IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MCG CAPITAL CORPORATION, for itself and in the right and for the benefit of Jenzabar, Inc.,	)	
Plaintiff,	)	
v.	)	Civil Action No. 4521-CC
ROBERT A. MAGINN, JR., LING CHAI, JAMISON BARR, JOSEPH SAN MIGUEL, DANIEL QUINN MILLS, JENZABAR, INC.,	)	
Defendants,	)	
and	)	
JENZABAR, INC.,	)	
Nominal Defendant.	)	

OPINION

Date Submitted: March 3, 2010
Date Decided: May 5, 2010

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CHANDLER, Chancellor

I. INTRODUCTION

Before the court are defendants' separate motions to dismiss eleven of the twelve counts in plaintiff's complaint under Court of Chancery Rules 12(b)(6) and 23.1. For the reasons that follow, defendants' motions are granted in part and denied in part. A summary of my ruling can be found in the conclusion of this Opinion.

II. FACTS

Defendant Jenzabar, Inc. ("Jenzabar" or "the Company") is a Delaware corporation that principally operates out of Boston, Massachusetts. It is a private software and services company that provides business intelligence applications and services, internet enterprise software, and e-learning solutions to the higher education market.

Plaintiff MCG Capital Corporation ("MCG") is a publicly traded investment company that deals primarily in debt, debt-like, and derivative instruments. On June 30, 2004, MCG invested $5 million in Jenzabar in exchange for 5,000 shares of senior preferred stock, 109,800 shares of subordinated preferred stock, and warrants to purchase 5,879,150 shares of common stock. MCG also made two loans to Jenzabar totaling $30 million on June 30, 2004. These loans were paid off on March 17, 2006.

Through its investment MCG obtained a majority of Jenzabar's outstanding warrants and became the sole holder of Jenzabar's senior preferred shares. MCG did not, however, obtain any Jenzabar common shares. MCG's investment was made pursuant to a Preferred Stock and Warrant Purchase Agreement (the "PSWPA"), dated June 30, 2004. MCG and Jenzabar were the only two parties to the PSWPA. The Fifth Amended and Restated Certificate of Incorporation of Jenzabar (the "Charter") and the Fourth Amended and Restated Stockholders' Agreement (the "Stockholders' Agreement") were also adopted on June 30, 2004 as a condition of MCG's investment. MCG and Jenzabar were both parties to the Stockholders' Agreement. Defendants Robert A. Maginn Jr., the Chairman and Chief Executive Officer of Jenzabar, and Ling Chai, the Company's President and Chief Operating Officer, were also parties to the Stockholders' Agreement. Maginn and Chai are married.

As a condition of and simultaneous with MCG's investment, Jenzabar entered into employment agreements (the "Employment Agreements") with Maginn and Chai. The Employment Agreements were required and approved by MCG as part of the PSWPA.[1]

Central to this dispute are special consent rights MCG obtained in connection with its investment. These consent rights are contained in the PSWPA

[1] PSWPA § 2.3(ii)(J).

and the Charter and prohibit Jenzabar from taking certain corporate actions without MCG's approval. Specifically, Section 5.12(h) of the PSWPA and Article V, Section A.1(b)(x) of the Charter require MCG's approval before Jenzabar enters into certain transactions with "Affiliates," as that term is defined in the agreements. MCG has consent rights under the PSWPA because it holds a majority of Jenzabar's warrants. Similarly, MCG has special consent rights under the Charter because it holds a majority of Jenzabar's senior preferred shares.

Another contractual provision important to this dispute is Article V, Section A.4(b) of the Charter. When it made its investment, MCG agreed that Jenzabar would have the right to repurchase MCG's senior preferred stock so long as Jenzabar had first repaid all its debts to MCG. If Jenzabar made such a repurchase before April 30, 2009, MCG was required to make a choice: MCG could put its warrants to Jenzabar and retain its consent rights under the PSWPA, or MCG could continue to hold the warrants, and lose its consent rights under the PSWPA.[2] Of course, MCG's consent rights under the Charter would be extinguished when Jenzabar repurchased the senior preferred shares held by MCG.

One more provision of the agreements between MCG and Jenzabar bears note. Section 4.2(a) of the Stockholders' Agreement provides that when the $30 million MCG had loaned to Jenzabar was repaid, the Jenzabar board would consist

[2] PSWPA § 5.11(a) and (g).

of five members elected as follows: one director elected by MCG, two directors elected by Maginn and Chai, and two directors elected by mutual agreement between MCG, Maginn, and Chai. After Jenzabar paid off the $30 million in loans on March 17, 2006, this arrangement was followed to appoint directors to the Jenzabar board. At the time the actions underlying this dispute occurred, the Jenzabar board consisted of Maginn and Chai (who were self-appointed), Peter Malekian (who was appointed by MCG), and defendants Joseph San Miguel and Daniel Mills (who were appointed by mutual agreement between MCG, Maginn, and Chai). Malekian is an MCG employee. San Miguel and Mills were both former professors of Maginn at Harvard Business School. San Miguel and Mills were initially approached by Maginn to join the Jenzabar board but both were ultimately approved by MCG, Maginn, and Chai. San Miguel, Mills, and Malekian made up the compensation committee.

Now to the conflict. All twelve counts in MCG's complaint are essentially based on three events. The first event occurred on December 18, 2008, when the compensation committee approved salary increases and retroactive bonuses (the "Compensation Increases") for Maginn and Chai without seeking MCG's approval. Maginn's salary was increased 12.5% from $400,000 to $450,000 and Chai's salary was increased 12% from $340,000 to $380,000. Retroactive bonuses for fiscal years 2007 and 2008 totaling $794,000 were also approved by the compensation committee.[3] San Miguel and Mills voted in favor of the Compensation Increases; Malekian voted against them. The compensation committee was advised by Jenzabar's General Counsel, defendant Jamison Barr, as well as Jenzabar's regular outside counsel, Christopher Austin. Barr introduced Austin to the compensation committee; Maginn had previously hired him to represent Jenzabar on other matters. Malekian took the position that the Compensation Increases were subject to MCG's consent rights, while San Miguel and Mills took the opposite position after being advised by Barr and Austin. According to the complaint, San Miguel and Mills excluded Malekian from some of their conversations with Barr and Austin about MCG's consent rights. Malekian objected to receiving advice from Barr and Austin and suggested that the compensation committee retain independent counsel to advise it regarding the Compensation Increases, but San Miguel and Mills decided not to retain independent counsel.

The second event that gave rise to this dispute occurred on December 23, 2008, when the Jenzabar board approved a $750,000 bonus (the "2002 Bonus") for Maginn that purportedly had first been approved in 2002 but never paid. Maginn and Barr allegedly brought this overlooked bonus to the board's attention. Only three of the five directors voted on the 2002 Bonus; Maginn and Chai abstained.

[3] It is not clear from the record how this $794,000 was divided between Maginn and Chai.

San Miguel and Mills voted in favor of the 2002 Bonus and Malekian voted against it. Malekian's principal objection to the 2002 Bonus was that it too was subject to MCG's consent rights. According to MCG, sometime after the 2002 Bonus was approved, Maginn and Barr explained to San Miguel and Mills that the reason the 2002 Bonus had not been paid previously was because it was only conditionally approved by the board in 2002. The precondition to payment was the consent of a third-party investor in Jenzabar. Allegedly, this consent was never obtained and thus the 2002 Bonus was never paid. Maginn purportedly sought approval of the 2002 Bonus anew so that he could be paid the $750,000 free of the condition. MCG's complaint alleges that when San Miguel and Mills learned they had been misled by Maginn and Barr they did nothing to recover the 2002 Bonus from Maginn.

The third event that gave rise to this dispute occurred on March 31, 2009, when Jenzabar emailed MCG a "Notice to Repurchase" stating that it intended to repurchase all of the senior preferred stock MCG held on or before April 29, 2009. MCG objected to Jenzabar's effort to repurchase the senior preferred shares based on its belief that Jenzabar did not wish to repurchase the shares for any legitimate business purpose, but rather desired to force MCG to choose between putting its warrants at an unfavorable price and losing its consent rights. MCG asserts that defendants hoped this transaction would eliminate MCG's ability to object to the increased compensation Maginn planned to seek for himself and Chai. On April 29, 2009, Jenzabar transferred the entire liquidation value of the senior preferred stock—amounting to more than $6.2 million—to a paying agent for the benefit of MCG. MCG contends that it still owns Jenzabar's senior preferred stock, while Jenzabar contends the stock has been repurchased effective April 29, 2009.

In addition to the three events just described, there are additional alleged acts of defendants that play a less significant, albeit important, role in MCG's complaint. On December 28, 2008, Maginn purportedly sought approval of additional retroactive bonuses in the amount of $3.5 million for himself and $3.1 million for Chai. If awarded, these bonuses would have been retroactive compensation for the preceding five-years. As of today, these bonuses have not been approved. MCG also asserts that Maginn, Chai, and Barr conduct internal board processes in a manner designed to keep non-management board members "in the dark," permitting them to operate Jenzabar for their own advantage.[4] To that end, MCG alleges that board members are not provided timely information before meetings, that board minutes are not circulated until months after meetings occur, and that Malekian's suggested changes and additions to board minutes are never acted upon.

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[4] Compl. ¶ 60.

III. PROCEDURAL HISTORY

MCG's twelve-count complaint was filed April 21, 2009. Though the complaint contains derivative claims, MCG filed it without making a demand on the board. On May 18, 2009, defendants filed two separate motions to dismiss.[5] Defendants target eleven of the twelve counts in MCG's complaint, arguing that the counts alleging direct claims should be dismissed for failure to state a claim under Court of Chancery Rule 12(b)(6) and the counts alleging derivative claims should be dismissed under Court of Chancery Rule 23.1 for failure to make a demand or to plead facts demonstrating that demand would be futile.[6] Briefing and oral argument on defendants' motions was completed March 3, 2010. I turn now to my analysis of defendants' motions to dismiss.

IV. LEGAL STANDARDS

MCG's complaint contains direct and derivative claims. Defendants ask the Court to dismiss MCG's direct claims under Rule 12(b)(6) and MCG's derivative claims under Rule 23.1. I describe both standards of dismissal broadly here. More nuanced contours of each standard will be described, to the extent necessary, on a count-by-count basis in my analysis of MCG's complaint below.

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[5] Maginn and Chai jointly filed a motion to dismiss and Barr, San Miguel, Mills, and Jenzabar jointly filed a separate motion to dismiss.

[6] Defendants seek dismissal of Counts One through Ten and Count Twelve. Defendants do not seek dismissal of Count Eleven, but anticipate challenging it on the merits at a later date.

To survive a motion to dismiss under Rule 12(b)(6), "a complaint must plead enough facts to plausibly suggest that the plaintiff will ultimately be entitled to the relief [sought]."[7] All well-pleaded factual allegations are accepted as true and all reasonable inferences drawn from those allegations are viewed in the light most favorable to plaintiff.[8] The Court may consider "documents outside the pleadings … as long as [they] are integral to the plaintiff's claim."[9] If the Court determines, after assuming the truth of plaintiff's allegations, that the law affords no remedy, the claim must be dismissed.

Surviving a Rule 23.1 motion to dismiss is more difficult than surviving a Rule 12(b)(6) motion to dismiss. Rule 23.1 requires plaintiff's complaint to "allege *with particularity* the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[10] Thus, "to cause the corporation to pursue litigation, a shareholder must either (1) make a pre-suit demand by presenting the allegations to the corporation's directors, requesting that they bring suit, and showing that they wrongfully refused to do so, or (2) plead

[7] *Desimone v. Barrows*, 924 A.2d 908, 929 (Del. Ch. 2007).
[8] *Haber v. Bell*, 465 A.2d 353, 357 (Del. Ch. 1983).
[9] *Sanders v. Devine*, 1997 WL 599539, at *4 (Del. Ch. Sept. 24, 1997). In this case, for example, I consider the Charter, the PSWPA, the Employment Agreements, and the Stockholders' Agreement.
[10] CT. CH. R. 23.1 (emphasis added).

facts showing that demand upon the board would have been futile."[11] The pre-suit demand requirement is a corollary to the elementary principle that "directors, rather than shareholders, manage the business and affairs of the corporation."[12]

There is some debate between MCG and defendants over which counts state direct claims and which counts state derivative claims. MCG made no attempt in its complaint to identify which claims are direct, which are derivative, and which are simultaneously direct and derivative. I must, of course, make my own determination regarding the nature of the claims in MCG's complaint.[13] But my analysis would have been more efficient had MCG made some effort to characterize the claims it was bringing.[14] I have spent considerable time analyzing the complaint, the briefs, and the oral argument transcript in an effort to accurately characterize each of the eleven counts at issue. I confess that after undergoing this exercise I appreciate more fully MacDuff's sentiment: "Confusion now hath made his masterpiece."[15] But I believe I have confronted Confusion and come off conqueror. Hopefully this will be evident in my count-by-count analysis of

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[11] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

[12] *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

[13] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004); *Litman v. Prudential-Bache Prop., Inc.*, 611 A.2d 12, 15 (Del. Ch. 1992).

[14] I also confess that, from a judge's perspective, when a plaintiff does not make the effort to identify the derivative claims in its complaint a tinge of skepticism begins to color the demand futility analysis. A judge will naturally question how thoroughly the plaintiff evaluated demand futility before filing the complaint. As will be seen, this tinge of skepticism is just a tinge; it does not color the demand futility analysis in a cloud of darkness. Nevertheless, it adds a hue that the plaintiff would be better off without.

[15] WILLIAM SHAKESPEARE, THE TRAGEDY OF MACBETH act 2, sc. 3.

MCG's complaint below. The accurate characterization of a claim as direct or derivative is important because the heightened pleading standards of Rule 23.1 apply only to derivative claims. The relatively simpler notice pleading requirements of Rule 8(a) apply to direct claims.

V. ANALYSIS

A. Preliminary Matters

Before embarking on my count-by-count analysis I address a few matters of law that bear more generally on the complaint.

1. Maginn And Chai Will Not Be Treated As Controlling Shareholders

MCG's opposition brief to defendants' motions to dismiss alleges in various places that Maginn and Chai are controlling shareholders of Jenzabar. According to MCG, Maginn and Chai each individually own large blocks of Jenzabar common stock, which are not alone sufficient to place Maginn and Chai in control of Jenzabar, but are nevertheless substantial. MCG further alleges in its opposition brief that Maginn has obtained a proxy from a third-party shareholder for a substantial number of shares that effectively places Maginn and Chai in control of Jenzabar when they combine the proxy shares with their own shares. The problem for MCG is that it does not allege that Maginn and Chai are controlling shareholders anywhere in its complaint. Nor does it make reference anywhere in the complaint to the proxy. When defendants filed their motions to dismiss MCG had a choice to make under Court of Chancery Rule 15(aaa). It could either seek leave to amend its complaint or stand on its complaint and answer the motion to dismiss.[16] Having chosen the latter course of action, it is bound to the factual allegations contained in its complaint. It cannot supplement the complaint through its brief.[17] Accordingly, I will not treat Maginn and Chai as controlling shareholders in my analysis of MCG's claims.

2. Preferred Shareholder Standing to Bring Derivative Claims

An interesting question of law was raised during briefing: does a preferred shareholder have standing to bring a derivative suit and, if so, are there any limitations on the type of preferred shareholder who may bring a derivative suit? This question was raised because MCG did not own any Jenzabar common stock at the time of defendants' alleged malfeasance or at the time the complaint was filed.[18] Derivative suits are usually brought by common shareholders. MCG's interest in Jenzabar was comprised only of preferred stock and common stock warrants. Delaware law is clear that holders of common stock warrants do not

[16] *Braddock v. Zimmerman*, 906 A.2d 776, 783 (Del. 2006) ("Rule 15(aaa) was written to . . . requir[e] plaintiffs, when confronted with a motion to dismiss pursuant to any of Ch. Ct. R. 12(b)(6), (c) or 23.1, to elect to either: stand on the complaint and answer the motion; or, to amend or seek leave to amend the complaint before the response to the motion was due.").

[17] *Orman v. Cullman*, 794 A.2d 5, 28 ("any attempt contained within [briefs] to plead new facts or expand those contained in the complaint will not be considered").

[18] To bring a derivative suit on a corporation's behalf the shareholder plaintiff must (1) own stock at the time the alleged wrong occurs, (2) own stock at the time the complaint is filed, and (3) continue to own stock throughout the litigation. *Lewis v. Anderson*, 477 A.2d 1040, 1046 (Del. 1984).

have standing to bring a derivative suit.[19] Thus, any standing MCG has to bring a derivative suit must be based on its status as a preferred shareholder.

The parties cite no Delaware case that directly addresses the question of preferred shareholder standing to bring derivative claims. To be sure, this is not the first derivative suit filed by preferred shareholders. But cases in previous derivative suits appear not to have directly addressed the question of standing.[20]

MCG argues that, by default, preferred shareholders have the same standing as common shareholders to bring derivative actions. MCG premises its argument on the notion that preferred shareholders enjoy the same rights and remedies as common shareholders unless those rights and remedies are modified by contract.[21] MCG also notes that the standing requirements for derivative actions in 8 *Del. C.* § 327 and Rule 23.1 do not expressly proscribe preferred shareholders from bringing a derivative action. Further, MCG argues that while 8 *Del. C.* § 151 gives corporations the ability to adjust the preferences of and place limitations on different classes of stock, Section 151 also requires that any preferences or limitations be expressly written in the articles of incorporation or preferred stock designations.[22]

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[19] *In re New Valley Corp. Derivative Litig.*, 2004 WL 1700530, at *4-6 (Del. Ch. June 28, 2004).
[20] *See e.g.*, *Rosan v. Chicago Milwaukee Corp.*, 1990 WL 13482 (Del. Ch. Feb. 6, 1990); *Lewis v. Great W. United Corp.*, 1978 WL 2490 (Del. Ch. Mar. 28, 1978).
[21] *See Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 593 (Del. Ch. 1986) ("At common law and in the absence of an agreement to the contrary all shares of stock are equal.").
[22] *See e.g.*, 8 *Del. C.* § 151(f).

Defendants concede that in some instances preferred shareholders have standing to pursue derivative claims but argue that limits should be placed on the type of preferred shareholder that is given standing. Specifically, defendants assert that preferred shareholders should have standing to pursue derivative litigation only if (1) the preferred shares' terms are such that preferred shareholders enjoy a proportionate economic interest with common shareholders in the appreciation or depreciation in corporate value that could result from the derivative litigation *or* (2) the preferred shareholders have "taken the place" of the common shareholders as the "residual beneficiaries of any increase in value."[23] Based on this theory, defendants posit that there are two scenarios in which a preferred shareholder might have standing to bring a derivative suit. The first scenario is where the preferred shares' terms provide that preferred stock will participate proportionally with the common stock in dividends or upon liquidation once the preference amount has been paid. The second scenario is where the economic condition of the corporation is such that preferred shareholders, like creditors of an insolvent corporation, have taken the place of common shareholders as the residual beneficiaries of any increase in value.[24]

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[23] Defendants cite *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007), for this latter proposition. In *Gheewalla*, the Delaware Supreme Court held that creditors have standing to bring a derivative claim when a corporation is insolvent because at that point a corporation's creditors "take the place of the shareholders as the residual beneficiaries of any increase in value." *Id.* at 101.

[24] *See Gheewalla* at 101-02.

After thorough consideration of this issue, I believe MCG has correctly argued that preferred shareholders have standing to bring a derivative claim absent some express restriction or limitation in the articles of incorporation, the preferred share designations, or some other appropriate document. I begin with the proposition that all stock is created equal. By this I mean that all classes of stock enjoy the same rights and privileges unless an affirmative expression alters those rights.[25] Where there is an affirmative expression altering the rights of a class of stock, only those specific rights are altered, other default rights remain unaltered.[26] The ability to bring a derivative action has been a right enjoyed by common shareholders for some time. To exercise this right, common shareholders have been required to own stock at certain critical points in the dispute.[27] They have also been required to demonstrate that the board either wrongly refused to pursue the action or was disqualified from considering whether to pursue the action.[28] Independent of these requirements, the law does not appear to place a limit on the type or class of shareholder who may bring a derivative claim. Nothing in the statutes, rules of procedure, or case law of this state expressly prevents preferred

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[25] *Jedwab*, 509 A.2d at 593-94.
[26] *See id.* ("If a certificate designating rights, preferences, etc. of special stock contains *no* provision dealing with voting rights or *no* provision creating rights upon liquidation, it is not the fact that such stock has no voting rights or no rights upon liquidation. Rather, in such circumstances, the preferred stock has the same voting rights as common stock or the same rights to participate in the liquidation of the corporation as has such stock.")
[27] *Lewis v. Anderson*, 477 A.2d 1040, 1046 (Del. 1984).
[28] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

shareholders, as opposed to common shareholders, from pursuing a derivative action. For example, Section 327 simply states that "[i]n any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that plaintiff was a *stockholder* of the corporation at the time of the transaction of which such stockholder complains . . . ."[29] The statute does not bar certain classes of shareholders from bringing a derivative suit.[30]

Moreover, Section 151 suggests that any limitation on a preferred shareholder's ability to bring a derivative suit would have to be expressly stated in the articles or some other appropriate document.[31] And the Supreme Court has

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[29] 8 *Del. C.* § 327 (emphasis added).

[30] Similarly, Rule 23.1 simply states "[i]n a derivative action brought by one or more shareholders . . . to enforce a right of a corporation . . . the complaint shall allege that the plaintiff was a *shareholder* . . . at the time of the transaction of which the plaintiff complains . . . ." (emphasis added). This rule does not place limits on the type or class of shareholder that may bring a derivative claim.

[31] *See e.g.*, 8 *Del. C.* § 151(a):

> Every corporation may issue 1 or more classes of stock . . . [with] such preferences and relative, participating, optional or other special rights, and qualifications, *limitations or restrictions* thereof, as shall be *stated and expressed* in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it . . . . (emphasis added)

and 8 *Del. C.* § 151(f):

> If any corporation shall be authorized to issue more than 1 class of stock . . . the powers, designations, preferences and relative, participating, optional, or other special rights of each class of stock . . . and the qualifications, *limitations, or restrictions* of such preferences and/or rights shall be *set forth* in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class . . . . (emphasis added).

made clear that "[a]ny rights, preferences and limitations of preferred stock that distinguish that stock from common stock must be expressly and clearly stated, as provided by statute. Therefore, these rights, preferences and limitations will not be presumed or implied."[32] Accordingly, I conclude that preferred shareholders have standing to bring derivative claims unless the ability to bring a derivative claim has been expressly limited in the articles, preferred stock designations, or some other appropriate document. As a preferred shareholder, MCG has standing to bring its derivative claims, provided it complied with the ownership and demand requirements in Section 327 and Rule 23.1.

3. Demand Must Be Made Or Excused For Each Derivative Claim

Demand need only be made upon a board for derivative claims belonging to the corporation.[33] MCG was free to bring direct claims against defendants without giving the board the opportunity to consider those claims, as direct claims belong to MCG, not the Company.[34] Each derivative claim for which no demand was

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[32] *Matulich v. Aegis Comm. Group, Inc.*, 942 A.2d 596, 601 (Del. 2008) (citing 8 *Del. C.* § 51(a)).
[33] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004).
[34] *Id.* ("A stockholder who is directly injured, however, does retain the right to bring an individual action for injuries affecting his or her legal rights as a stockholder. Such a claim is distinct from an injury caused to the corporation alone.").

made on the board must be evaluated independently to determine whether demand was futile as to that claim.[35]

4. The Test For Determining Direct Versus Derivative Claims

In analyzing each count of MCG's complaint I must first determine whether the claims asserted therein are direct or derivative. The test under Delaware law for distinguishing between direct and derivative claims is articulated in *Tooley v. Donaldson*.[36] It can be stated simply. Whether a claim is direct or derivative turns *solely* on two questions: (1) who suffered the alleged harm, the corporation or the shareholders individually and (2) who would receive the benefit of any recovery or other remedy?[37] If the corporation was harmed and would be the recipient of the relief requested, the claim is derivative, at least to the extent of the harm the corporation suffered.[38] In contrast, if the shareholder can demonstrate that he or she has suffered an injury that is not dependent on an injury to the corporation, the claim is direct.[39] To make the direct versus derivative determination the Court must read the complaint as a whole to ascertain the exact nature of the wrong

[35] *See, e.g.*, *CalPERS v. Coulter*, 2002 WL 31888343 (Del. Ch. Dec. 18, 2002) (applying demand futility analysis on a claim-by-claim basis).
[36] 845 A.2d 1031 (Del. 2004).
[37] *Id.* at 1033.
[38] *Id.* at 1036.
[39] *Id.*

alleged and the relief that may be ordered if plaintiff is successful.[40] Though the test may be stated simply, in practice it is not always simple to apply.

Having covered these general points of law, I now turn to a count-by-count analysis of MCG's complaint.

B. Counts One, Two, Nine, And Ten – Claims For Breach Of Contract And Declaratory Relief

1. Counts One, Two, Nine, And Ten Plead Direct Claims Under *Tooley*

Counts One and Two allege that defendants breached the PSWPA and the Charter by approving "compensation increases" for Maginn and Chai without the consent of MCG.[41] Both Counts One and Two assert that, as a result of these alleged breaches, "*MCG* has suffered a violation of its special voting rights . . . ."[42] Counts Nine and Ten seek declaratory judgments that MCG's consent rights under the PSWPA and the Charter apply to "any compensation" paid to Maginn and Chai other than amounts initially set forth in the Employment Agreements.[43] The language in the complaint demonstrates that all four counts state direct claims.

[40] *Id.* at 1038.

[41] Though the complaint is not specific, the phrase "compensation increases" appears to encompass the Compensation Increases and the 2002 Bonus. This was clarified by MCG's counsel at oral argument. Tr. of Oral Argument at 56. Under notice pleading standards applicable to direct claims, I find that the phrase "compensation increases" was sufficient to place defendants on notice of MCG's argument that both the Compensation Increases and the 2002 Bonus were subject to its consent rights. CT. CH. R. 8(a).

[42] Compl. ¶¶ 90, 94 (emphasis added).

[43] Compl. ¶¶ 130, 135. The phrase "any compensation" is also broad enough to put defendants on notice that MCG contends the Compensation Increases and 2002 Bonus were subject to MCG's consent rights.

Counts One and Two allege that MCG was the party specifically harmed by the alleged breaches while Counts Nine and Ten seek a declaration that MCG was deprived of its consent rights. If MCG ultimately convinces the Court that the Compensation Increases and the 2002 Bonus were awarded in violation of MCG's consent rights, then MCG will prevail on all four counts regardless of whether Jenzabar was harmed. Accordingly, all four counts plead direct claims.

2. Counts One, Two, Nine, And Ten Survive Defendants' Rule 12(b)(6) Motion To Dismiss Because Defendants' Interpretation Of The PSWPA And The Charter Is Not The Only Reasonable Interpretation

Counts One, Two, Nine, and Ten plead a dispute about the proper interpretation of the PSWPA and the Charter. Under Delaware law, questions of contract interpretation can be pure questions of law that are appropriate to consider on a motion to dismiss.[44] When deciding such a motion, however, the Court may not choose between two opposing interpretations if both interpretations are reasonable.[45] The Court may only dismiss a breach of contract claim if defendants' interpretation is the *only* reasonable interpretation.[46] The proper application of ambiguous contract provisions is a question of fact that cannot be

[44] *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006). The PSWPA is a conventional contract between MCG and Jenzabar. The Charter is a contract between Jenzabar and its shareholders as well as a contract among the Jenzabar shareholders. *In re Explorer Pipeline Co.*, 781 A.2d 705, 713 (Del. Ch. 2001).
[45] *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 614-15 (Del. 2003).
[46] *Id.*

determined on a motion to dismiss.[47] To resolve the ambiguity, the Court must look to extrinsic evidence to ascertain the parties' intent.[48]

MCG contends that Section 5.12(h) of the PSWPA and Article V, Section A.1(b)(x) of the Charter gave it the right to consent to the Compensation Increases and 2002 Bonus. Section 5.12(h) of the PSWPA states:

> [T]he Company and its subsidiaries shall not, without the written consent or affirmative vote of the holders of at least a majority of the then outstanding Warrants or Warrant Shares, take any action or series of actions that would . . . :
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> . . .
>
> (h) *enter into* any transaction, contract, agreement or arrangement with an Affiliate, including, without limitation, any transaction, contract, agreement or arrangement with a shareholder, officer, or director of the Company or any Subsidiary thereof; *provided that this Section 5.12(h) shall not apply to the Company's business arrangements with New Media Japan or Bain & Co. existing as of March 31, 2004 and the MCG Loan Agreement.*[49]
>
> Similarly, Article V, Section A.1(b)(x) of the Charter provides that:
>
> So long as any shares of Senior Preferred Stock remain outstanding, the [Company] and its Subsidiaries shall not, without the written consent or affirmative vote of at least a majority of the then outstanding shares of Senior Preferred Stock, take any action or series of actions that would . . . :
>
> . . .

[47] *See Vanderbilt Income and Growth Assocs. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996).
[48] *Appriva S'holder Litig. Co., LLC v. EV3, Inc.*, 937 A.2d 1275, 1292 (Del. 2007).
[49] PSWPA §5.12(h) (emphasis added).

> (x) *enter into* any transaction, contract, agreement or arrangement with an Affiliate, including, without limitation, any transaction, contract, agreement or arrangement with a shareholder, officer or director of the Corporation or any subsidiary thereof; *provided that this Section A.1(b)(x) shall not apply to the Corporation's business arrangements with New Media Japan or Bain & Co. existing as of March 31, 2004 and the Credit Facility Agreement, dated as of June 30, 2004 . . . .*[50]

At the time the Compensation Increases and 2002 Bonus were approved, MCG held a majority of Jenzabar's outstanding common stock warrants and was the sole holder of Jenzabar senior preferred shares. Accordingly, MCG enjoyed consent rights under the PSWPA and the Charter whenever those rights were triggered. The question is whether the Compensation Increases and the 2002 Bonus triggered those rights.

MCG contends that the words "transaction, contract, agreement, or arrangement" in the PSWPA and the Charter indicate that MCG's consent rights are to be construed broadly when it comes to transactions with Affiliates such as Maginn and Chai.[51] Specifically, MCG contends that its consent rights apply to any transactions or arrangements between Jenzabar, on the one hand, and Maginn and Chai, on the other, including new agreements and material changes to existing agreements. Thus, MCG believes its consent rights applied to the Compensation Increases and the 2002 Bonus.

[50] Charter Article V, §A.1(b)(x) (emphasis added).

[51] The parties do not dispute that Maginn and Chai are "Affiliates" as that term is defined in the PSWPA and the Charter.

Defendants concede that MCG's consent rights are to be construed broadly, but counter that the consent rights are only triggered when Jenzabar *enters into* a transaction, contract, agreement, or arrangement with Maginn and Chai. Defendants contend that by awarding the Compensation Increases, Jenzabar was simply performing the terms of the Employment Agreements, which MCG approved when it invested in Jenzabar.[52] Thus, according to defendants, by approving the Compensation Increases, Jenzabar was not "entering into" a transaction, contract, agreement, or arrangement that would trigger MCG's consent rights, it was simply performing an agreement MCG had already consented to.

In support of this argument, defendants point to sections 5(a) and (b) of the Employment Agreements. Section 5(a) addresses salary compensation and specifies that Maginn and Chai's base salaries are to be $400,000 and $340,000 per year respectively and further provides that:

> The Board <u>shall</u> periodically review [Maginn and Chai's] Base Salar[ies] consistent with the compensation practices and guidelines of [Jenzabar], <u>but</u> shall have no obligation or requirement to increase such Base Salar[ies] at any time . . . . If [Maginn and Chai's] Base Salar[ies] [are] increased by the Board during the Term, <u>then</u> such increased Base Salar[ies] shall then constitute the Base Salar[ies] for all purposes of this Agreement.

Section 5(b) addresses bonus compensation, specifies an initial formula for calculating Maginn and Chai's bonuses, and further provides that "[t]he Board

[52] I will address defendants' argument regarding the 2002 Bonus separately.

shall periodically review [Maginn and Chai's] Quarterly Bonus[es] for increase (but not decrease . . .), consistent with the compensation practices and guidelines of the Company." Defendants contend that these provisions require the board to periodically review Maginn and Chai's salaries and bonuses and give the board authority to increase the same after a review. Defendants contend that MCG already approved the Employment Agreements when it invested in Jenzabar and should not be permitted to use its consent rights to undermine the performance of those agreements.[53]

MCG counters that the phrase "enters into" in the PSWPA and the Charter does not simply apply to brand new transactions or arrangements with Maginn and Chai, but also to circumstances in which Jenzabar participates in or becomes a party to material changes to existing agreements with Maginn and Chai. According to MCG, the Compensation Increases materially changed the compensation due under the Employment Agreements and therefore triggered MCG's consent rights. In support of this position, MCG points to the provisions in Section 5.12(h) and Article V.A.1(b)(x) that exclude certain agreements from MCG's consent rights that either existed at the time of MCG's investment or that were executed when MCG made its investment. These agreements include

[53] That MCG approved the Employment Agreements is evidenced by two facts. First, Section 2.3(a)(ii)(J) of the PSWPA contains a closing condition that specifically required Jenzabar to execute the Employment Agreements before MCG was obligated to complete its investment in Jenzabar. Second, the Employment Agreements were attached as an exhibit to the PSWPA when it was executed by MCG.

existing arrangements with New Media Japan and Bain & Co. and the $30 million in loans MCG made to Jenzabar when it invested. MCG argues that it approved the loan agreements when it approved the Employment Agreements, yet the parties still felt it necessary to specify that the loan agreements were not subject to MCG's consent rights. The parties also felt it was necessary to clarify that existing arrangements were exempt from MCG's consent rights. MCG's view is that the parties could have included the Employment Agreements in the list of arrangements exempt from MCG's consent rights but chose not to; thus, the Employment Agreements are subject to MCG's consent rights under the doctrine of *inclusio unius est exclusio alterius* (*i.e.*, specifying that certain agreements are not subject to MCG's consent rights logically implies that unspecified agreements are subject to MCG's consent rights).[54]

MCG and defendants both posit reasonable interpretations of the PSWPA and the Charter as it applies to the Compensation Increases. I cannot determine whether the Compensation Increases were subject to MCG's consent rights without exploring evidence extrinsic to the PSWPA, the Charter, and the Employment Agreements.[55]

[54] *Kansas City S. v. Grupo TMM, S.A.*, 2003 WL 22659332, at *3 (Del. Ch. Nov. 4, 2003) (applying the doctrine of *inclusio unius est exclusio alterius).*

[55] It is also possible that the $3.5 million and $3.1 million retroactive bonuses that Maginn has allegedly sought for himself and Chai respectively would be subject to MCG's consent rights. I cannot make this determination for certain without exploring extrinsic evidence.

The 2002 Bonus was not covered by the Employment Agreements because it related to compensation awarded before June 30, 2004, the date the Employment Agreements were signed. Defendants argue that MCG's consent rights were not triggered when the board approved the 2002 Bonus a second time in December 2008 because it had first been approved before MCG ever obtained consent rights. Defendants basically posit that the December 2008 approval of the 2002 Bonus was redundant and unnecessary. But MCG alleges in the complaint that the reason the 2002 Bonus had not been paid was because it was only conditionally approved in 2002. According to MCG, before Maginn was entitled to receive the 2002 Bonus the consent of a third-party investor in Jenzabar had to be obtained. MCG avers that this consent was never obtained and thus Maginn was never paid the 2002 Bonus. Accordingly, Maginn sought a second approval of the 2002 Bonus from the board in December 2008 free of the condition that approval of the third-party investor be obtained. According to MCG, the second approval of the 2002 Bonus either caused Jenzabar to "enter into" a new arrangement with Maginn involving his compensation for the year 2002 or materially altered an existing arrangement between Jenzabar and Maginn. Either way, MCG pleads sufficient facts to survive a Rule 12(b)(6) motion to dismiss. If the December 2008 approval was an "entering into" transaction then MCG's consent rights were clearly violated. If the December 2008 approval was a material alteration to an existing arrangement then it is not clear, at this stage of the proceedings, whether that triggers MCG's consent rights because, as described above, the PSWPA and the Charter are susceptible of two opposing yet reasonable interpretations regarding material alterations to existing contracts with "affiliates."[56]

For all of the above reasons, defendants' motions to dismiss Counts One, Two, Nine, and Ten are denied.

3. Counts One, Two, Nine, And Ten Are Dismissed As To San Miguel, Mills, And Barr

Defendants contend that Counts One, Two, Nine, and Ten cannot be pursued against the individual defendants because only Jenzabar was a party to the PSWPA and the Charter vis-à-vis MCG. The argument is that the individual defendants were not party to these agreements, and so could not have breached them.[57] Moreover, defendants point out that neither Maginn, nor Chai, nor Barr voted to approve the salary increases and bonuses at issue. MCG concedes that the individual defendants are not parties to the PSWPA or the Charter but contends

[56] Unlike the Employment Agreements, MCG never approved the 2002 Bonus. There may be a legally significant distinction between changes to affiliate agreements MCG initially approved and changes to affiliate agreements MCG never approved. For now, I simply note the difference between the Compensation Increases (which were based on an agreement MCG approved) and the 2002 Bonus (which was not based on an agreement MCG approved). I need not decide whether this difference carries any legal import at this stage of the proceedings, but it may be important when the procedural posture of the case has matured.

[57] In support of this argument defendants cite *Wallace v. Wood*, 752 A.2d 1175, 1180 (Del. Ch. 1999) ("It is a general principal of contract law that only a party to a contract may be sued for breach of that contract.").

that they should still be named as defendants because they are "indispensable parties" under Court of Chancery Rule 19(a)(1).[58]

It is true that under Delaware law corporate officers and directors are not parties to a contract simply because the corporation they serve is a party to the contract.[59] Accordingly, the individual defendants cannot be joined as defendants on Counts One, Two, Nine, and Ten on the theory that they are personally responsible for breaching the PSWPA or the Charter. If there was a breaching party, it was Jenzabar, acting through its directors.

But that does not end the inquiry as to whether an individual is an indispensible party. Under Rule 19(a) a person is indispensible and must be joined as a defendant if that person has an interest in the controversy that will be affected by a final decree on the matter.[60] If the plaintiff's claims involve an agreement or transfer between the corporation and some other person, it is necessary to join that other person as a defendant on the claims because that person has a substantial interest in the determination of whether or not the agreement or transfer was legitimate.[61] In this case, Jenzabar transferred funds to Maginn and Chai as a result of actions taken by the compensation committee and the board. Moreover,

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[58] CT. CH. R. 19(a)(1) reads in relevant part: "A person . . . whose joinder will not deprive the Court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties . . . ."

[59] *Ruggiero v. FuturaGene, plc.*, 948 A.2d 1124, 1132 (Del. Ch. 2008).

[60] *Elster v. American Airlines, Inc.*, 106 A.2d 202, 204 (Del. Ch. 1954).

[61] *Id*.

Maginn and Chai are parties to the Employment Agreements with Jenzabar and the Compensation Increases made pursuant to these agreements are being challenged. I cannot issue a final decree on MCG's claims in Counts One, Two, Nine, and Ten without affecting Maginn and Chai's interests in the funds they have already received or in their respective Employment Agreements.[62] Accordingly, they are indispensable parties on these claims.

In contrast, neither San Miguel, nor Mills, nor Barr have received challenged compensation from Jenzabar. Nor are these individuals party to an agreement that has been challenged by MCG. Even though San Miguel and Mills approved the Compensation Increases and the 2002 Bonus, they cannot be held personally liable to MCG if Jenzabar is found to have breached its agreements through these acts because voting on compensation increases was within their role as compensation committee members.[63] These individuals are not indispensable parties because a final decree could be made without affecting their personal interests. Accordingly, Counts One, Two, Nine, and Ten are dismissed as against defendants San Miguel, Mills, and Barr.

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[62] For example, if I were to conclude that the Compensation Increases and the 2002 Bonus were awarded in violation of MCG's consent rights and that rescission was the appropriate remedy Maginn and Chai would need to be joined parties so that disgorgement could be ordered.

[63] *Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 590 (Del. Ch. 1994) ("[D]irectors of a contracting corporation cannot be held personally liable for inducing a breach of contract by their corporations when they act within their role.") Whether approval of the Compensation Increases and the 2002 Bonus was a breach of fiduciary duty for which San Miguel and Mills could be held liable to Jenzabar is another matter. I will discuss San Miguel and Mills' fiduciary duties in my analysis of Count Five.

B. *Counts Three And Four – Claims For Intentional Interference With Contract*

1. Counts Three And Four Plead Direct Claims Under *Tooley*

Counts Three and Four are stylized as claims for aiding and abetting breach of the PSWPA and the Charter respectively. These counts are only lodged against Maginn, Chai, and Barr. In its opposition brief to defendants' motions to dismiss MCG clarifies that these counts plead claims for intentional interference with contract rather than for aiding and abetting a breach of contract. I will analyze whether MCG has sufficiently plead a claim for intentional interference with contract momentarily. For now, I note that Counts Three and Four both allege that "[a]s a result of the misconduct of Defendants Maginn, Chai, and Barr, *MCG has suffered damages*, including a violation of its special voting rights . . . ."[64] Thus, Counts Three and Four allege that MCG was the party specifically harmed by Maginn, Chai, and Barr's purported interference with the PSWPA and the Charter. I find these are direct claims under *Tooley*.

2. Counts Three And Four Are Dismissed For Failure To State A Claim

Counts Three and Four allege that Maginn, Chai, and Barr intentionally encouraged San Miguel and Mills to approve the Compensation Increases and 2002 Bonus in violation of MCG's consent rights. To state a claim for intentional

[64] Compl. ¶¶ 100, 105.

interference with contract plaintiff must allege (1) the existence of a contract (2) about which defendants knew and (3) an intentional act by defendants that is a significant factor in causing the contract to be breached (4) without justification (5) injuring plaintiff.[65] For an officer or director to be held personally liable for intentional interference with contract, plaintiff must also show that the intentional acts of that officer or director exceeded the scope of their authority.[66]

The facts alleged in MCG's complaint do not support the conclusion that Maginn, Chai, or Barr acted without justification. If Maginn, Chai, or Barr plainly believed MCG had a right to consent to the Compensation Increases and the 2002 Bonus but nevertheless encouraged San Miguel and Mills to intentionally ignore those rights, this would be unjustified behavior. But MCG's complaint does not allege facts sufficient to conclude that these individuals knowingly ran roughshod over MCG's consent rights. At best, the factual allegations in the complaint show there was a dispute about whether MCG's consent rights applied to the Compensation Increases and the 2002 Bonus and all three defendants concluded they did not.

MCG's complaint also does not allege facts that demonstrate Maginn or Chai acted outside their corporate role in asking the compensation committee for the Compensation Increases and the 2002 Bonus. Nor does the complaint allege

[65] *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 992 (Del. Ch. 1987).
[66] *Goldman v. Pogo.com Inc.*, 2002 WL 1358760, at *8 (Del. Ch. June 14, 2002).

facts that demonstrate Barr acted outside his corporate role in advising the compensation committee on these matters.

As to Barr, he simply advised the compensation committee about Jenzabar's obligations under the PSWPA and the Charter. He also suggested that the compensation committee receive the advice of Austin, Jenzabar's outside counsel. A company's general counsel is frequently tasked with advising committees on difficult questions of contract interpretation. General counsel frequently consult outside counsel on such matters. Even if the advice of Barr and Austin was incorrect, Barr was not acting outside his corporate role.

As to Maginn and Chai, they did not act outside their corporate role by encouraging or accepting the Compensation Increases and the 2002 Bonus without first obtaining MCG's consent. Maginn and Chai believed decisions about their compensation were not subject to MCG's consent rights. As Jenzabar officers and directors, they were not required to concede MCG's position that it was entitled to a vote on these matters. They may have been wrong about MCG's consent rights, but being wrong on a question of contract interpretation does not mean they exceeded the scope of their corporate authority.[67] We cannot hold officers and

[67] Even if Maginn and Chai's conclusion that MCG's consent rights did not apply was influenced by the specter of personal benefit this would not lead me to conclude they had acted outside their corporate role. As this Court has held, "[m]erely because directors are alleged to have acted in part with adverse motives does not necessarily lead to the conclusion that they acted outside the scope of their authority for purposes of holding directors personally liable *in tort* for interfering with the contractual rights of a shareholder." *Goldman,* 2002 WL 1358760, at *9.

directors liable for intentional interference with contractual relations if their misinterpretation of a contract causes the company they serve to breach that contract.[68]

Based on all of the foregoing, Counts Three and Four are dismissed in their entirety.

C. Count Five – Claims For Breach Of Fiduciary Duty

1. A Preliminary Note On Count Five

Count Five alleges that all individual defendants, as Jenzabar officers and directors, breached the fiduciary duties of care, loyalty, and good faith they owed to MCG, as a preferred shareholder, and to Jenzabar, the company they served. Count Five is a jumble of claims. In their briefs, the parties battle over the exact nature of these claims, arguing over whether they are direct or derivative, whether they implicate the duty of care or the duty of loyalty, and so forth. To cobble these arguments together and line them up so as to describe them in the cogent fashion appropriate for judicial opinions would be a painful task. It has been said that "[t]he art of life is the art of avoiding pain; and he is the best pilot, who steers

[68] None of the foregoing should be interpreted to mean that it was permissible for either Maginn or Barr to mislead the compensation committee regarding the 2002 Bonus or any other matter. Such behavior would constitute bad faith, and would be a breach of the fiduciary duty of loyalty both individuals owe to Jenzabar. Accordingly, the above analysis of Counts Three and Four is limited purely to questions of tort liability. Fiduciary duties exist independent of tort obligations. *But cf.* J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, DEL. L. REV. (forthcoming 2010) (characterizing a breach of fiduciary duty as "a unique [tort] species historically called an 'equitable tort'").

clearest of the rocks and shoals with which it is beset."[69] Accordingly, I steer a course that will be more comfortable for all involved. I will simply describe, in summary fashion, what I understand the claims in Count Five to be. I will then analyze whether those claims survive defendants' motions to dismiss.

2. Count Five Pleads Direct And Derivative Claims Under *Tooley*

MCG's complaint alleges that, as a result of the conduct described in Count Five, "*MCG and Jenzabar* have suffered and continue to suffer substantial damages . . . ."[70] In Count Five, MCG describes conduct that it believes gives rise to both direct and derivative claims. Under Delaware law, it is possible for the same set of facts to generate both a direct claim and a derivative claim.[71]

I begin with the direct claims that I believe are plead in Count Five; there are three of them. The first is that defendants breached their fiduciary duties "to MCG by . . . approving [the Compensation Increases] and [2002 Bonus] . . . in violation of MCG's known special voting rights as provided by the PSWPA . . . [and] by [the] Charter."[72] Clearly this pleads a direct claim for breach of fiduciary duty

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[69] THOMAS JEFFERSON, THE JEFFERSONIAN CYCLOPEDIA: A COMPREHENSIVE COLLECTION OF THE VIEWS OF THOMAS JEFFERSON 503 (John P. Foley ed., Funk & Wagnalls Co. 1900).
[70] Compl. ¶ 109 (emphasis added).
[71] *Gentile v. Rossette*, 906 A.2d 91, 100 n.19 (Del. 2006) (citing *Grimes v. Donald*, 673 A.2d 1207, 1212 (Del. 1996), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000)).
[72] Compl. ¶ 108.

under *Tooley*.[73] MCG alleges that its unique consent rights were ignored and asks the Court to undo approval of the Compensation Increases and the 2002 Bonus on that basis. This states a direct claim because MCG's success on this claim does not require that it show any harm to Jenzabar. If MCG's consent rights were improperly ignored, MCG was directly harmed, regardless of any impact on Jenzabar.

The second direct claim Count Five pleads is that defendants breached their fiduciary duties to MCG by "asserting to MCG that it must give its Warrant Put Notice by April 29, 2009 or lose its special voting rights, notwithstanding the fact that Jenzabar's Repurchase Notice did not provide 30 days prior notice . . . and did not provide information required" by the Charter.[74] In this claim, MCG alleges that its unique notice rights were not complied with and, on that basis, asks the Court to declare that Jenzabar's attempt to repurchase the senior preferred shares was void. This states a direct claim for breach of fiduciary duty under *Tooley* because MCG's success on this claim does not require that it show any harm to Jenzabar.[75] If MCG's notice rights were not complied with, MCG was directly harmed.

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[73] I will analyze whether the individual defendants actually owed MCG any direct fiduciary duties related to this claim below.
[74] Compl. ¶ 108.
[75] I will also analyze whether the individual defendants actually owed MCG any direct fiduciary duties related to this claim below.

The third direct claim Count Five pleads is that defendants breached their fiduciary duty to MCG by "improperly attempt[ing] to exclude Malekian from [board] deliberations . . . ."[76] As an example, the complaint alleges that after Malekian told the compensation committee that he believed MCG's consent rights applied to the Compensation Increases, "Barr, San Miguel, and Mills and Austin then conferred amongst themselves about MCG's consent right before voting to purportedly authorize the [Compensation Increases] . . . ."[77] The complaint also alleges that defendants "fail[] to incorporate Malekian's comments, changes, and additions to the Board minutes . . . ."[78] Under the *Tooley* analysis this pleads a direct claim for breach of fiduciary duty.[79] The PSWPA and the Stockholders' Agreement gave MCG a right to unilaterally place Malekian on the board. If defendants neutralized Malekian's ability to represent MCG in the boardroom, MCG was directly harmed. No injury to Jenzabar need be shown to prevail on such a claim.

I now move to the derivative claims that I believe Count Five pleads; there are also three. The first is that that Maginn and Barr breached their duty of loyalty

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[76] Compl. ¶ 68. This paragraph of the complaint is incorporated into Count Five by paragraph 106 of the complaint.
[77] Compl. ¶ 46. This paragraph of the complaint is incorporated into Count Five by paragraph 106 of the complaint.
[78] Compl. ¶ 108.
[79] Again, I will analyze below whether defendants actually owed MCG a direct fiduciary duty related to this claim.

to Jenzabar because they "knew at the time that they represented to the Board that the [2002 Bonus] had been previously 'approved,' that, in fact, it had been only conditionally approved and that the necessary precondition (the consent of a third-party investor in Jenzabar) had never occurred . . . ."[80] The complaint further alleges that San Miguel and Mills breached either their duty of care or loyalty by approving the 2002 Bonus without investigating or informing themselves as to why it had never been paid and by doing nothing to rescind the 2002 Bonus after learning that Maginn and Barr had misled them.[81] These allegations plead a derivative claim under *Tooley*. They allege deliberate misrepresentations by Maginn and Barr to the Jenzabar board. They also allege intentional or grossly negligent failure by San Miguel and Mills to carry out the duties they owed Jenzabar.

[80] Compl. ¶ 52. This paragraph of the complaint is incorporated into Count Five by paragraph 106 of the complaint.

[81] Compl. ¶ 53, 55. It is unclear from the complaint whether San Miguel and Mills' alleged lack of effort to recover the 2002 Bonus pleads a duty of care or a duty of loyalty claim. It would plead a duty of loyalty claim if San Miguel and Mills' failure to research the 2002 Bonus before approving it or to do anything to recover the 2002 Bonus was a "conscious disregard" of a known duty. *See Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). That is, it would be a breach of the duty of loyalty if San Miguel and Mills knew they had a duty to research the 2002 Bonus and deliberately declined to do so or clearly understood that Maginn was not entitled to the 2002 Bonus, because he had fraudulently secured its approval, but deliberately refused to do anything about it. In contrast, these allegations may plead a duty of care claim if San Miguel and Mills were grossly negligent in failing to research the 2002 Bonus or were unsure what legal significance to attach to Maginn and Barr's misrepresentation once they learned of it and then carelessly failed to make an effort to inform themselves.

The second derivative claim Count Five pleads is that San Miguel and Mills breached their fiduciary duty of care to Jenzabar by approving the Compensation Increases and the 2002 Bonus without hiring independent counsel to advise the compensation committee regarding MCG's consent rights or a financial consultant to advise the compensation committee on compensation levels and structures for executives. These allegations plead a derivative claim under *Tooley*; they paint a picture of defendants carelessly causing Jenzabar to raise executive compensation when it was not appropriate, allegedly because it was a breach of Jenzabar's contractual obligations to do so without MCG's consent or because Maginn and Chai's performance did not merit the increases. The harm alleged is to Jenzabar, because it was purportedly subjected to liability for breach of contract and because it purportedly paid compensation to Maginn and Chai that it otherwise would not have had to pay.

The third derivative claim Count Five pleads is that defendants breached their duty of care to Jenzabar by tolerating poor board management practices. MCG's complaint alleges that Barr, as board secretary, failed to provide agendas in advance of board meetings and failed to distribute board minutes until months after meetings were held. According to MCG's complaint, with the exception of Malekian, the other Jenzabar directors tolerated these practices. MCG alleges that this lackadaisical behavior makes it impossible for defendants to be effective and informed directors. I find these allegations plead a derivative claim under *Tooley* because, if anyone or anything is harmed by general inattentiveness of board members, it is the corporation. Any harm suffered by a shareholder by virtue of such behavior would be indirect, flowing from the harm incurred by the corporation.

Having determined that Count Five pleads direct and derivative claims I must now analyze whether the direct claims survive a motion to dismiss under Rule 12(b)(6) and whether the derivative claims survive a motion to dismiss under Rule 23.1. I begin with the direct claims.

3. <u>The Direct Breach Of Fiduciary Duty Claims Are Dismissed Because They Are Duplicative Of The Contract Claims Asserted In Counts One, Two, Nine, Ten, And Eleven</u>

Under Delaware law, directors do not owe fiduciary duties to warrant holders under any circumstances.[82] The rights of warrant holders are governed exclusively by the terms of their warrants.[83] Accordingly, MCG cannot bring direct claims for breach of fiduciary duty based on its status as a warrant holder. Any direct fiduciary duties owed to MCG must arise by virtue of its position as a preferred shareholder.

In contrast to warrant holders, preferred shareholders are owed fiduciary duties in some circumstances. Specifically, when the preferred shareholders share

[82] *Feldman v. Cutaia*, 2006 WL 920420, at *6 n.37 (Del. Ch. Apr. 5, 2006) ("[D]irectors do not owe fiduciary duties to future stockholders.").
[83] *See Cont'l Airlines Corp. v. Am. Gen. Corp.*, 575 A.2d 1160, 1168 (Del. 1990).

a right equally with the common shareholders the directors owe the preferred shareholders the same fiduciary duties they owe the common shareholders *with respect to those rights*.[84] When the articles of incorporation, the preferred share designations, or some other appropriate document articulate rights that are *uniquely* enjoyed by the preferred class of stock, however, those rights are purely contractual in nature; directors do not owe preferred shareholders any fiduciary duties with respect to those rights.[85] The import of this is that when preferred shareholders assert fiduciary claims that relate to obligations expressly treated by their unique contractual rights with the corporation, the Court will review those claims as breach of contract claims and the claims for breach of fiduciary duty will be dismissed as superfluous.[86]

All three of MCG's direct claims for breach of fiduciary duty are based on alleged violations of the protective rights granted MCG in the Charter, the PSWPA, and the Stockholders' Agreement. These rights are unique protections afforded to MCG in its capacity as a preferred shareholder and warrant holder.

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[84] *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 594 (Del. Ch. 1986) ("where . . . the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards.").

[85] *Id.*

[86] *Nemec v. Shrader*, 2009 WL 1204346, at *4 (Del. Ch. Apr. 30, 2009), *aff'd*, 2010 WL 1320918 (Del. 2010); *Blue Chip Capital Fund II Ltd. P'ship v. Tubergen*, 906 A.2d 827, 833-34 (Del. Ch. 2006); *Madison Realty Co. v. AG ISA, LLC*, 2001 WL 406268, at *6 (Del. Ch. Apr. 17, 2001); *HB Korenvaes Inv., L.P. v. Marriott Corp.*, 1993 WL 205040, at *6 (Del. Ch. June 9, 1993).

MCG negotiated for these rights and required that they be memorialized in the Charter, the PSWPA, and the Stockholders' Agreement before making its investment in Jenzabar. The common shareholders do not enjoy these same protections. Accordingly, I find that the direct claims MCG alleges in Count Five are based solely on its contractual rights and defendants do not owe a separate fiduciary duty to MCG related to these claims. Jenzabar is contractually bound to honor MCG's protective rights, but the directors do not owe an independent fiduciary duty to MCG to honor them. Thus, MCG does not have any direct claims for breach of fiduciary duty and all direct claims in Count Five are dismissed. MCG's recourse for the direct claims it asserts in Count Five will be tried on the merits in Counts One, Two, Nine, Ten, and Eleven, which appropriately plead claims for breach of contract.

Before moving on I discuss MCG's claim that defendants have made attempts to neutralize Malekian's board participation. MCG has the unilateral right to elect one member to the five-member Jenzabar board. This right is derived from the Stockholders' Agreement (a contract between MCG, Maginn, and Chai) and the PSWPA (a contract between MCG and Jenzabar). Exercising this right, MCG placed Malekian, one of its employees, on the board. Consequently, defendants' alleged efforts to neutralize Malekian's ability to perform his duties would, at heart, be an effort to undermine MCG's contractual right to board representation.[87] Thus, any claim MCG has against defendants for their treatment of Malekian must sound in contract.

MCG did not plead a breach of contract claim in its complaint for the alleged mistreatment of Malekian. Normally, Rule 15(aaa) would bar MCG from amending its complaint at this stage of the proceedings. In the discretion given me under Rule 15(aaa), however, I will permit MCG to amend its complaint to plead a breach of contract claim if it truly believes it has sufficient evidence to support such a claim.[88] In bringing such a claim, MCG should be specific as to which defendants have made efforts to neutralize Malekian's participation on the board and how they went about doing so.

4. The Derivative Claim Related To The 2002 Bonus Will Not Be Dismissed Because Demand Was Excused As To This Claim

MCG did not make a demand on the Jenzabar board before filing its complaint. Accordingly, to avoid dismissal under Rule 23.1, MCG's "complaint must plead with particularity facts showing that demand on the board would have been futile."[89] Under the well known *Aronson* test, to establish that a pre-suit demand would have been futile, MCG must plead particularized facts that create a reasonable doubt as to: (1) the disinterestedness or independence of the directors,

[87] *Acker v. Transurgical, Inc.*, 2004 WL 1230945, at *2 (Del. Ch. Apr. 22, 2004).
[88] *See* CT. CH. R. 15(aaa) ("[If] the Court thereafter concludes that the complaint should be dismissed under Rule 12(b)(6) . . ., such dismissal shall be with prejudice . . . unless the Court, for good cause shown, shall find that dismissal with prejudice would not be just under all the circumstances.").
[89] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

or (2) whether the challenged actions constituted a valid exercise of business judgment by the board.[90] Generally speaking, demand may be excused where the particularized facts alleged in the complaint indicate that at least one of the following is present: "(1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment."[91]

The *Aronson* test is a disjunctive one. If the plaintiff satisfies either prong demand is excused.[92] To survive a motion to dismiss for failure to make a demand, the complaint need only recite, albeit with particularity, facts sufficient to create a reasonable doubt that the board is capable of making an independent decision regarding the challenged transaction.[93]

When applying the second prong of *Aronson*, the Court does not assume the challenged transactions constitute a wrong to the corporation.[94] Instead, the Court substantively reviews the challenged transactions in light of the facts alleged in the complaint to discern whether there is a reasonable doubt under the circumstances

[90] *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).
[91] *In re Affiliated Computer Serv., Inc. S'holders Litig.*, 2009 WL 296078, at *8 (Del. Ch. Feb. 6, 2009) (quoting *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996)).
[92] *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000).
[93] *Grimes*, 673 A.2d at 1217.
[94] *Aronson,* 473 A.2d at 814.

that the board's decision was a valid exercise of business judgment.[95] Demand futility will be established under *Aronson's* second prong if the plaintiff pleads particularized facts that create a reasonable doubt (1) the action was taken honestly and in good faith or (2) the board was adequately informed in making the decision.[96] The Court will consider whether the directors took steps to inform themselves of material information and whether they adequately inquired into the reasons for or terms of the transaction.[97]

As to the derivative claim related to the 2002 Bonus I find that demand was excused under the second prong of *Aronson*. Accepting the facts in MCG's complaint as true for purposes of defendants' motions to dismiss, I find there is a reason to doubt that approval of the 2002 Bonus was a valid exercise of business judgment. MCG alleges that Maginn and Barr explained to the board at the December 23, 2008 meeting that "an extensive search of historic documents" had revealed the 2002 Bonus had never been paid.[98] Maginn and Barr purportedly represented to the board that they were unable "to provide any explanation for why the [2002] [B]onus had not been paid;"[99] that it was simply "the result of an oversight."[100] MCG alleges that San Miguel and Mills were content with this

[95] *Id.*
[96] *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003).
[97] *Bakerman v. Sidney Frank Importing Co.*, 2006 WL 3927242, at *9 (Del. Ch. Oct. 10, 2006).
[98] Compl. ¶ 49.
[99] Compl. ¶ 51.
[100] Compl. ¶ 50.

explanation and did not “undertak[e] any independent investigation of the facts” surrounding the 2002 Bonus.[101] Rather, they “hastily ‘approved’ the [2002 Bonus] over the objection of MCG’s Direct Designee Malekian.”[102]

Assuming the truth of these facts, I find that this behavior would not be a valid exercise of business judgment. The 2002 Bonus was for $750,000; significantly more than Maginn’s annual salary. It is difficult for me to believe that Maginn simply forgot about this money, only to be reminded by an extensive search of company documents. Admittedly, I have not been apprised of Maginn’s net worth so I cannot make an exact determination as to the materiality of $750,000 to him. But I cannot conceive that it was so insignificant that he would simply overlook it for six years. There is nothing to suggest that he sits in the same economic strata as Warren Buffett or Bill Gates. Accordingly, a conscientious board member would have had reason to question whether a simple oversight was a plausible explanation for the 2002 Bonus having not been paid; this would have been important information the board needed to consider. The alleged representation by Maginn and Barr to the board was that Maginn was entitled to the 2002 Bonus for work he had already performed and that there were no preconditions to payment. If this was so, why was it necessary to obtain board

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[101] Compl. ¶ 51.

[102] Compl. ¶ 51. Only three of the five Jenzabar board members voted on the 2002 Bonus: Malekian, San Miguel, and Mills. Maginn and Chai abstained, presumably because Maginn was interested in the transaction, and because Chai is married to Maginn.

approval a second time? The board was duty bound to take steps to inform itself as to the terms of this transaction. If the board members who voted in favor of the transaction took no steps to inform themselves about the terms of the 2002 Bonus or the reason it was not paid when approved then the action was not a valid exercise of business judgment.[103]

There is a second reason demand was excused for the derivative claim related to the 2002 Bonus. According to MCG's complaint, some time after the 2002 Bonus had been approved, "Maginn and Barr disclosed the true facts about the [2002 Bonus] to . . . San Miguel and Mills."[104] Maginn and Barr also "disclosed the true facts to . . . Malekian in mid-April 2009."[105] Thus, the board allegedly learned after approving the 2002 Bonus that they had been misled by Maginn and Barr. But the board allegedly has "done nothing to rescind th[e] [2002 Bonus]."[106] In my mind, this creates a reasonable doubt that the board's decisions regarding the 2002 Bonus are the product of a valid exercise of business judgment. Once Maginn and Barr had allegedly come clean about the 2002 Bonus, the board

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[103] It is true that board members are entitled to rely in good faith on reports or statements presented to them by the corporation's officers or employees, including general counsel. 8 *Del. C.* § 141(e). But they are also duty bound to make reasonable inquiry into inadequacies of the presentation by those employees. *See Smith v. Van Gorkom*, 488 A.2d 858, 875 (Del. 1985) ("At a minimum for a report to enjoy the status conferred by § 141(e), it must be pertinent to the subject matter upon which a board is called to act, and otherwise be entitled to good faith, not blind, reliance."). In this case, the lack of explanation for why the 2002 Bonus had not been paid was an inadequacy that the board was required to inform itself of.
[104] Compl. ¶ 53.
[105] *Id.*
[106] Compl. ¶ 55.

would have been aware that their prior decision was an uninformed one, made in reliance on misrepresentation. For the board to do nothing to rescind the decision leads me to reasonably doubt that their decisions regarding the 2002 Bonus have been made honestly and in good faith. This is sufficient to excuse demand under the second prong of *Aronson*.

Because the *Aronson* test is a disjunctive one, it is unnecessary to address whether demand was excused under the first prong of *Aronson* for the derivative claim related to the 2002 Bonus. MCG's complaint pleads facts with the particularity necessary for this claim to survive a Rule 23.1 motion to dismiss.

Before moving on I note that there are no facts alleged in the complaint that demonstrate Chai had anything to do with the 2002 Bonus. Her marriage to Maginn is not a basis upon which I can impute an allegation of wrongful conduct as to her. Accordingly, as to Chai, the derivative claim related to the 2002 Bonus is dismissed.

5. The Derivative Claim Related To The Compensation Increases Is Dismissed For Failure to Make A Demand

Demand futility must be determined on a claim-by-claim basis.[107] Just because demand is futile with respect to one of the board's challenged actions does not mean it is futile with respect to other challenged actions. Accordingly, I

[107] *See e.g., CalPERS v. Coulter*, 2002 WL 31888343 (Del. Ch. Dec. 18, 2002) (applying demand futility analysis on a claim-by-claim basis).

review the derivative claim related to the Compensation Increases apart from the derivative claim related to the 2002 Bonus. I find that demand was not excused under either prong of *Aronson* for the derivative claim related to the Compensation Increases.

Under the first prong of *Aronson*, demand may be excused as to a director who has a direct financial interest in the challenged transaction.[108] In this case, Maginn and Chai were both interested in the Compensation Increases. Thus, demand as to them would have been futile. That left three directors upon whom MCG might have made a demand: Malekian, San Miguel, and Mills. Malekian did not have a financial, familial, or other interest in the Compensation Increases. Nor was he beholden to Maginn or Chai, as evidenced by his vote against the Compensation Increases. Thus, demand as to him would not have been futile. The focus, then, is on San Miguel and Mills. If either of these two directors was interested or not independent, demand is excused under the first prong of *Aronson* because a majority of the board would have been disabled.[109]

Neither San Miguel nor Mills had a direct financial interest in the Compensation Increases; neither stood on both sides of the transaction.[110] MCG alleges that San Miguel and Mills were nevertheless interested in the

[108] *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996).
[109] *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984).
[110] *Id.* at 812.

Compensation Increases because they "were members of the Compensation Committee that approved, in breach of their fiduciary duties, the [Compensation Increases] . . . [and] are substantially likely to be held liable" for it.[111]

Under the first prong of *Aronson*, the "mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge . . . the disinterestedness of directors . . . ."[112] Demand is not excused simply by naming the directors as defendants in the suit or alleging that they participated in the challenged transaction.[113] Rather, the plaintiff must plead facts sufficient to show that approval of the transaction was "so egregious on its face that . . . a substantial likelihood of director liability exists."[114]

The derivative claim asserted by MCG with respect to the Compensation Increases alleges, at most, a breach of the duty of care. MCG's complaint proffers a straightforward theory to support its duty of care claim; San Miguel and Mills were grossly negligent in seeking only the advice of Barr and Austin to determine if MCG's consent rights applied to the Compensation Increases. MCG asserts that San Miguel and Mills should have consulted independent counsel on this decision because Austin had previously been retained by Maginn to represent Jenzabar and

[111] Compl. ¶ 86.
[112] *Aronson*, 473 A.2d at 815.
[113] *Id.* at 818.
[114] *Id.* at 815; *see also Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

because Barr was dependent on Maginn and Chai for his employment as general counsel.[115]

Assuming MCG could prove that San Miguel and Mills conduct was a breach of the duty of care, San Miguel and Mills still face no threat of personal liability for this claim. The Charter contains an exculpatory provision pursuant to 8 *Del. C.* § 102(b)(7) that protects San Miguel and Mills from liability against monetary damages for grossly negligent behavior, which is what MCG seeks in Count Five.[116] "When the certificate of incorporation exempts directors from liability, the risk of liability does not disable them from considering a demand fairly unless particularized pleading permits the court to conclude that there is a substantial likelihood that their conduct falls outside the exemption."[117] Conduct

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[115] Unlike the 2002 Bonus, there is no allegation of misrepresentation on the part of Maginn and Barr with respect to the Compensation Increases. There is simply the allegation that Maginn, Chai, Barr, and Austin "knew" MCG's consent rights applied to the Compensation Increases and flagrantly ignored them. *See e.g.*, Compl. ¶ 88 (defendants approved the Compensation increases "contrary to their known obligations under the Charter and PSWPA"). Despite this being a motion to dismiss, I cannot accept MCG's contention that defendants "knew" MCG's consent rights were in play because the ambiguity of the Charter and the PSWPA belies that assertion. *See Malpiede v. Townson*, 780 A.2d 1075, 1083 n.19 (Del. 2001) ("If the appended document, to be treated as part of the complaint for all purposes under Rule 10(c) . . . reveals facts which foreclose recovery as a matter of law, dismissal is appropriate.") (quoting *Associated Builders, Inc. v. Alabama Power Co.*, 505 F.2d 97, 100 (5th Cir. 1974)) (internal quotation marks omitted).

[116] *See* Compl. ¶ 109 ("As a result of Defendants' misconduct . . . Jenzabar ha[s] suffered and continue[s] to suffer substantial damages in an amount to be determined at trial."). The Charter's Section 102(b)(7) provision provides that "[t]o the fullest extent permitted by law, a director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director." *See* Charter Article VIII.

[117] *In re Baxter Int'l Inc., S'holders Litig.*, 654 A.2d 1268, 1270 (Del. Ch. 1995). *Baxter* was analyzing the effect of a Section 102(b)(7) charter provision on demand futility under *Rales* rather than the first prong of *Aronson*. The first prong of *Aronson* and the test in *Rales* differ

outside the Section 102(b)(7) exemption, for which directors may not be exculpated, includes (i) breaches of the duty of loyalty, (ii) acts or omissions not in good faith or which involve intentional misconduct or knowing violations of the law, or (iii) transactions from which the director derives an improper personal benefit.[118] MCG's complaint does not plead particularized facts sufficient to establish that San Miguel and Mills conduct with respect to the Compensation Increases fell outside the exemption. Neither San Miguel nor Mills derived a personal benefit from the Compensation Increases, neither stood on both sides of the transaction, and there are no facts alleged demonstrating bad faith or intentional misconduct on their part with respect to the Compensation Increases. The major question that was brought to San Miguel and Mills' attention was whether MCG had a right to consent to the Compensation Increases. To get this question answered, San Miguel and Mills sought the advice of Barr and Austin, in-house and outside counsel. Perhaps it would have been more prudent to procure counsel that had no previous affiliation with Maginn or Chai whatsoever, but failure to do that was, at most, a breach of the duty of care.[119] Thus, San Miguel and Mills were

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only slightly. I see no reason why the impact of a Section 102(b)(7) charter provision on the demand futility analysis would not be the same under both tests.

[118] 8 *Del. C.* § 102(b)(7).

[119] A company's general counsel is competent to advise a board committee of the company's contractual obligations to third parties. In companies that seek the regular advice and assistance of outside counsel, such outside counsel is also competent to advise a board committee of the company's legal obligations. It is only in special circumstances that a board committee must seek the advice of special outside counsel. *See* E. Norman Veasey, *Separate and Continuing*

protected by the Section 102(b)(7) provision in the Charter, did not face a substantial likelihood of personal liability, and therefore did not have a personal interest in the Compensation Increases.

MCG also asserts that demand was excused because San Miguel and Mills were not independent of Maginn and Chai and therefore would not do anything to negatively affect their compensation. According to the complaint, San Miguel and Mills are beholden to Maginn and Chai for two reasons. First, they are both professors who taught Maginn at Harvard Business School. Second, they each receive $100,000 in compensation for their service on the board and are allegedly dependent upon Maginn and Chai for this compensation.

Counsel for Independent Directors: An Idea Whose Time Has Not Come As A General Practice, 59 BUS. LAW. 1413, 1418 (2004) ("Most of the time, the general counsel and the regular outside counsel of the corporation are up to the task of providing the right advice. Special outside counsel to the independent committees or the independent directors should be the exception, not the rule . . . ."). Thus, it is an open question whether San Miguel and Mills breached their duty of care by declining to hire separate outside counsel. Admittedly, the allegation that Barr made misrepresentations to the board regarding the 2002 Bonus will cause one to question the notion that the compensation committee could rely on his advice about the Compensation Increases. But the allegations in the complaint do not support the inference that Barr's advice about the Compensation Increases was tied to the misrepresentation regarding the 2002 Bonus. MCG's consent rights and the precondition placed on the 2002 Bonus were independent obstacles to Maginn's receipt of additional compensation. It is perfectly conceivable that Barr did not believe that MCG's consent rights applied to the Compensation Increases (nothing in the record suggests otherwise) but did believe that the precondition on the 2002 Bonus was a legitimate obstacle that could only be overcome surreptitiously. Moreover, there is nothing in the record to suggest that Austin had any incentive not to give candid legal advice to the compensation committee about the applicability of MCG's consent rights to the Compensation Increases. The simple fact that Maginn hired Austin to represent Jenzabar is not enough to infer that Austin was doing Maginn's bidding. Jenzabar, not Maginn, was Austin's client. Moreover, MCG does not assert that Austin gave any advice regarding the 2002 Bonus, so he was in no way connected to the alleged misrepresentations.

Under the first prong of *Aronson*, "[i]ndependence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[120] The plaintiff must plead particularized facts from which the Court can infer that the board members who approved the transaction are being directed or controlled by the allegedly dominating individual.[121] The inquiry is subjective and personalized; it takes into account the specific circumstances of the particular director in question.[122] Stand-alone allegations of long-standing professional or personal relationships are insufficient to demonstrate that a director is beholden to the person with whom he or she has that relationship.[123] There may be a reasonable doubt about a director's independence if his or her continued employment and compensation can be affected by the directors who received the challenged benefit.[124] For director compensation to create independence problems, however, it must be shown that the compensation is material to the director.[125]

The facts plead in MCG's complaint are insufficient to support an inference that San Miguel and Mills are beholden to Maginn and Chai. MCG does not

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[120] *Aronson*, 473 A.2d at 816.

[121] *Heineman v. Datapoint Corp.*, 611 A.2d 950, 955 (Del. 1992), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

[122] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995).

[123] *See, e.g.*, *Orman v. Cullman*, 794 A.2d 5, 27 (Del. Ch. 2002).

[124] *Rales v. Blasband*, 634 A.2d 927, 937 (Del. 1993); *Kahn v. Tremont*, 1994 WL 162613, at *2 (Del. Ch. Apr. 21, 1994).

[125] *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

provide any particulars about the former relationship between San Miguel, Mills, and Maginn that demonstrate an impairment of independence. The simple fact that San Miguel and Mills were professors of Maginn is not enough; it is the sort of basic professional relationship that Delaware law has long treated as not disabling. Moreover, the Stockholders' Agreement belies MCG's assertion that Maginn and Chai hold sway over San Miguel and Mills. The Stockholders' Agreement specifies limited circumstances in which San Miguel and Mills can be removed and they cannot be unilaterally removed by Maginn and Chai.[126] MCG must consent to their removal. Finally, even if Maginn and Chai could have unilaterally removed San Miguel or Mills, MCG failed to allege facts that demonstrate the threatened loss of compensation would have disabled either San Miguel or Mills' judgment. While it is certainly possible that $100,000 in director compensation might be material to a Harvard professor, MCG's complaint alleges nothing about San Miguel and Mills to suggest that $100,000 is, in fact, personally material to either of them. MCG need not have offered conclusive evidence of the materiality of $100,000 to San Miguel or Mills, but it was required to provide the Court with some particulars from which it could reasonably be inferred that San Miguel or Mills' objective judgment would be impaired by the threat of losing their director

[126] Stockholders' Agreement §§ 4.2(a)(iii), 4.2(b).

compensation.[127] Based on all of the above, I find that demand was not excused under the first prong of *Aronson* for the derivative claim related to the Compensation Increases.

Nor do I find demand was excused under the second prong of *Aronson*. Unlike the 2002 Bonus, San Miguel and Mills appear to have taken steps to inform themselves of the advisability of approving the Compensation Increases. They sought the advice of Barr and Austin, in-house and outside counsel, on MCG's consent rights. There was nothing remiss, per se, about Maginn and Chai asking for a raise or for retroactive bonuses. The Employment Agreements entitled them to a periodic review of their compensation. From the compensation committee's perspective, they were simply asking for something they were entitled to ask for. Unlike the 2002 Bonus, there are no factual allegations in the complaint that suggest Maginn's presentation as to why he and Chai were entitled to the Compensation Increases was suspect. It is certainly not abnormal for executive officers to seek an increase in their remuneration, especially if they believe their performance warrants it. Moreover, retroactive bonuses are not per se impermissible or inappropriate where "the amount awarded is not unreasonable in

[127] *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991) ("Conclusory allegations of fact or law which are not supported by allegations of specific fact may not be taken as true. On the other hand, plaintiffs are not required to plead evidence inasmuch as discovery is foreclosed.") (internal quotations omitted), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

view of the services rendered."[128] The complaint does not plead that the retroactive compensation was unreasonable in light of the services Maginn and Chai had provided to Jenzabar.

Because demand was not excused under either prong of *Aronson* for the derivative claim related to the Compensation Increases, this claim is dismissed for failure to make a demand.

6. The Derivative Claim For Poor Board Management Practices Is Dismissed For Failure To Make A Demand

In its complaint MCG alleges that Barr is generally remiss in his duties as board secretary. He allegedly fails to distribute agendas to the board sufficiently in advance of board meetings and fails to circulate minutes until months after the meetings have concluded. According to MCG, only Malekian has sought to improve these internal board processes; the other defendant directors purportedly accept them.

I find that demand was not excused as to this derivative claim. MCG has not demonstrated that a majority of the board was disabled via interest or a lack of independence with respect to this claim such that they could not have adequately considered a demand. The principal alleged wrongdoer, Barr, is not on the board. With respect to the other defendants, this claim demonstrates, at most, a breach of

[128] *Zupnick v. Goizueta*, 698 A.2d 384, 388 (Del. Ch. 1997).

the duty of care.[129] Assuming MCG could prove this conduct was a breach of the duty of care, Jenzabar has a Section 102(b)(7) provision that exculpates directors from personal liability for money damages arising from duty of care breaches.

MCG argues that demand was futile for this claim despite the Section 102(b)(7) provision because the complaint requests injunctive relief, specifically an order from the Court requiring defendants "to provide full and timely information to all members of the Jenzabar Board of Directors and to timely and accurately record the deliberations and actions of the Board and its Committees."[130] Such a request for equitable relief does not subject defendants to the type of personal liability necessary to excuse demand. The possibility that defendants might be subject to a court order instructing them to be more expedient with the handling of information was not sufficient to render them incapable of fairly considering a demand. This type of personal liability is not what *Aronson* contemplates as giving directors a disabling "interest" in the litigation. Accordingly, none of the director defendants faced a substantial likelihood of

[129] I confess I have serious doubts as to whether the generalized allegations in this claim demonstrate a breach of the duty of care. Typically one cannot prove a breach of the duty of care without demonstrating that the directors were grossly negligent with respect to a particular transaction. *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985). In my view, if board members tolerate sloth-like delivery of information as a general practice this is not gross negligence per se, unless the sloth-like delivery actually causes the directors not to be adequately informed when they make a corporate decision.

[130] Compl. ¶ I.

personal liability on this claim and demand was not excused. This claim is dismissed.

7. MCG Is An Adequate Plaintiff To Pursue The Derivative Claim Related To The 2002 Bonus

Defendants argue that MCG is not an adequate derivative plaintiff because its interests conflict with Jenzabar's interests and the interests of other Jenzabar shareholders. In support of this argument, defendants make two assertions. First, defendants argue that this case is really about MCG's consent rights and repurchase notice rights, and that MCG is pursuing the derivative claims simply to give it more leverage on its direct claims. In that vein, defendants argue that MCG has named Jenzabar as a defendant on MCG's direct contract claims and that this fact renders MCG incapable of simultaneously pursuing a derivative claim on Jenzabar's behalf. Second, defendants argue that MCG's direct contractual claim in Count Eleven puts it in a position that is directly adverse to Jenzabar's other shareholders. Defendants' theory is that MCG brings Count Eleven in order to invalidate the attempted repurchase of the senior preferred shares so that it might negotiate a buyout of its investment in Jenzabar on terms more favorable than those already provided in the Charter and the PSWPA for the repurchase of senior preferred shares and the exercise of warrant puts.[131]

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[131] *See* Transcript of Oral Argument at 14 ("One of the claims that MCG has asserted here is that the repurchase notice is invalid, and they want that repurchase process to be set back because

Under Delaware law, a derivative action may be dismissed if the Court determines that the plaintiff is an inadequate representative of the company's other shareholders. *Katz v. Plant Industries* articulates the traditional factors that the Court considers to determine plaintiff's representative adequacy. The Court may look to (1) the existence of economic antagonisms between the plaintiff and the company's other shareholders, (2) the nature of the remedy sought, (3) indications that the plaintiff was not the driving force behind the litigation, (4) whether the plaintiff is familiar with the litigation, (5) the existence of other litigation pending between the plaintiff and defendants, (6) the relative magnitude of the plaintiff's personal interests as compared with its interest in the derivative action, (7) plaintiff's vindictiveness towards the defendants, and (8) the degree of support plaintiff receives from the other shareholders.[132] The burden is on the defendant to prove that plaintiff is an inadequate representative of the company and the other shareholders.[133] Hypothetical or potential conflicts of interest do not bar a plaintiff from acting as representative.[134] Nor will a plaintiff with interests that go beyond the interests of the class be barred from acting as representative so long as the plaintiff's personal interests are coextensive with the class.[135]

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they want to be able to negotiate or at least somehow convince the company to pay a greater amount for that stock.").

[132] *Youngman v. Tahmoush*, 457 A.2d 376, 379-80 (Del. Ch. 1983).

[133] *Emerald Partners v. Berlin*, 564 A.2d 670, 674 (Del. Ch. 1989).

[134] *Youngman*, 457 A.2d at 380.

[135] *Id.*

In this case, MCG has interests that go beyond those of the Jenzabar shareholders. MCG has unique contract rights, not enjoyed by other shareholders, the alleged breach of which it is pursuing in this action. I find that those rights, at least at this stage of the proceedings, are not in conflict with the interests of Jenzabar's other shareholders. To demonstrate why MCG's personal interests do not at this moment conflict with Jenzabar's other shareholders, I briefly apply the relevant *Katz* factors to MCG's situation.

Defendants posit that there is an economic antagonism between MCG and Jenzabar's other shareholders because MCG's ultimate desire is to be bought out at a higher price than it is likely to get if Jenzabar's attempted repurchase of its senior preferred shares was valid. Defendants allege that MCG has brought Count Eleven to invalidate the repurchase of the senior preferred shares in an effort to realize this desire. Defendants argue that if MCG receives a higher price from Jenzabar for its investment, there will be less value to distribute to common shareholders.[136] Allegedly, MCG's personal interest in the buyout dwarfs any value it might realize on the derivative claims.[137]

[136] Transcript of Oral Argument at 14 ("If [MCG is] bought out, if it is able to wrest a concession, if it's able to convince [Jenzabar] that it's better to pay it off, there will be that much value less, that much money less available to the other common stockholders.").

[137] *Id.* at 14-15 ("MCG has asserted contract rights for its warrants and its preferred stock on the order of $30 million. The claims for compensation at issue here amount to -- I think the numbers that we have seen have been about $1.5 million."). There are not enough facts on the record at this point to substantiate the $30 million MCG purportedly seeks. I include this simply to demonstrate defendants' argument on this point.

At this stage of the proceedings this argument is not persuasive. Defendants' allegation that MCG's ultimate goal in bringing this suit is to gain leverage for a better buyout is no more than an allegation at the moment. MCG posits a counterfactual. It argues that what is really occurring here is an attempt by defendants "to remove MCG as an investor in the Company at a price that is artificially low on the basis of reductions in cash flow attributable to the [Compensation Increases and 2002 Bonus] or, failing that, to attempt to strip it of any meaningful ability to object to [d]efendants' continued use of the Company for their own self-interests."[138] Thus, I am left with conflicting stories as to MCG's real motivation in bringing Count Eleven. If MCG's version of events is true then its efforts to stop defendants' alleged siphoning of money from Jenzabar would redound to the benefit of common shareholders. If defendants' version of events is true it is plausible that MCG's interests conflict with the common shareholders. On a motion to dismiss, I cannot resolve this conflict in favor of defendants because they are the moving party. If at some point later in the proceedings, after discovery has shed more light on the dispute, it appears that MCG's interests conflict with common shareholders we can revisit the issue then.

Defendants also argue that MCG cannot be an adequate plaintiff because it has named Jenzabar as a defendant on its direct breach of contract claims. I find

[138] Compl. ¶ 79.

that this fact does not render MCG an inadequate plaintiff because the remedies MCG seeks in the breach of contract claims that survive this motion are coextensive with the interests of Jenzabar common shareholders. Counts One and Two seek the return of the Compensation Increases and the 2002 Bonus to Jenzabar, with interest.[139] Such a remedy would increase the cash position and net assets of Jenzabar, thereby increasing the value of the company to common shareholders. Counts Nine and Ten seek a declaration that MCG's consent rights apply to the Compensation Increases and the 2002 Bonus. MCG must prevail on Counts Nine and Ten to prevail on Counts One and Two; therefore, the same analysis applies and MCG's interests are coextensive with the common shareholders on Counts Nine and Ten. Count Eleven seeks a declaratory judgment that MCG's repurchase notice rights were violated when defendants caused Jenzabar to attempt a repurchase of the senior preferred shares. If MCG were to prevail on this claim, the declaratory judgment, standing alone, would not be inimical to the interests of Jenzabar's common shareholders. The remedy sought in Count Eleven is only problematic if it would permit MCG to carry out its alleged scheme of extracting an overpriced buyout of its investment position to the detriment of the common shareholders. At this point in the proceedings, there is no evidence that MCG is pursuing such an objective.

[139] Compl. ¶¶ 91, 95.

8. Summary of Count Five

Before moving on, I make a final note on Count Five for clarity's sake. The only claim that has survived this motion to dismiss is the derivative claim associated with the 2002 Bonus lodged against Barr and Maginn for breach of the duty of loyalty and against San Miguel and Mills for breach of either the duty of care or loyalty.[140] All other claims in Count Five are dismissed under Rule 12(b)(6) and Rule 23.1 as described above.

D. Count Six – Claim For Unjust Enrichment

Count Six is a claim for unjust enrichment lodged against Maginn and Chai. Count Six alleges that as a result of the Compensation Increases and the 2002 Bonus, Maginn and Chai have been unjustly enriched to the tune of at least $1.5 million, possibly more.

1. Count Six Pleads A Derivative Claim Under *Tooley*

Count Six avers that, as a result of the Compensation Increases and the 2002 Bonus, "Maginn and Chai have been unjustly enriched *at the expense of and to the detriment of Jenzabar* . . . ."[141] Count Six further contends that "[t]o remedy [Maginn and Chai's] unjust enrichment, the Court should order them to disgorge

[140] As noted, there is no factual basis alleged in the complaint that permits me to conclude that Chai bears any liability for the 2002 Bonus. As to her, Count Five is dismissed in its entirety.
[141] Compl. ¶ 111 (emphasis added).

immediately *to the Company* all of the unlawful payments, with interest."[142] The language of Count Six plainly alleges harm to Jenzabar and seeks a remedy for Jenzabar. Accordingly, I find that Count Six pleads a derivative claim under *Tooley*.

2. <u>The Unjust Enrichment Claim Related To The Compensation Increases Is Dismissed For Failure To Make a Demand</u>

The bases of MCG's unjust enrichment claim are twofold; unjust enrichment is alleged to have been caused by the Compensation Increases and the 2002 Bonus. As to the claim for unjust enrichment arising out of the Compensation Increases, I find that demand was not excused for the reasons articulated in Count Five. MCG should have made a demand on the Jenzabar board alleging that Maginn and Chai were unjustly enriched by the Compensation Increases. Because it did not do this, Count Six is dismissed insofar as it pursues recovery for unjust enrichment arising out of the Compensation Increases.

At any rate, had demand been excused, Jenzabar would not have had a claim for unjust enrichment related to the Compensation Increases that would have survived a Rule 12(b)(6) motion to dismiss. Courts developed unjust enrichment

[142] Compl. ¶ 113 (emphasis added).

as a theory of recovery to remedy the absence of a formal contract.[143] As this Court has stated:

> [C]laims of unjust enrichment may survive a motion to dismiss when the validity of the contract is in doubt or uncertain. When the complaint alleges an express, enforceable contract that controls the parties' relationship, however, a claim for unjust enrichment will be dismissed. This is the case even when the enforceable contract gives rise to a fiduciary relationship between the parties.[144]

In this case, the Employment Agreements between Jenzabar, Maginn, and Chai govern the Compensation Increases. The Employment Agreements provide the board with the discretion and authority to increase Maginn and Chai's salaries or bonuses, and explicitly require the board to periodically review both types of compensation to see if an increase is warranted. Thus, the Compensation Increases were made pursuant to and within the express authority delegated by existing contracts. If there was something remiss about the Compensation Increases Jenzabar could pursue Maginn or Chai for breach of the Employment Agreements, but it could not pursue them for the tort of unjust enrichment. Accordingly, MCG may not prosecute such on claim derivatively on Jenzabar's behalf.

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[143] *Bakerman v. Sidney Frank Importing Co., Inc.*, 2006 WL 3927242, at *18 (Del. Ch. Oct. 10, 2006).

[144] *Id.*; *see also Rossdeutscher v. Viacom, Inc.*, 768 A.2d 8, 23-24 (Del. 2001) ("Courts generally dismiss claims for quantum meruit on the pleadings . . . when it is clear from the face of the complaint that there exists an express contract that clearly controls") (internal citation and quotation omitted); *ID Biomedical Corp. v. TM Technologies, Inc.*, 1995 WL 130743, at *15 (Del. Ch. Mar. 16, 1995) ("A party cannot seek recovery under an unjust enrichment theory if a contract is the measure of [the] plaintiff's right") (internal citation and quotation omitted); *CIT Communications Fin., Corp. v. Level 3 Commc'ns, LLC*, 2008 WL 2586694, at *14 (Del. Super. Ct. June 6, 2008) ("The existence of an express contract governing the relationship of the parties precludes a claim of unjust enrichment arising from the same relationship").

3. Demand Was Excused For The Unjust Enrichment Claim Related To The 2002 Bonus

As to the claim for unjust enrichment related to the 2002 Bonus, I find that demand was excused for the reasons articulated in Count Five. Accordingly, this aspect of Count Six will not be dismissed under Rule 23.1. I also find that MCG's complaint adequately pleads a claim for unjust enrichment against Maginn that survives a Rule 12(b)(6) motion to dismiss.

Preliminarily, I note that the Employment Agreements do not cover the 2002 Bonus because it was purportedly approved before the Employment Agreements were executed. Thus, there is no contract governing the 2002 Bonus that precludes MCG from alleging that Maginn was unjustly enriched. I also note that none of the factual allegations in the complaint support the theory that Chai was unjustly enriched by the 2002 Bonus. Therefore, as to her, Count Six is dismissed in its entirety.

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.'"[145] The elements of an unjust enrichment claim are (i) an enrichment, (ii) an impoverishment, (iii) a relation between the enrichment and impoverishment, (iv) the absence of justification, and

[145] *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1999) (quoting 66 Am. Jur. 2d *Restitution and Implied Contracts* § 3 (1973)).

(v) the absence of a remedy provided by law.[146] MCG's complaint pleads adequate facts to satisfy these elements. The complaint alleges that (i) Maginn was enriched to the tune of $750,000 by the 2002 Bonus, (ii) Jenzabar was deprived of $750,000, (3) the funds flowed directly from Jenzabar to Maginn (4) the 2002 Bonus was unjustified because it was procured by Maginn's breach of the duty of loyalty he owed to Jenzabar, and (5) disgorgement or rescission of the 2002 Bonus, rather than money damages, is the appropriate remedy. Accepting all of the foregoing as true for purposes of this motion, I find that it states a claim for which relief can be granted if MCG ultimately prevails.[147]

E. Count Seven – Seeking An Accounting

Count Seven seeks an accounting of all compensation or any other payment paid to or for the benefit of Maginn and Chai. This is really a remedy plead as a cause of action.[148] So long as the underlying cause of action is well plead,

[146] *Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 585 (Del. Ch. 1998).

[147] If MCG is able to prove Maginn breached his duty of loyalty in Count Five then it will also be successful in proving unjust enrichment in Count Six. Both claims hinge on whether Maginn was disloyal to Jenzabar by the manner in which he procured the 2002 Bonus. Of course, in the event MCG makes its case on both claims, Jenzabar will only be entitled to one recovery; return of the 2002 Bonus plus interest. In this case, then, for all practical purposes, the claims for breach of fiduciary duty and unjust enrichment are redundant. One can imagine, however, factual circumstances in which the proofs for a breach of fiduciary duty claim and an unjust enrichment claim are not identical, so there is no bar to bringing both claims against a director.

[148] *Rhodes v. Silkroad Equity, LLC*, 2007 WL 2058736, at *11 (Del. Ch. July 11, 2007) ("An accounting is not so much a cause of action as it is a form of relief.").

requested relief styled as a claim will not be stricken from the complaint.[149] MCG's complaint adequately pleads claims that have survived defendants' motions to dismiss. Ultimately, should MCG prevail on those claims, an accounting may be an appropriate remedy. I leave that determination for another day, as well as the determination of the appropriate scope of any accounting ordered. Accordingly, I will treat Count Seven as having been included in MCG's prayer for relief.

F. Count Eight – Seeking Rescission

Count Eight seeks rescission of all "unlawful payments" paid to Maginn and Chai.[150] This too is really a remedy plead as a cause of action. If MCG ultimately prevails on the claims that survive this motion to dismiss I will consider at that time whether rescission is an appropriate remedy. Accordingly, I will treat Count Eight as having been included in MCG's prayer for relief.[151]

G. Count Eleven – Claim For Declaratory Judgment Regarding The Repurchase Of Jenzabar Senior Preferred Shares Held By MCG

Count Eleven seeks a declaratory judgment that (1) Jenzabar's attempt to repurchase MCG's senior preferred stock before April 30, 2009 was invalid and (2) Jenzabar's assertion that MCG had to exercise its warrant put in order to avoid

[149] *AQSR India Private, Ltd. v. Bureau Veritas Holdings, Inc.*, 2009 WL 1707910, at *14 (Del. Ch. June 16, 2009) (denying motion to dismiss claims for injunctive relief, an accounting, and constructive trust).
[150] Compl. ¶ 125.
[151] Incidentally, MCG has already requested rescission in its prayer for relief.

losing its consent rights under section 5.12 of the PSWPA was incorrect. Defendants have not sought dismissal of Count Eleven. Accordingly, I will address this count another day.

H. Count Twelve – Rescission Of The 2002 Bonus

Count Twelve alleges that the 2002 Bonus was invalid because it was only approved by two of five directors at a duly convened board meeting. Count Twelve can be distinguished from Counts One, Two, Nine, and Ten in that it challenges a decision of the entire board rather than a decision of the compensation committee. Count Twelve also seeks rescission of the 2002 Bonus, a remedy that I will treat as having been included in the prayer for relief.

1. Count Twelve Pleads A Derivative Claim Under *Tooley*

Count Twelve alleges that the 2002 Bonus was not properly authorized by the board and therefore "should be rescinded, and all such sums promptly returned to Jenzabar, with interest."[152] I find that Count Twelve pleads a derivative claim under *Tooley* because it seeks to recover for a harm purportedly suffered by Jenzabar; the carrying out of a board resolution that was not properly approved. Count Twelve also seeks relief that specifically runs to Jenzabar.

[152] Compl. ¶ 146.

2. <u>Demand Is Excused For Count Twelve</u>

I find that demand was excused for Count Twelve for essentially the same reasons it was excused for the derivative claim related to the 2002 Bonus in Count Five. Maginn is interested in the 2002 Bonus, Chai is not independent of Maginn, and MCG has plead facts that create a reasonable doubt San Miguel and Mills' approval of the 2002 Bonus was a valid exercise of business judgment. Accordingly, a majority of the board was disabled and could not have considered a demand.

I also find that Count Twelve asserts sufficient factual allegations to survive a Rule 12(b)(6) motion to dismiss. The complaint asserts that the 2002 Bonus was not validly approved because out of a quorum of five directors only two voted in favor of the 2002 Bonus and thus, the majority of a quorum necessary for approval was not obtained. The analysis is not as simple as that. 8 *Del. C.* § 144 provides in relevant part:

> No contract or transaction between a corporation and 1 or more of its directors or officers . . . shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction . . . if: (1) The material facts as to *the director's or officer's* relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the

> disinterested directors, even though the disinterested directors be less than a quorum . . . .[153]

With regards to the 2002 Bonus, Malekian, San Miguel, and Mills were disinterested. Of these three directors, two approved the 2002 Bonus. Thus, the affirmative votes of a majority of disinterested directors were obtained. There is an open question of fact, however, as to whether all of the material facts of Maginn's interest were disclosed to the board. Maginn's basic interest in the transaction was certainly disclosed, it was obvious he was to be the recipient of the 2002 Bonus. MCG alleges, however, that the existing precondition to the 2002 Bonus was not disclosed to the board. This fact would have been material to the board in considering whether to approve the 2002 Bonus free of any conditions, as they purportedly did on December 23, 2008. Accepting the allegation that Maginn withheld information about the precondition on the 2002 Bonus, I find that MCG's complaint sufficiently pleads a claim that the 2002 Bonus was not validly approved by a majority of fully-informed, disinterested board members.

I make a final note on Count Twelve, to ensure clarity going forward. Count Twelve deals solely with the legitimacy of the board's approval of the 2002 Bonus under Section 144. Whether approval of the 2002 Bonus without MCG's consent was a breach of the PSWPA and the Charter is an independent issue that will be addressed in Counts One, Two, Nine, and Ten. For now, I note that it is possible

[153] 8 *Del. C.* § 144(a)(1).

the 2002 Bonus was validly approved by a fully informed majority of disinterested board members but was nevertheless a breach of the Charter and the PSWPA. Conversely, it is possible the 2002 Bonus was not validly approved by a fully informed majority of disinterested board members but was nevertheless not in breach of the Charter and the PSWPA. Other permutations are possible; I will not go through them all. I will decide both issues at a later stage in the proceedings after the facts have been more fully developed.

VI. CONCLUSION

For the reasons given above, defendants' motions to dismiss are GRANTED IN PART and DENIED IN PART. Specifically, Counts One, Two, Nine and Ten are DISMISSED with prejudice with respect to San Miguel, Mills, and Barr but are NOT DISMISSED with respect to all other defendants. Counts Three and Four are DISMISSED with prejudice in their entirety. Count Five is NOT DISMISSED as to the derivative claim related to the 2002 Bonus but is DIMISSED with prejudice as to all other direct and derivative claims with the exception that MCG may amend its complaint to plead a direct breach of contract claim for defendants' alleged neutralization of Malekian's board participation. Count Five is DISMISSED with prejudice in its entirety with respect to Chai. Count Six is NOT DISMISSED as to the derivative claim for unjust enrichment related to the 2002 Bonus but is DISMISSED with prejudice as to all other derivative claims for unjust enrichment. Count Six is DISMISSED with prejudice in its entirety with respect to Chai. Counts Seven and Eight plead remedies and will be treated as having been included in the prayer for relief. Count Eleven was not subject to defendants' motions to dismiss and thus remains an operative claim going forward. Count Twelve is NOT DISMISSED.

Counsel shall confer and agree upon an appropriate implementing Order to be submitted to the Court within twenty days of this date.