IN THE COURT OF CHANCERY FOR THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

LEONARD T. GANTLER, PATRICIA A. CETRONE, JOHN GERNAT, PATRICIA GERNAT, PAUL MITCHELL and MARSHA MITCHELL,	)	
Plaintiffs,	)	
v.	)	C.A. No. 2392-VCP
WILLIAM L. STEPHENS, P. JAMES KRAMER, WILLIAM S. EDDY, DANIEL E. CSONTOS, ROBERT I. SHAKER, LAWRENCE SAFAREK and FIRST NILES FINANCIAL, INC., a Delaware corporation,	)	
Defendants.	)	

DEFENDANTS' REPLY BRIEF IN SUPPORT OF THEIR
<u>MOTION TO DISMISS PLAINTIFFS' AMENDED COMPLAINT</u>

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INTRODUCTION

Leonard T. Gantler, the first named plaintiff in this case, is a disgruntled former director and current shareholder of First Niles Financial, Inc. ("First Niles" or the "Company") (Amended Complaint ("Am. Compl.") ¶ 6) who disagrees with the actions taken by the Board on March 9, 2005 and December 5, 2005. *See* Am. Compl. ¶¶ 54, 67. Unwilling to accept the fact that he was out voted by his fellow directors when the Board voted on the issues, he filed this lawsuit. Despite their prolix submission, Gantler and the other Plaintiffs are unable to overcome three critical hurdles that are fatal to the viability of their Amended Complaint: (1) the majority of the Board at all relevant times was independent and disinterested; (2) the Reclassification[1] was overwhelmingly approved by the shareholders; and (3) that approval was based on full and accurate disclosure in the Proxy.[2]

While this failure is sufficient alone to warrant dismissal, there remain several other grounds that support a finding that Plaintiffs' Amended Complaint fails to state a claim, none of which Plaintiffs have managed to overcome in their Answering Brief: (1) Plaintiffs cannot show that the Board's decision to reclassify the Company's stock was a breach of fiduciary duty; (2) Safarek and Csontos cannot be liable under Counts I and III because they were not directors during the votes not to sell the Company and in favor of Reclassification; (3) Shaker cannot be liable under Count III because he was not a director during the vote for Reclassification; and (4) personal jurisdiction is improper as to Csontos for Counts I and III and as to Shaker for Count III.

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[1] "Reclassification" refers to the plan to reclassify the shares of common stock held by shareholders who were the record holders of 300 or fewer shares of First Niles common stock into shares of Series A Preferred Stock.

[2] "Proxy" refers to the Definitive Proxy Statement filed with the Securities and Exchange Commission ("SEC") on November 16, 2006.

ARGUMENT

I. COUNTS I AND III SHOULD BE DISMISSED BECAUSE PLAINTIFFS HAVE FAILED TO ALLEGE WITH SPECIFICITY FACTS GIVING RISE TO A REASONABLE DOUBT AS TO THE OBJECTIVITY OF A MAJORITY OF THE BOARD.

Plaintiffs have failed to overcome the business judgment rule because they have failed to allege facts sufficient to rebut the threshold judicial presumptions of disinterest and independence. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).[3]

Contrary to Plaintiffs' claim, it is they, not the Defendants, who recast the facts from their own Amended Complaint.[4] According to the Amended Complaint, March 9, 2005 is the operative date for the decision not to sell the Company and December 5, 2005 is the operative date for approval of the Reclassification. *See* Am. Compl. ¶¶ 54, 67. In their Answering Brief, however, they change their story and identify new dates in June of 2006 in an effort to focus on a different group of board members. Notwithstanding Plaintiffs' recast contentions that March 9, 2005 and December 5, 2005 are not the operative dates or the effective votes (*see* PAB at pp. 36-37), the majority of the Board was also disinterested and independent during June of 2006.

Stephens, Kramer, Zuzolo, Eddy, and Gantler comprised the Board when the Board voted not to sell the Company on March 9, 2005. *See* Am. Compl. ¶ 54. Kramer, Zuzolo, Eddy and Gantler were disinterested and independent.[5]

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[3] Plaintiffs have never pled gross negligence or bad faith. Their unsupported and cursory footnote comment that Defendants were "grossly negligent" with regard to certain actions taken on December 5, 2006 is insufficient to satisfy the gross negligence or bad faith prong of *Aronson*. *See* Plaintiffs' Answering Brief ("PAB") p. 36 n.14.

[4] Plaintiffs argue as a side note that the Defendants' statement of the relevant votes is at odds with the Proxy. This is untrue. The Proxy states the date of the relevant Reclassification vote (December 5, 2005) and the vote count on that date. *See* Proxy p. 14-15.

[5] The Court need only find that three out of these four are disinterested and independent for the business judgment rule protection to apply to the vote not to sell the Company.

Stephens, Kramer, Eddy, and Gantler comprised the Board when the Board voted in favor of Reclassification on December 5, 2005. *See* Am. Compl. ¶ 67. Kramer, Eddy, and Gantler were disinterested and independent.

While it is true that the Board met twice in June of 2006 to *discuss* what they had already decided, the composition of the Board during those discussions is not the relevant Board for purposes of analyzing the Board's decisions to reclassify and not to sell the Company according to Plaintiffs' own Amended Complaint. Notwithstanding, the majority of the Board in June 2006 was also disinterested and independent.[6] In June 2006, the Board consisted of Stephens, Kramer, Eddy, Shaker, and Csontos. Three of the five members, Kramer, Eddy, and Shaker, were disinterested and independent.

Plaintiffs argue further that "the appropriate Board for this Court's loyalty analysis is the one that Plaintiffs sued, a majority of which defendants do not even contest suffer from a disabling conflict." *See* PAB at p. 37. Apparently, Plaintiffs contend that a majority of those sued must be disinterested and independent for purposes of the business judgment rule analysis. This is simply untrue. The parties sued in this case are not all directors, half of them are officers or employees of the Company, and at least one (though Defendants argue, three) of them were not on the Board during any of the relevant time periods. *See* Am. Compl. ¶¶ 8, 11-12. Safarek does not factor into the composition of the outside directors on the Board at any given time. Csontos and Shaker do not factor into the composition of the outside directors on the Board unless the Court accepts Plaintiffs' newly minted contentions regarding the relevant time periods.

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[6] If this is the relevant Board, however, then Plaintiffs face a different hurdle regarding their allegations that Gantler's dissention and the reasons therefore were not adequately disclosed in the Proxy. If the relevant board was the Board as of June 2006, Gantler was not a member of the Board and the vote was unanimous and so no information regarding the non-existent dissent was required. The Plaintiffs cannot have it both ways.

A. **<u>Plaintiffs Have Failed To Allege An Entrenchment Motive.</u>**

Plaintiffs claim that the Defendants did not vote to sell the Company and instead supported Reclassification in an effort to entrench themselves in office. In support of their proposition, they direct the Court to cases which either hold to the contrary or are simply inapplicable.

First, Plaintiffs cite to *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), where a company made a self-tender for its own shares in response to a minority shareholder's hostile tender offer for company stock. The Delaware Supreme Court reversed the Chancery Court's grant of a preliminary injunction and found that directors were *not* attempting to entrench themselves simply because they rejected the tender offer. The Court found that "the board acted in the proper exercise of sound business judgment." 493 A.2d at 949. Even in a case where the directors were faced with a clear threat, the Court did not find that the board members acted for entrenchment purposes. Here, where the Plaintiffs fail to allege that the Defendants acted in response to any threat, they have not pled any facts that support an entrenchment motive.

Plaintiffs also erroneously rely upon *Chrysogelos v. London*, 1992 WL 58516 (Del. Ch.) and *California Public Employees' Retirement System v. Coulter*, 2002 WL 3188343 (Del. Ch.). In *Chrysogelos*, the death of the majority shareholder triggered certain changes regarding how officers were elected. In response to this threat to their directorships, the board of directors improperly used corporate funds to repurchase company stock so that they could maintain control of director elections. 1992 WL 58516, at **5, 8. In *Coulter*, the board of directors attempted to adopt favorable change of control agreements for senior management in response to a proposal from the shareholders to require a majority of independent and disinterested directors on the board. 2002 WL 31888343, at **4, 16. Here, Plaintiffs do not sufficiently allege that Defendants acted in response to any real or perceived threat. Plaintiffs acknowledge that the Board undertook to solicit purchase bids and explore Reclassification on its own. *See* Am. Compl. ¶¶ 28, 55. Because neither action was taken in response to any proposed threat to the Defendants' positions at the Company, the Plaintiffs' reliance on *Unocal*, *Chrysogelos* and *Coulter* to support an entrenchment claim is misplaced.

The conclusory allegations that the Defendants acted to entrench themselves are insufficient to defeat the business judgment rule and survive a motion to dismiss. The Amended Complaint even acknowledges that the purchase offer from First Place Financial Corporation ("First Place"), the only definitive bid submitted, "made no mention of whether directors would be offered board seats with the combined entity." *See* Am. Compl. ¶¶ 34, 48. In fact, this Court has found no entrenchment motive under facts similar to those present here. In *Grobow v. Perot*, 526 A.2d 914 (Del. Ch. 1987), for example, the Court held that plaintiffs had failed to allege that the director defendants believed themselves vulnerable to removal from office by reason of a takeover or otherwise. Thus, the Court found that the plaintiffs failed to adequately allege that the director defendants acted as they did with entrenchment motives. *Id.* at 922-923. Similarly, here, no reading of the Amended Complaint suggests that the Defendants acted because they felt threatened or vulnerable to removal from office. Also, as the Court found significant in *Grobow*, the Defendants here received no additional benefits after their votes against selling the Company and later in favor of Reclassification, that they did not have before either action. Further, as in *Grobow*, the Defendants did not gain any control-related benefit from Reclassification, such as vote-blocking power. *Id.*

B. <u>Shaker Was Disinterested And Independent At All Relevant Times.</u>

Plaintiffs' only allegation attacking Shaker as interested in the decision to reclassify the Company's stock[7] is that he holds a "substantial amount of First Niles stock." *See* PAB p. 38. In reality, he holds 17,708 shares, approximately 1.3% of the outstanding shares of the Company. *See* Proxy p. 38. Plaintiffs also claim that he is interested because the Company "may" later "buy back" his shares. Plaintiffs do not allege that Shaker has plans to have his shares repurchased by the

[7] Plaintiffs do not assert Count I against Shaker.

Company or that he has ever had his shares repurchased by the Company in the past. Their allegation regarding possible future buy backs is purely speculative.

Throughout their Answering Brief, Plaintiffs imply that buy backs are only available to the Defendants. Yet, Plaintiffs' own assertion is that the "Privatization Proposal advocated reclassification because it allowed maximum flexibility for future capital management activities, such as open market purchase and negotiated buy backs." *See* Am. Compl. ¶ 61. Plaintiffs do not allege that the Privatization Proposal advocated for buy backs, negotiated or otherwise, were *only* for officers and directors. Indeed, Plaintiffs continuously reference buy backs as part of a "program" or "plan," thus presumably available to the other shareholders. *See* Am. Compl. ¶¶ 4-5, 15, 23, 36; *see also* PAB pp. 5, 38. In fact, the Company has offered to repurchase stock from non-director shareholders on various occasions in the past. *See* First Niles' press releases announcing these repurchase offers in the Company's Forms 8-K dated May 21, 1999, January 28, 2000, July 26, 2000, June 29, 2001, July 3, 2002, and November 19, 2003; *see also* First Niles' Form 10QSB dated August 14, 2003 at p. 9 (copies of these SEC filings are attached hereto as Exhibits A through G).[8]

Moreover, the mere possibility that Shaker "could" have his stock repurchased, even assuming it was a benefit available only to directors and officers, is insufficient to establish interestedness for three reasons. In *Nebenzahl v. Miller*, 1993 WL 488284 (Del. Ch.), a case that Plaintiffs fail to distinguish effectively, the Court found that the defendants were not interested in the transaction at issue merely because consummation of the transaction would have conferred benefits upon them pursuant to pre-existing employment agreements. Plaintiffs attempt to argue that *Nebenzahl* does not apply because there is a connection between the Board's vote to reclassify the Company's stock and the Defendants' continued receipt of alleged benefits. But the Board's vote created no benefit nor do Plaintiffs so allege. Thus, the holding of *Nebenzahl* applies here. Second,

[8] The Court may consider documents that are required by law to be filed, such as SEC filings, on a motion to dismiss. *In re Tyson Foods, Inc.*, 2007 WL 1018209, at *13 (Del. Ch.).

if buy back opportunities are existing benefits of directorships, the continued existence of these benefits cannot show interestedness. Retaining one's directorship is insufficient to show interestedness; therefore, retaining the benefits that go along with one's directorship is also insufficient to show interest. *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984) (*overruled on other grounds*);[9] *In re Paxson Communications Corp. Shareholders Litig.*, 2001 WL 812028, at *9 (Del. Ch.). If an allegation that directors wanted to keep their positions was enough to show interestedness, then any complaint based on any change of control transaction could be the subject of litigation. It will always be true that a successful vote against a change of control offer will likely allow the directors to keep their directorships. A complaint that does not allege more cannot survive a motion to dismiss and the Amended Complaint does not allege more.

Third, Plaintiffs fail to allege that any proceeds that Shaker "may" gain from a potential buy back are material to him, which is required:

> [I]n order to rebut the business judgment rule presumption, an interest must be subjectively material to the director. In other words, the alleged benefit must be significant enough as to make it improbable that the director could perform his fiduciary duties to the shareholders. [Plaintiff] has failed to allege how the benefits it alleges were subjectively material to any of these directors. [Plaintiff] argues only that the Court must consider all of the various benefits received by the directors and their affiliates and states in a conclusory fashion that in the aggregate, these benefits are material. Without more, [plaintiff] has not alleged enough to suggest that the Board could not perform its fiduciary duties to shareholders.

H-M Wexford LLC v. Encorp. Inc., 832 A.2d 129, 150 (Del. Ch. 2003) (internal quotations and footnotes omitted) (applying motion to dismiss standard).[10]

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[9] Plaintiffs unsuccessfully attempt to distinguish *Pogostin* claiming that the complaint at issue in that case alleged nothing more than that the defendants rejected a hostile bid for the purpose of entrenching themselves. In fact, the plaintiffs in *Pogostin* allege facts similar to those alleged here, namely that as a benefit of their directorships, directors received bonuses in the form of cash and stock. 480 A.2d at p. 622-23. Despite allegations of these benefits, the Court confirmed well-settled Delaware law that maintaining one's directorship, and the associated benefits, is insufficient to show interestedness.

[10] Here and with regard to discussion regarding the disinterestedness and independence of the other Defendants, Plaintiffs fault Defendants' reliance on cases decided under the Rule 23.1 pleading

> The key issue is not simply whether a particular director receives a benefit from a challenged transaction not shared with the other shareholders, or solely whether another person or entity has the ability to take some benefit away from the particular director, but whether the possibility of gaining some benefit or the fear of losing a benefit is likely to be of such importance to that director that it is reasonable for the Court to question whether valid business judgment or selfish considerations animated that director's vote on the challenged transaction.

Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002) (applying motion to dismiss pleading standard); *see also CompuCom*, 2005 WL 2481325, at *8 (applying motion to dismiss standard and finding that plaintiffs did not sufficiently allege that purported benefits received from certain relationships were material). Plaintiffs do not allege any information regarding Shaker's personal financial situation (other than the fact that he is an attorney) or how much money he might receive from any future buy backs (the latter omission arising necessarily from the wholly conjectural nature of the allegation itself).

C. <u>Eddy Was Disinterested And Independent At All Relevant Times.</u>

Plaintiffs do not allege that Eddy is interested and the only reason they offer in support of his alleged lack of independence is that he has a voting record similar to Stephens. Though Plaintiffs mischaracterize *Khanna v. McMinn*, 2006 WL 1388744 (Del. Ch.), the fatal flaw in their argument is that Plaintiffs fail to allege that Eddy gained *any benefit*, much less a benefit that is material to him, as a result of casting the same votes as Stephens.

As discussed above, allegations regarding materiality are required to show interestedness or lack of independence. Plaintiffs wrongly suggest that Eddy's and Stephens' similar voting records

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standard, ignoring the Rule 12(b)(6) cases that Defendants cite to support their argument. *See* Defendants' Opening Brief ("DOB") pp. 6, 8-10, 13. Moreover, though Plaintiffs are correct that Rule 23.1 (applicable to demand futility cases) sets a tougher pleading standard than Rule 12(b)(6), the Rule 23.1 cases that address disinterest and independence are applicable to this case. Delaware law regarding whether certain circumstances are sufficient to rebut disinterest or independence does not change based upon the stage of the pleadings. *See In re CompuCom Systems, Inc. Stockholders Litig.*, 2005 WL 2481325, at *9 n.51 (Del. Ch.) ("[I]nterpretation of the type of relationship required to rebut the presumptive independence of an outside director [in a Rule 23.1 case] provides insight in the context of this dismissal motion brought pursuant to Rule 12(b)(6).").

are enough, standing alone, to show that Eddy is beholden to Stephens and that they do not need to allege some benefit flowing to Eddy as a result of his voting record. Plaintiffs erroneously suggest that they must only show either that there was a similar voting record or that Eddy received a material benefit. Delaware law, however, is clear that the bare allegation that one director is beholden to another is insufficient without an allegation as to how that director benefits as a result. *CompuCom*, 2005 WL 2481325, at *8. In *CompuCom*, the Court granted the defendants' motion to dismiss because the plaintiffs did not sufficiently allege that the purported benefits received were material to the defendant – specifically, the Court noted that the plaintiffs did not allege how much the alleged benefits were worth to the defendants. Thus, it is simply not sufficient to allege that Eddy has a similar voting record to Stephens without linking those votes to a material benefit received by Eddy. *See In re Tyson Foods, Inc.*, 2007 WL 1018209 (Del. Ch.) (attached as Exhibit P hereto) (finding circular argument that pattern of deferring to controlling stockholder in connection with approving certain transactions was insufficient to demonstrate a lack of independence).

Moreover, Plaintiffs merely allege that Eddy voted with Stephens on all votes while Gantler was on the Board, but do not provide the Court with any indication of how many votes actually took place during the time period that Eddy and Gantler were both on the Board, from April of 2003 until April of 2006, or the subject-matter of any of the alleged identical votes. *See* Am. Compl. ¶¶ 6, 10. Without detail on the number or subject-matter of the votes, the allegation that Eddy voted with Stephens is insufficient for the Court to infer that Eddy lacked independence.

D. <u>Zuzolo Was Disinterested And Independent At All Relevant Times.</u>

Plaintiffs allege that Zuzolo was interested and lacked independence with regard to the decision not to sell the Company.[11] The basis of their allegations is that his title company performed services for the Company and that he voted against selling the Company so that he could continue to provide title services and curry favor with Stephens, upon whom the Plaintiffs allege he was dependent to maintain the business relationship. The fatal flaw in Plaintiffs' allegations, once again, is that they fail to allege the amount of money that Zuzolo's business received for the title services and how it was material to him. Although Plaintiffs cite to a number of cases that they contend support their claim that they need not allege how Zuzolo's business relationship with the Company was material to him, none of the cases are applicable because in each of them the plaintiffs specifically alleged the amount of the benefit received, thereby providing some basis for the Court to infer materiality. *In re Nat. Auto Credit, Inc. Shareholders Litig.*, 2003 WL 139768 (Del. Ch.) (increase in directors' receipt of fees from $1,000 per meeting to $55,000 annually and directors' receipt of an additional $5,000 per year for committee service was material); *In re The Limited, Inc. Shareholders Litig.*, 2002 WL 537692 (Del. Ch.) (court presumed that $150,000 for consulting fees was relevant to a university professor); *Orman*, 794 A.2d 5 ($75,000 for consulting services was material); *In re Ply Gem Indus., Inc. Shareholders Litig.*, 2001 WL 755133 (Del. Ch. June 26, 2001) ($1 million per year in legal fees presumed material to attorney director); *Friedman v. Beningson*, 1995 WL 716762 (Del. Ch.) ($48,000 for consulting fees was material). Contrary to Plaintiffs' assertion, as discussed above, Delaware law provides that information regarding how a benefit is material to a director is necessary for an adequate allegation of disinterest or independence.

Plaintiffs admit that they do not cite to a majority opinion to support their claim that they should not be held to this well-established pleading standard because facts regarding a person's

[11] Plaintiffs apparently concede that Zuzolo was not involved in the Reclassification decision as they do not assert allegations regarding his independence or interest as to that decision.

financial status may not be available publicly. *See* PAB p. 29 n.8 (citing to *Brehm v. Eisner,* 746 A.2d 244 (Del. 2000)). Even if this was the law in Delaware, which it is not, the Plaintiffs have failed to demonstrate how providing the underlying facts for their allegations that the Defendants are interested or lack independence is holding them to too high a pleading standard. Yet Plaintiffs have not and cannot allege that information regarding benefits received or payments for other services provided to the Company by the directors' companies are not readily available to them through a books and records request. The majority opinion in *Brehm*, suggested that plaintiffs should use books and records requests to gather information sufficient to submit an adequately pled complaint. 746 A.2d at 266-267.[12] Here, Plaintiffs have reverted to the circular contention that they should be permitted to proceed with this lawsuit for the very reason they have been unable to plead facts sufficient to sustain their claim – a quintessential bootstrap argument.

E. <u>Kramer Was Disinterested And Independent At All Relevant Times.</u>

Plaintiffs allege that Kramer was interested in the transactions at issue and lacked independence because (1) he would continue to receive director fees and the opportunity for stock buy backs and stock option grants as alleged benefits of his directorship, (2) his family-owned business would continue to provide heating and air conditioning work for the Company; (3) he might work for the Company in the future; and (4) he felt "owingness" to Stephens for previous actions relating to stock purchases and sales. None of these conclusory allegations are sufficient to establish interestedness or lack of independence.

Plaintiffs do not allege that the Company's purchase of Kramer's stock was an opportunity available only to him. In fact, during the time periods that the Plaintiffs allege that the Company repurchased stock from Kramer, during 2002 and May 2003 (Am. Compl. ¶¶ 18-19) the Company had issued public announcements offering to buy back its stock. *See* Exhibits E and F. Moreover,

[12] Presumably, when Gantler was a director, he had access to that information and if it was material, he would be able to do more now than speculate.

Plaintiffs do not allege that the Company will, in fact, later repurchase Kramer's stock. Plaintiffs only speculate that Kramer will have this opportunity.

Even assuming that the opportunity to have one's stock repurchased was available only to the Defendants, and that it was certain that the Company would later repurchase Kramer's stock, Plaintiffs fail to sufficiently plead how any of the alleged benefits, or the heating and air-conditioning work that Kramer may get from the Company are material to him, either individually or collectively. Plaintiffs contend that regardless of the amount of director benefits or service payments, the alleged benefits are material to Kramer because he is a "man of modest means," operates a family-owned heating and air-conditioning company in an economically depressed area, and at some point in time in some context uttered the words "I need the money." *See* PAB p. 30. They cite to no case law supporting their contention that such vague allegations are sufficient to show materiality. As discussed above, without an allegation as to how the benefits are material to Kramer, Plaintiffs cannot overcome the business judgment rule and these allegations are insufficient to defeat disinterested director status because a desire to retain one's directorship, and any benefits that flow from it, do not create interest.[13]

Plaintiffs urge this Court to create new law and adopt a "realism" approach and find that because they allege Kramer is a man of "modest means" and operates a family-owned business in a small town, then any benefits or business that he receives from his relationship with the Company are material to him. In support of this argument, Plaintiffs can cite only to *Steiner v. Meyerson*, 1995 WL 441999 (Del. Ch. 1995), but Steiner is of no help. In Steiner, Plaintiffs alleged that a director

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[13] Plaintiffs incorrectly cite to *In re Nat. Auto Credit, Inc. Shareholders Litig.*, 2003 WL 139768 (Del. Ch.), and *Grobow v. Perot*, 526 A.2d 914 (Del. Ch. 1987), to support their contention that the benefits Kramer received from his directorship rendered him interested. In *Grobow*, the Court found that the Plaintiffs did not sufficiently plead an entrenchment motive because they did not show that the defendants received *new* benefits as a result of the relevant transaction. In *Nat. Auto Credit*, the Court found that *increased* director fees as a result of the challenged transaction, not *existing* director fees, rendered the defendants interested.

lacked independence because he was indirectly dependent upon the relevant company's CEO for $1 million in legal work annually. Neither the CEO nor his company were the director's client, but the Court acknowledged that the CEO had direct control and influence over the director's client and found that "realistically" the CEO could have influence over the director. *Id*. at *10. Steiner discusses realism with regard to relationships, not materiality. Even assuming that case suggested that courts should apply "realism" to materiality, "realistically" there are very few people for whom $1 million would not be material and the case does not apply here.

In fact, the "realism" argument with regard to materiality has been rejected by this Court: "To follow Plaintiff's urging to discard 'formalistic notions of interest and independence in favor of a realistic approach' expressly would be to overrule the Delaware Supreme Court." *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 360 (Del. Ch. 1998) (footnote omitted), *aff'd in part, rev'd in part on other grounds*, 746 A.2d 244 (Del. 2000). In *Walt Disney*, the Court rejected the plaintiffs' allegation that because a teacher director's salary was low compared to her director fees and stock options, then she was beholden to the CEO. The Court further stated that to find the director beholden because of her low salary "would be to discourage the membership on corporate boards of people of less than extraordinary means. Such 'regular folks' would face allegations of being dominated by other board members, merely because of the relatively substantial compensation provided by the board membership compared to their outside salaries." *Id.* Moreover, even if "realism" with regard to materiality was a proper consideration, it is hardly realistic to infer that the heating and air-conditioning work that Kramer receives from the Company, "a single branch" bank (Am. Compl. ¶ 4), is sufficient to render him interested.

Plaintiffs conjure up the possibility that the Company will employ Kramer in the future, and that because of this, Kramer is beholden to Stephens. They claim in the Amended Complaint that "Kramer has [merely] discussed becoming a full time banker" and now in their Answering Brief, they have recast their allegation to claim that "Kramer is considering accepting a full-time job with the Bank." Compare Am. Compl. ¶ 9 to PAB ¶ 31. Plaintiffs mischaracterize their claim in an apparent attempt to imply that the Company made a job offer to Kramer – an incorrect claim that the Plaintiffs have not alleged in their Amended Complaint. Though this recast allegation is no better than the one in the Amended Complaint in terms of supporting a claim of interestedness or lack of independence, the Court should be aware of this change.[14]

Plaintiffs cite three cases to support their argument that Kramer is beholden to Stephens because he may hypothetically work for the Company in the future. These cases, however, each involve an important fact not present here – the director allegedly beholden was *currently* employed by or dependent upon the relevant other person for his full-time employment. *Cal. Public Employees Retirement System v. Coulter*, 2002 WL 31888343, at *9 (Del. Ch. 2002) (fellow director was a director's supervisor in his current primary employment and was his supervisor in his last three positions and last two employers); *Rales v. Blasband*, 634 A.2d 927, 937 (Del. 1993) (director dependent upon company's Chairman for his current employment for which he earned a salary of $1 million per year); *Orman v. Cullman*, 794 A.2d 5, 42 n.50 (Del. Ch. 2002) (providing an example of a director's lack of independence relating to his current employer). Plaintiffs cite to no case supporting their claim that a director can be beholden to another because of speculative future employment possibilities. Though Plaintiffs acknowledge that in order to show dominance, one must allege that a dominating individual or entity can "exert influence over the dominated director" (PAB p. 32 (citing to *Steiner*, 1995 WL 441999, at **9-10)), they have not shown and cannot show how Stephens was capable of exerting influence or control over Kramer or any other director.

Finally, Plaintiffs claim that Kramer lacks independence from Stephens because he felt a sense of "owingness" to him. This "owingness" arose because Stephens allegedly allowed Kramer to

[14] Similarly, in an apparent effort to bolster their frail claim that Kramer is beholden to Stephens, Plaintiffs improperly insert an entirely new allegation into their Answering Brief. They claim that Kramer's family business has an outstanding loan controlled by the Company. *Compare* Am. Compl. ¶ 30 to PAB p. 30. Nowhere in Plaintiffs' Amended Complaint do they include this allegation and the Court may not properly consider it.

participate in a buy back without filing a Form 144 and allowed him to exercise options in alleged violation of the Company's 1999 Option Plan.[15] Plaintiffs are incorrect as a matter of law.

First, Plaintiffs allegations confuse the rules regarding Form 144. If the Company purchased Kramer's shares directly, as Plaintiffs allege (Am. Compl. ¶ 20), then Kramer was not required to file a Form 144. A Form 144 may be filed pursuant to Rule 144 under the Securities Act of 1933, as amended (the "Act"), if one seeks a "safe harbor" exemption from underwriter liability under the Act for persons engaged in a distribution of an issuer's securities. *See* 17 C.F.R. § 230.144. The mere failure to file a Form 144, or to comply with Rule 144 at all, does not mean that the sale was improper. According to Plaintiffs' own allegations, there was no distribution, as they allege that Kramer sold his shares back to the issuer, First Niles. If Kramer's sale of stock to the Company was part of a broker transaction, then he had the option to file a Form 144 to take advantage of the "safe harbor," but he was not required to do so:

> Although this rule provides a means for reselling restricted securities and securities held by affiliates without registration, it is not the exclusive means for reselling such securities in that manner. Therefore, it does not eliminate or otherwise affect the availability of any exemption for resales under Securities Act that a person or entity may be able to reply upon.

Id. Moreover, in the over eight years that First Niles has been a public company, only one employee has filed a Form 144 for stock trades. *See* Forms 144 filed by Thomas G. Maley on March 22, 2004 and May 27, 2004 attached hereto as Exhibits H and I. There was nothing improper or unusual about Kramer not filing a Form 144. Accordingly, Plaintiffs allegation that Kramer feels "owingness" to Stephens because he did not file a Form 144 is of no effect.

Second, Plaintiffs mischaracterize Kramer's stock purchase in May of 2004 and his subsequent sales. Plaintiffs allege that Kramer's action was a "cashless" exercise. *See* Am. Compl. ¶

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[15] The Court should give no credence to Plaintiffs' conclusory and unsupported allegations that Kramer's previous purchases and sales of Company stock were at "favorable" and "above market" prices. *See* PAB p. 26. Plaintiffs have failed to allege any information from which the Court could infer that the prices were unfair.

22. The sale was "cashless," but not from the Company's perspective, as the Plaintiffs claim. The sale was a "broker-assisted cashless exercise of options," meaning the broker provided cash to the Company. *See* SEC Form 4 filed by Kramer on June 16, 2004, attached hereto as Exhibit J. Besides being incorrect regarding the nature of Kramer's sale, Plaintiffs are also incorrect in their allegation that a "cashless" exercise was an "apparent violation" the 1999 Stock Option and Incentive Plan ("Stock Option Plan"), which provides as follows:

> The [Board] shall determine the time or times at which an Option may be exercised in whole or in part *and the method or methods by which*, and the form or forms (including, without limitation, cash, Shares, other Awards or any combination thereof, having a fair market value on the exercise date equal to the relevant exercise price) in which, *payment of the exercise price with respect thereto may be made or deemed to have been made*.

See Section 5(a)(iii) of the Stock Option Plan, attached hereto as Exhibit K (emphasis supplied).[16]

Even assuming Kramer was required to file a Form 144, which he was not, or that he violated the Stock Option Plan, which he did not, Plaintiffs incorrectly rely upon *In re Primedia Inc. Derivative Litig.*, 910 A.2d 248 (Del. Ch. 2006), to support their claim. In the *Primedia* case, the plaintiffs sufficiently alleged that a director lacked independence because the director was dependent upon an interested director for his current, full-time employment. *Id.* at 261 n.45. Kramer is self-employed and does not rely on Stephens for his job. Even if Plaintiffs' demonstrably false claims were true, Plaintiffs have failed to cite to any case law showing that the Form 144 and Stock Option Plan allegations discussed above would be enough to rise to the level of "owingness" sufficient to support their allegation that Kramer lacked independence.

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[16] The Court may consider the Stock Option Plan because Plaintiffs incorporated the document by reference in their Amended Complaint (Am. Compl. ¶¶ 15, 17, 22-23). *See Orman v. Cullman*, 794 A.2d 5, 20 n.36 (Del. Ch. 2002).

II. COUNTS I AND III SHOULD ALSO BE DISMISSED BECAUSE THE PLAINTIFFS CANNOT SHOW THAT THE DECISIONS NOT TO SELL THE COMPANY AND TO RECLASSIFY THE COMPANY'S STOCK WERE BREACHES OF FIDUCIARY DUTY.

Because the Defendants have shown that the majority of the Board was at all times disinterested and independent, the Court's analysis regarding Counts I and III need not proceed any further. However, Plaintiffs also fail to rebut the Defendants' arguments that the Board's decisions not to sell the Company and to reclassify the Company's stock were not breaches of fiduciary duty.

Plaintiffs can cite to no case law supporting their claim that the Defendants here breached their fiduciary duties when they voted to reclassify the Company's stock. Plaintiffs attempt to support their argument by citing to *Hamilton v. Nozko*, 1994 WL 413299 (Del. Ch.), *Seagraves v. Urstadt Property Co., Inc.*, 1989 WL 137918 (Del. Ch.), and *Berger v. Scharf*, 816 N.Y.S.2d 693 (N.Y. Sup. 2006), to support their contention, but these cases are inapposite. The foregoing cases are all distinguishable because in each of those cases there was a majority shareholder that stood to gain considerable new benefits apart from the other shareholders as an effect of de-listing and the Court found that the defendants made the decision to de-list for purely self-interested reasons. Similar allegations are not present here.[17]

As discussed in Defendants' Opening Brief, "Delaware law recognizes a corporate board's ability, in a proper exercise of their business judgment, to cause the corporation to take steps to deregister even if, as an incidental matter, deregistration might adversely impact the market for the corporation's securities." *Wynnefield Partners Small Cap Value, LP v. Niagara Corp.*, 2006 WL 1737862 (Del. Ch. 2006), *aff'd in part, rev'd in part on other grounds*, 907 A.2d 146; *see also* DOB p. 17.

[17] *Berger* is a trial court case from New York that merely applies Delaware law and is not binding on this Court.

Plaintiffs apparently concede Defendants' argument that the Board's decision not to sell the Company is an improper subject for a breach of fiduciary duty claim because they do not even address it.

III. PLAINTIFFS ALSO CANNOT STATE CLAIMS FOR COUNT I AND III AGAINST DEFENDANTS WHO WERE NOT ON THE BOARD AND DID NOT PARTICIPATE IN THE VOTES ON THE CHALLENGED TRANSACTIONS.

Defendants acknowledge that officers, as well as directors, owe fiduciary duties to a corporation and its shareholders. Plaintiffs, however, have failed to allege a breach of fiduciary duty claim in Counts I and III against Safarek or Csontos as officers of the Company.[18] Plaintiffs have also failed to set forth a claim as to Counts I and III against other non-directors, Csontos and Shaker. The Amended Complaint sets forth a vote-centered argument for their claims for breach of fiduciary duty and alleges that the wrongful acts that were breaches of fiduciary duty were the Board's decisions not to sell the Company and to reclassify the Company's stock. Safarek and Csontos were not on the Board and did not participate in either of the relevant votes and Shaker was not on the Board and did not participate in the vote to reclassify the Company's stock. Plaintiffs do not allege otherwise. Because these defendants were not on the Board and did not participate in the relevant votes, they cannot be held liable for a breach of fiduciary duty based upon those votes. *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 499 (Del. Ch. 1990) (holding that plaintiff failed to establish a factual or legal basis for claim against defendants who played no role in the decision-making process); *see also In re Tri-Star Pictures, Inc. Litig.*, 1995 WL 106520, at *2 (Del. Ch.) (holding that there can be no breach of fiduciary duty where one was not a director voting on the relevant transaction).

[18] Plaintiffs add another new allegation in their Answering Brief to bolster their claims and they say that management was present at the Board meeting on October 3, 2005 and made a recommendation in favor of Reclassification. *Compare* Am. Compl. ¶ 66 to PAB p. 17. The Court may not properly consider this new allegation. Further, Plaintiffs offer no precedential support for their novel claim that merely making a *recommendation* to the Board cannot provide support for a breach of fiduciary duty claim.

IV. COUNT II SHOULD BE DISMISSED BECAUSE THE PROXY CONTAINED ADEQUATE DISCLOSURES AND PLAINTIFFS FAILED TO ALLEGE SPECIFIED HARM FOR THEIR DISCLOSURE CLAIMS.

A. Plaintiffs Failed To Allege Separate Damages For Their Disclosure Claims.

Plaintiffs contest the adequacy of the disclosures regarding the Board's consideration of three potential business combinations, the choice to reclassify the Company's stock, and the effects of that Reclassification.[19] As an initial matter, to state a valid claim for breach of the fiduciary duty of disclosure, Plaintiffs must set forth particularized facts showing "deprivation to [their] economic interest or impairment of their voting rights." *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 147 (Del. 1997). "[N]ondisclosure of wrongdoing not material to the transaction *but for* the fact that it was wrongful is – barring exceptional, well-pled circumstances – not a separate claim." *Brown v. Perrette*, 1999 WL 342340, at *6 (Del. Ch.) (emphasis in original). Plaintiffs' disclosure claims are add-on claims for which they allege no additional damage apart from the damages for the alleged breaches of fiduciary duty. The allegations of wrongdoing that support Plaintiffs' disclosure violation claims are themselves being litigated in this action. Accordingly, Plaintiffs' disclosure claims should be dismissed for failure to allege a separate damage as a result of the alleged disclosure violations. *Id*. at *5.[20]

B. The Proxy Adequately Disclosed The Board's Consideration Of A Potential Sale.

The disclosures were entirely adequate, particularly in view of the purpose of the Proxy. That purpose was to gain approval of the Reclassification, *not* to approve the Board's decision not to sell. Providing the basic facts regarding a potential sale of the Company was more than adequate as

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[19] Plaintiffs make continuous reference to the "preliminary proxy." *See* PAB ¶¶ 1, 19 n.2, 35 n.13, 43 n.18. Any reference to the preliminary proxy is, of course, a red herring, as the preliminary proxy was never distributed to the Company's shareholders and so provides no guidance as to the issues before the Court.

[20] Obviously, Plaintiffs did not feel the alleged non-disclosures were material because they abandoned their claim for injunctive relief when they amended their Complaint.

details of the Board's consideration of a potential sale were not relevant to the issue upon which the shareholders were voting, namely Reclassification. *See id*., at *9 (court expresses agreement with statement that "a deal declined is a deal not before the shareholders"). There is no need to provide superfluous facts that will likely confuse the shareholders as to the vote before them:

> [D]isclosure of a single unadorned fact can quickly snowball into wide-ranging disclosure of facts and opinions that otherwise would never come before the shareholders. Meanwhile, the shareholder must keep distinct in her mind the details of the intermediate offer being critiqued and the final offer for which approval is sought.

Id. at *8 (footnote omitted). Plaintiffs contend that the "facts" regarding how that bid was handled were omitted. In fact, the Proxy discloses more than sufficient facts about the Board's consideration of a potential sale. The Proxy discloses that a potential sale was considered, that First Niles received three indications of interest, that one of the bidders submitted a definitive merger proposal to the Board, and that the proposal was ultimately rejected. *See* Proxy p. 13; *see also* DOB p. 24. The cases that Plaintiffs rely upon for the proposition that more disclosure regarding how the potential sale was handled is necessary, *McMullin v. Beran*, 765 A.2d 910 (Del. 2000), and *Clements v. Rogers*, 790 A.2d 1222 (Del. Ch. 2001), are inapposite.

In *Clements*, a special committee that misunderstood its role, rather than the full board of directors, was tasked with reviewing and making decisions on purchase offers for a company with a majority shareholder. 790 A.2d at 1242. The special committee in *Clements* thought its role was to find a price that was fair and acceptable to both the majority shareholder and the minority shareholders, when in fact its role was solely to protect the minority shareholders. Because the Proxy disclosures reflected the special committee's true role and stated that the members of the special committee had negotiated with the controlling shareholder "at arm's length," and the plaintiff alleged that the special committee did not understand or act pursuant to its true role, but rather acted for the benefit of the majority and minority shareholders, summary judgment for the defendants on the disclosure claims was inappropriate. *Id.* at 1240. In *McMullin*, the board of directors delegated the task of evaluating purchase offers to the majority shareholder and failed to conduct its own evaluation regarding the fairness of the transaction to the minority shareholders. 765 A.2d at 919.

The present case does not compare to those cases where the purpose of the proxy statements was to disclose the circumstances surrounding a sale and where those proxy statements misrepresented who was receiving and evaluating purchase offers, those tasked with receiving and evaluating purchase offers misunderstood their directives, and where the board of directors failed to provide an opinion regarding the fairness of the transaction to the minority shareholders. Here, Plaintiffs make no allegation regarding improper delegation of the task of evaluating the offers, claiming that the Board "misunderstood" its role to act in the best interest of the shareholders, or that the Defendants did not render an opinion as to whether the transaction was fair to the shareholders. Moreover, there is no majority shareholder. Again, as set out above, the "true facts" of the potential sale were set out in the Proxy.

Plaintiffs also attempt to compare this case with *Arnold v. Society for Sav. Bancorp., Inc.*, 650 A.2d 1270 (Del. 1994), to support their claim the Proxy should have disclosed more regarding the potential sale. In *Arnold*, the Court found that the proxy statement was insufficient because although it disclosed nine bids received by the company, it failed to include a later bid, which was the highest bid received. Here, there is no allegation that the Defendants failed to include such basic facts. The Plaintiffs allege that three institutions provided indications of interest and one presented a definitive proposal. *See* Am. Compl. ¶¶ 31 and 34. The very same facts were disclosed in the Proxy. *See* Proxy p. 13.

Plaintiffs also cite to *In re Tele-Communications, Inc. Shareholders Litig.*, 2005 WL 3642727 (Dec. 21, 2005 Del. Ch.), to support their contention that the disclosure in the Proxy that the Board rejected the offer from First Place "after careful deliberations" was inadequate. In the *Tele-Communications* case, the Court found that the defendants' statement in the proxy regarding "careful consideration" could be a material misstatement and could support a claim for disclosure violations because the Plaintiffs had adequately alleged concerns that the board of director's did not consider the purchase offers at all, but rather *delegated the task* of soliciting and reviewing purchase bids. Here, however, there is no allegation that the Board did not review the purchase bids.

Further, the holding in *Tele-Communications* actually supports Defendants' contention that they are not required to disclose all the details relating to their review of the indications of interest and their decision regarding the First Place bid:

> No Delaware decision has ever held that a more detailed description of a committee's deliberations, either akin to the minutes of that committee, or a transcript of committee meetings, or some other description of the give and take and discussions of the committee must be disclosed in order to support a statement of "careful consideration." Instead, the courts of Delaware have repeatedly stated that, in the context of disclosures, less disclosure is often more appropriate than more in order to avoid burying shareholders beneath a tome of impenetrable complexity and length.

Id. at *5.

Plaintiffs further complain that the history of due diligence conducted in connection with a potential sale of the Company was not adequately disclosed. Plaintiffs' allegation that the Defendants "sabotaged" due diligence is conclusory and unsupported. Plaintiffs do not allege that there was any urgency to sell the Company that necessitated the Company to conduct due diligence immediately upon receive of any indications of interest. Instead, they allege only that Gantler and Keefe, Bruyette & Woods ("KBW") wanted the Company to move faster. The Company's decision to attend to managing the Company first and due diligence for a potential sale second is immaterial and the Defendants were not required to disclose that decision in the Proxy.

C. The Proxy Adequately Disclosed The Lone Dissent To The Decision To Reclassify.

Plaintiffs admit that they do not challenge the "quality" of the disclosure regarding the litigation. Yet they complain instead that because Gantler's name and the claims of the litigation are "buried at the end of the Proxy" their disclosure is somehow inadequate. *See* PAB p. 43. They can point to no support for this claim and the Court should not take it seriously. In fact, the Proxy fully sets out both the 3-1 vote and the reasons for the dissent. *See* Proxy p. 15.

Moreover, although the reasons for Gantler's dissent are fully disclosed, the Delaware Chancery Court has rejected the argument that a proxy statement must disclose reasons why a director dissented from a board decision. *Newman v. Warren*, 684 A.2d 1239 (Del. Ch. 1996). In *Newman*, the Court specifically pointed out the problem of disclosing reasons for director dissent when there is only a single dissenter: "directors' reasons – as opposed to the facts respecting the company and the transaction – are [then] regarded as material matter for disclosure." *Id.* The Court has specifically rejected Plaintiffs' claim that failure to adhere to regulations of the SEC creates a disclosure violation. To the extent that Reg M-A may require such identification, as Plaintiffs claim, Delaware courts are an improper venue for claims of violation of securities regulations. *See RGC Int'l Investors, LDC v. Greka Energy Corp.*, 2001 WL 312454, at *9 (Del. Ch.) (attached hereto as Exhibit Q) ("Delaware courts have consistently refused to regulate the securities markets….").

D. <u>The Proxy Adequately Disclosed The Effects Of Reclassification.</u>

1. <u>Future Acquisition.</u>

Plaintiffs claim that the Proxy is deficient because it fails to state that future acquisition of the Company is "unlikely" after Reclassification.[21] As explained in Defendants' Opening Brief, any such doomsday prediction is speculation and speculation is not the proper subject of proxy statement disclosures. *Loudon*, 700 A.2d at 145. Plaintiffs also claim that expert testimony can establish whether future acquisition of the Company is "unlikely" following the Reclassification and so their claim should survive Defendants' Motion to Dismiss. Not only do they cite no authority for this

[21] Plaintiffs pick and choose quotes from an article cited by Defendants, attempting to imply that Plaintiffs' prediction regarding future acquisition has merit. The article states only that after a reclassification, a bank "will not be able to offer liquid stock in an acquisition," but does not state that an acquisition becomes "unlikely" following reclassification. *See* Mark R. Baran and Katherine M. Koops, *Escaping SOX: The angst of Sarbanes-Oxley needn't be your future if you reconsider the benefit of being a public company*, COMMUNITY BANKING (May 2005) at p. 20-28.

assertion, but this claim proves the Defendants' point. If Plaintiffs need an expert "opinion," then by its very nature the likelihood of future acquisition is not a fact that should be disclosed because it is uncertain.

Further, Defendants did not disclose that acquisition of the Company was "unlikely" following Reclassification because companies that have reclassified their stock have been the subject of acquisitions. *See, e.g.,* Big Lake Financial Corporation's Form 15 reflecting its suspension of the duty to file reports with the SEC on March 16, 2005 and Seacoast Banking Corporation of Florida's Form 8-K reflecting its agreement to acquire Big Lake Financial Corporation dated November 22, 2005, less than eight months after completing its reclassification. *See also, e.g.,* Republic Bancshares of Texas, Inc.'s Form 15 reflecting its suspension of the duty to file reports with the SEC on February 2, 2006 and Trustmark Corporation's Form 8-K reflecting its agreement to acquire Republic Bancshares of Texas, Inc. dated April 13, 2006, less than three months after completing its reclassification. (Copies of the relevant Forms 15 and Forms 8-K are attached hereto as Exhibits L through O). In fact, the very same investment banker previously employed by First Niles, KBW, participated in Trustmark Corporation's acquisition of Republic Bancshares of Texas, Inc. *See* p. 2 of the press release announcing the agreement for acquisition, attached as exhibit 99.1 of Exhibit O, and Am. Compl. ¶ 28.

2. <u>Reincorporation In Another State.</u>

The Proxy did not disclose that the Company intends to surrender the Bank's federal charter and reincorporate in a state other than Delaware because it disclosed just the opposite. In the Proxy, the Company states the following:

> Other than as described in this proxy statement, we do not have any current plans or proposals to effect any extraordinary corporate transaction such as a merger, reorganization or liquidation; to sell or transfer any material amount of our assets; to change our board of directors or management; to change materially our indebtedness or capitalization; or otherwise to effect any material change in our corporate structure or business.

Included in that statement is, of course, a change of the state of incorporation. Even if the reincorporation issue is not included in the Proxy language, the Plaintiffs' contention is pure speculation. *See Loudon*, 700 A.2d 145. In *Loudon*, the plaintiff argued that a special litigation committee's current intention not to seek dismissal of a lawsuit should have been disclosed in the proxy statement. *Id.* The Court disagreed, stating that requiring disclosure of the current intention "would oblige the Committee to speculate about its future plans. Speculation is not an appropriate subject for a proxy disclosure." *Id.*

Moreover, Plaintiffs fail to allege any facts sufficient to show that a plan of reincorporation was imminent. Plaintiffs claim that reincorporation in another state is not speculative because it is "an event purely within defendants' control." *See* PAB p. 45. If a plaintiff could allege any possible action that is within a board's control, even though the board was not considering it and so obviously would not disclose it, then a plaintiff could always avoid a motion to dismiss on disclosure claims. Moreover, Plaintiffs allege that reincorporation in a state other than Delaware was a part of the Reclassification. To date, over three months after the effective date of the Reclassification, the Company is still incorporated in Delaware.

E. <u>The Proxy Adequately Disclosed The Reasons For The Reclassification.</u>

1. <u>Buy Backs.</u>

Plaintiffs claim that Defendants failed to disclose that the Reclassification would allow greater flexibility to effectuate negotiated buy backs. First, as set out above, Plaintiffs failed to allege that the opportunity for buy backs was available only to the Defendants. Disclosure of an opportunity available to any Company stockholder is not a proper subject for disclosure. Second, as set out above, they fail to distinguish *Nebenzahl v. Miller*, 1993 WL 488284 (Del. Ch.). They do not and cannot rebut the fact that the vote in favor of Reclassification created no new benefit with regard to buy backs and so disclosure of such a continuing opportunity is immaterial. Finally, as discussed above, any finding that Defendants were interested (so that disclosure of this issue was required) because they would continue to have a benefit after a transaction that they had before the transaction flies in the face of well-settled Delaware law that retention of one's directorship is not enough to show interestedness.

2. Employee Stock Option Plan.

Plaintiffs claim that the Proxy does not adequately disclose the effects of the Reclassification on Employee Stock Option Plan ("ESOP") participants. The disclosures were adequate and the issue itself is immaterial. As set forth in Defendants' Opening Brief, the possibility that the Company's stock may not be "readily tradable" after the Reclassification, triggering the put right, is fully disclosed in the Proxy. If the possibility of the stock losing its status as "readily tradable," so that the put right is triggered, was enough to prevent the Company's shareholders from approving the Reclassification, they had that information before them and could cast an informed vote. *See* DOB p. 31; *see also* Proxy p. 22.

Moreover, the discussion of the possibility that the Company may be required to purchase any shares that an employee owns through the ESOP upon the employee's termination is immaterial because, as is fully disclosed in the Proxy, the ESOP has historically, independently decided to offer to purchase an employee's Company stock upon termination: "Historically, the ESOP has independently decided to offer to pay employees or their beneficiaries cash for shares owned through the ESOP upon an employee's termination or death, but these cash payments were not subject to an appraisal." *See* Proxy p. 22. Therefore, the only effect of the shares becoming not "readily tradable" would be the addition of an appraisal obligation. Plaintiffs fail to allege how not disclosing this increased protection to shareholders "altered the total mix of information" available to the shareholders, causing them to reject the proposal.

F. Plaintiffs Have Abandoned Certain Of Their Disclosure Violation Claims.

Notwithstanding their Amended Complaint, Plaintiffs have abandoned certain of their disclosure violation claims: (1) that the Proxy did not create a "false sense of urgency regarding

Reclassification" (DOB p. 26-29); (2) that the Proxy disclosed that the Company will no longer be quoted or traded on the NASDAQ SmallCap Market and will be listed, if at all, on the Over the Counter Bulletin Board or Pink Sheets electronic quotation system (DOB p. 31-32; Proxy p. 22); and (3) that the Proxy fully discloses that as a result of the Reclassification, publicly available information will decrease, liquidity of the Company's stock will be reduced, the Company will no longer be subject to the Securities and Exchange Commission's reporting requirements, and the directors' percentages of beneficial ownership will likely increase (DOB 32-33; Proxy pp. 21, 26). None of these claims were addressed by the Plaintiffs in their Answering Brief.

V. COUNT III SHOULD ALSO BE DISMISSED BECAUSE THE DECISION TO RECLASSIFY THE COMPANY'S STOCK WAS OVERWHELMINGLY APPROVED BY THE SHAREHOLDERS BASED ON THE PROXY'S FULL AND ACCURATE DISCLOSURE.

Plaintiffs do not deny that shareholder approval may provide Defendants with the protection of the business judgment rule, but argue only that such approval does not provide protection here because they claim that the disclosures in the Proxy were inadequate. Accordingly, because the Proxy disclosures were adequate, shareholder approval of the Reclassification provides an additional ground for dismissing Count III of Plaintiffs' Amended Complaint.

Plaintiffs mischaracterize Defendants' argument regarding the Proxy disclosures. The Defendants do not, as Plaintiffs contend, "claim there is no duty for them to disclose their own wrongdoing." *See* PAB p. 48. Rather, Defendants maintain that they disclosed all information required and that any other information that Plaintiffs claim they should have disclosed is immaterial, speculative, and/or is nothing more than Plaintiffs' false and baseless assumptions regarding why the Defendants took the actions that they did.

Plaintiffs claim that the use of the self-flagellation defense precludes the protection provided by a shareholder vote. They cite to *Sample v. Morgan*, 914 A.2d 647 (Del. Ch. 2007), and *Clements v. Rogers*, 790 A.2d 1222 (Del. Ch. 2001), for support of this mistaken argument, but these cases provide no such support. First, the *Sample* case stands only for the well-settled principle that shareholder approval does not provide protection without full disclosure and nothing more. The defendants in that case do not even raise the self-flagellation defense. In *Clements*, the Court did not reach the question of the defendant's self-flagellation defense, but denied summary judgment on plaintiff's disclosure claim and stated that the allegedly missing disclosures for which the defendant sought the protection of the self-flagellation defense were arguably facts that should be disclosed and were not merely plaintiff's characterization of those facts. 790 A.2d at 1243 n.62. Finally, Plaintiffs make a cursory reference to *Brown v. Perrette*, 1999 WL 342340 (Del. Ch.), implying that it provides support for their argument. Plaintiffs' citation to *Brown* is also incorrect. In *Brown*, the Court *granted* the defendant's motion to dismiss the disclosure claims and did not reach the merits of the self-flagellation and ratification defenses.

VI. THE COMPLAINT SHOULD ALSO BE DISMISSED AGAINST CSONTOS AND SHAKER FOR LACK OF PERSONAL JURISDICTION.

This Court may only properly exercise personal jurisdiction over non-residents who are company directors or company officers as the term "officer" is defined in 10 *Del. C.* § 3114(b). As set out in Defendants' Opening Brief and supported by the allegations of the Amended Complaint, Csontos and Shaker are not and never have been Delaware residents and are not and never have been officers as the term "officer" is defined in 10 *Del. C.* § 3114(b). Plaintiffs did not contest this argument in their Answering Brief. Further, neither Csontos nor Shaker were directors during the vote for Reclassification and Csontos was also not a director during the vote not to sell the Company.[22] As discussed above, the Court should not accept Plaintiffs' recast contentions regarding the relevant dates for the alleged breaches of fiduciary duty. Because Csontos and Shaker were not directors or officers, as "officer" is defined in 10 *Del. C.* § 3114(b), during the relevant time periods, this Court lacks personal jurisdiction over them.

[22] Plaintiffs do not assert Count I against Shaker.

CONCLUSION

For all of the foregoing reasons, Defendants respectfully request that the Court dismiss Plaintiffs' Amended Complaint with prejudice.

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