. First, Plaintiff has not adequately alleged demand futility under Delaware substantive law. Second, Plaintiff has failed to state a claim that could plausibly overcome the presumptions of the business judgment rule. Third, Plaintiff's claims are barred, in whole or in part, by the contemporaneous ownership requirement, the res judicata effect of the Bankruptcy Court's Confirmation Order, and the releases contained therein. Accordingly, the Complaint should be dismissed with prejudice.

Respectfully submitted this the 31st day of October, 2011.

SMITH, ANDERSON, BLOUNT, DORSETT,
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CERTIFICATE OF SERVICE

I hereby certify that, on the 31st day of October, 2011, I electronically filed the foregoing Memorandum of Law in Support of Defendants' Motion to Dismiss with the Clerk of the Court using the CM/ECF system, which will send notification to Plaintiff's counsel of record as follows:

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