THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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| MARTHA S. SUTHERLAND, as Trustee of the Martha S. Sutherland Revocable Trust dated August 18, 1976,<br><br>Plaintiff,<br>v.<br><br>PERRY H. SUTHERLAND, TODD L. SUTHERLAND, and MARK B. SUTHERLAND,<br>Defendants,<br>and<br><br>DARDANELLE TIMBER CO., INC., and SUTHERLAND LUMBER SOUTHWEST, INC.,<br><br>Nominal Defendants. | **PUBLIC VERSION**<br>**December 26, 2007**<br><br>C.A. No. 2399-VCL |

# PLAINTIFF MARTHA S. SUTHERLAND'S ANSWERING BRIEF IN OPPOSITION TO THE NOMINAL DEFENDANTS' MOTION TO DISMISS

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## INTRODUCTION

Brian Jeffrey ("Jeffrey"), the one member Special Litigation Committee ("SLC") of Nominal Defendants Dardanelle Timber Co., Inc. ("Dardanelle") and its wholly-owned subsidiary Sutherland Lumber-Southwest, Inc. ("Southwest," and together with Dardanelle the "Companies"), has moved to dismiss this derivative action (the "Motion"). Jeffrey seeks to terminate the efforts of plaintiff Martha Sutherland ("Plaintiff" or "Martha"), who is supported by her brother Dwight Sutherland, Jr. ("Dwight Jr."), to obtain redress for self-dealing and other wrongdoing by the three directors of Dardanelle and Southwest. The three directors are twin brothers Perry Sutherland ("Perry") and Todd Sutherland ("Todd"), and their cousin Mark Sutherland ("Mark," with Perry and Todd, the "Defendants"). Perry and Todd handpicked Mark as the third director of Dardanelle and Southwest following the death of Dwight D. Sutherland, Sr. ("Dwight Sr.") in 2003.

Martha and Dwight have each owned 25% (directly or beneficially) of Dardanelle's common stock for over 20 years. But neither of them has *ever received even a penny in dividends* from Dardanelle. Nonetheless, extraordinary amounts have been spent on perquisites and compensation for Perry and Todd's benefit. Such expenditures include $1.88 million for a private jet to have standing by for Perry, Todd and Mark to use for personal trips, for which the Companies fund substantial carrying, operating and other costs. And when Martha sought to review company books and records to understand such perquisites and compensation as well as the financial condition of the companies, the Defendants refused and caused Dardanelle to expend – while it was already losing money and in a net borrowing position to continue operations – some $750,000 to defend against Martha's Section 220 action. They also removed Martha from Southwest's board and contemporaneously voted to approve self-dealing

employment agreements to further entrench Perry and Todd and protect their financial benefits from the Companies.

Jeffrey of course finds nothing wrong with the foregoing or any of the Defendants' other actions and asks the Court to dismiss the litigation. Jeffrey's approach is predictable. Delaware courts have long acknowledged the potential for bias of an SLC, particularly when chosen by named defendants. The Defendants certainly understood that when their litigation counsel proposed this procedural move. This Court also recognized from the outset the extreme nature of the SLC proposed here, as it explained in the context of the SLC's request for a stay:

> Mr. Sparks, I do want to impress on you that this is a case that seems to take the idea of a special litigation committee to an extreme that I'm not sure I remember ever seeing before. A corporation, a small group of shareholders, 50 percent of whom are aligned on one side and 50 percent on the other, and a single person is brought in to be a special litigation committee. I was, I have to say, somewhat taken back.

Ex. 1 at 30.[1/] Recognizing the paucity of information about Jeffrey, the Court further stated:

> He submitted an affidavit in which he didn't identify himself, he didn't say where he lived, he didn't say what he does. He didn't indicate in any way what it was that caused – or to his knowledge, any way, resulted in his being named as this one-person special litigation committee. There will be lots of inquiry into those sections. In fact, I would have like to see more about that today, so I would have some more confidence in his ability to function in this capacity *than I have from knowing nothing*.

*Id.* (emphasis added). The Court's decision to grant the stay was based largely upon the representation to the Court by SLC Counsel[2/] that no fact existed which might even call into question Jeffrey's independence or good faith. *See id.*

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1/ Transcript of December 19, 2006 hearing (the "Stay Hearing"). Exhibits submitted in support of this answering brief are attached to the Transmittal Affidavit of Matthew F. Davis, Esq. (the "Davis Affidavit"), filed contemporaneously herewith.

2/ "SLC Counsel" or "MNAT" refers to Morris, Nichols, Arsht & Tunnell, LLP.

Several months later, Jeffrey eschewed any concept of candor to the 50% of Dardanelle's common stockholders by moving for a protective order to preclude virtually all discovery into the SLC's Report[3/] and investigation. This Court rejected that approach for reasons still quite relevant now:

> The facts here, at least inferentially, paint a vivid picture of two 50% owners of a closely-held family business determined to prevent the other 50% owners from ever having a voice in, or even obtaining essential information about, the basic operational affairs of the companies. Having waged and lost a futile, yet extremely expensive, campaign of attrition against the same plaintiff in a section 220 action only months earlier, *the defendants again seek to limit Martha's access to critical information—this time under the auspice of work conducted by a one-person special litigation committee whose bona fides have not yet been subject to rigorous examination*.

*Sutherland v. Sutherland*, No. Civ. A. 2399-VCL, 2007 WL 1954444, at *3 (Del. Ch. July 2, 2007) (emphasis added).

The Court was right. The SLC was just another procedural maneuver for the Defendants to hold 50% of Dardanelle's common stockholders at bay and to rid themselves of this litigation without Martha ever having the opportunities to do meaningful discovery, submit evidence and make the resulting arguments that could establish the Defendants are personally, jointly and severally liable for self-dealing, breaches of fiduciary duty and other wrongdoing. That is why the SLC is comprised of one person chosen by the Defendants in secret. That is why the facts surrounding how or why Jeffrey was chosen remain a secret even now, despite this Court's admonitions during the Stay Hearing. And that is why Jeffrey and SLC Counsel staunchly opposed meaningful discovery, just as the Defendants previously refused to provide corporate

3/ "Report" refers to the "Report of the Special Litigation Committees of the Board of Directors of Dardanelle Timber Co., Inc. and Sutherland Lumber Southwest, Inc," dated and filed on March 26, 2007.

information to Martha preferring instead to move into litigation and cause Dardanelle to incur some $900,000 in fees (of which almost $750,000 were paid) to defend against Martha's Section 220 action. Jeffrey and the Defendants wanted the Report and Motion to just slide through and be decided without any meaningful scrutiny, so this case can end regardless of the merits and the truth.

There are many reasons why the Motion must be denied. First, the SLC has not even tried to meet its mandatory *evidentiary* burden of showing there are no disputed issues of material fact regarding the independence and good faith of the SLC and the reasonableness of its investigation and resulting conclusions. Rather, the SLC cites only to the Report despite that the Report is *not* evidence. The Report itself incredibly does not cite to *evidence* as support for each of the myriad purported factual allegations, statements and conclusions that it contains. In taking that approach, Jeffrey and SLC Counsel consciously ignored the Supreme Court's directive in *Zapata* regarding what an SLC must do and prove to terminate a derivative action and, instead, they have sought to shift *their* burden of proof to Martha to "prove the SLC wrong." That is directly contrary to the law, common sense and any notion of fairness or due process. At the same time, Jeffrey and SLC Counsel destroyed material evidence, namely, their critical witness interview notes. Those notes undeniably were material, relevant and discoverable in this matter. That conscious destruction of critical evidence is antithetical to the SLC process and should negate here the SLC's ability to satisfy the stringent *Zapata* burdens of proof.

Second, the evidence developed in discovery affirmatively refutes Jeffrey's independence and good faith. It is undisputed that Jeffrey had a prior business relationship with Mark's wife, and a social relationship with her and Mark. The actual facts regarding these matters still remain a secret because Jeffrey consciously failed to submit any evidence on them. There also is

Jeffrey's substantial and continuing financial interest in this matter *as well as* his other continuing financial ties to the Defendants. Jeffrey was paid his hourly rate, just like a retained expert, amounting to over $60,000 just through completion of the Report; and Jeffrey's firm was paid another almost $25,000 purportedly for "clerical work." By now, the total fees to Jeffrey are certainly much higher and they continue to increase. Subsequent to the Report, Jeffrey apparently has gone on "inventory trips" with Perry and Todd for which he was paid his hourly rate. Jeffrey discussed early on with SLC Counsel and therefore contemplated while performing his work, that he could have an *ongoing business relationship* with the Companies and Defendants. Jeffrey followed-through on that desire and intention subsequent to the Report. Yet, Jeffrey and SLC Counsel made no disclosure of Jeffrey's business development efforts or continuing financial relationship when SLC Counsel made its representation at the Stay Hearing, in the Report, or otherwise.

Third, the SLC falls well short on the reasonableness of its investigation and the bases for its conclusions. There are gaping holes in its investigation as well as inexplicable contradictions between a variety of the unsupported statements in the Report and the discovery Martha was given over the SLC's staunch objections. Just one example is Jeffrey's grudging admission that provisions in Perry and Todd's self-dealing employment agreements were in Jeffrey's opinion *not reasonable* and, by definition therefore *not* entirely fair to the companies, despite contrary conclusions in the Report. Another example is Jeffrey's admission that he and SLC Counsel discussed how their "ripeness" theory "gave [them] another argument" that those employment agreements were not actionable wrongdoing. But in that slip, the truth came out: Jeffrey was not performing any independent investigation; he was a well compensated consultant looking for arguments he could use to protect the Defendants and end this litigation.

The truth is that Jeffrey and SLC Counsel blindly accepted as true whatever they were told by the Defendants and others biased in their favor; avoided probing areas that might contradict what they were told; and failed to dig beyond the superficial "record" that could be used to paper over Martha's claims. They then drafted a Report that does not cite evidence and actually destroyed critical evidence that cuts to the heart of the investigation and purported bases for the Report. The result? The Companies have spent another over $500,000 at the Defendants' direction to continue the Defendants' war of attrition against Martha. But all the SLC has done is to raise more questions, including substantial ones about the SLC process. The Motion must be denied.

## ARGUMENT

### I. THE SLC MUST SATISFY A HEAVY EVIDENTIARY BURDEN TO TERMINATE THIS ACTION.

The operation of a special litigation committee is the only instance in the law where a defendant can free itself from litigation and potential liability by merely appointing a committee to review the allegations of the complaint. *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985). Thus, an SLC seeking to "self-destruct" a stockholder's derivative lawsuit must meet exacting standards before a motion to terminate can be granted. *Id.*

As the Supreme Court explained in *Zapata*, the *SLC* – not the Plaintiff – has the burden of proof. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788 (Del. 1981). It is the SLC that *must* establish that its members are independent and acted in good faith, conducted a reasonable investigation and have reasonable bases for all of their conclusions. *Zapata*, 430 A.2d at 789. Independence, good faith and reasonable bases *cannot be presumed*. *Id.* The Supreme Court further directed that whether the SLC has satisfied its burden of proof is determined under the stringent summary judgment standard. *See id.* The SLC therefore "has the burden of demonstrating the absence of any material issue of fact, and any doubt as to the existence of such an issue will be resolved against [the SLC]." *Fuqua*, 502 A.2d at 966; *See also Zapata*, 430 A.2d at 780. The SLC even acknowledges its heavy burden of proof. *See* Nominal Defendants' Opening Brief ("OB") at 20.

*Zapata's* second step empowers the Court to apply, when appropriate, its own "independent business judgment as to whether the motion to dismiss should be granted." *Fuqua*, 502 A.2d at 972. The *Zapata* Court explained that a court's independent review and evaluation

> provides, we [on the Delaware Supreme Court] believe, *the essential key* in striking the balance between legitimate corporate claims expressed in a derivative stockholder suit and a corporation's best interests as expressed by an [SLC]. ... or the Court should determine, applying its own independent business judgment,

> whether the motion should be granted. This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation's motion denied.

*Zapata*, 430 A.2d at 788. (Emphasis added)

The SLC has not even come close to meeting its mandatory *Zapata* burden of proof. Certainly, at a minimum, there are numerous and substantial disputed factual issues as to Jeffrey's independence and good faith as well as the reasonableness of his investigation and the resulting conclusions and purported bases.

Equally, if not more important is that this Court's consideration using its own "independent business judgment" should result in the Court denying the Motion and allowing this case to proceed. The factual backdrop for this case is entirely unique, as this Court knows and so aptly described in its ruling on the SLC's motion for protective order barring discovery. *Sutherland*, 2007 WL 1954444 at *1. The Court in *Zapata* certainly never contemplated the appointment or operation in this unique context of a one member SLC to determine whether derivative claims supported by 50% of the common stockholders should proceed against the other, entrenched 50% of the common stockholders. The Court's comments at the Stay Hearing were to the same effect. The result of the SLC process is that, now, there has been almost 3.5 years during which the Defendants have caused Dardanelle to spend upwards of $1.5 million to litigate against and stop at all costs the other 50% of Dardanelle's stockholders from any meaningful access to the facts relating to the claims of alleged wrongdoing. The Defendants have done so despite protestations of innocence and claims that the facts and documents will exonerate them. The Defendants' actions simply make no sense. Now, as explained below, the one member SLC has undisclosed financial ties to the Defendants and critical interview notes were consciously destroyed by the SLC and SLC Counsel. The second prong of the *Zapata*

inquiry empowers this Court to consider all of these factors and others, and also should result in the Court denying the Motion.

## II. THE SLC'S FAILURE TO SUBMIT EVIDENCE IN SUPPORT OF ITS MOTION, TOGETHER WITH THE DESTRUCTION OF RELEVANT AND MATERIAL EVIDENCE, REQUIRES DENIAL OF THE MOTION.

### A. The SLC Failed To Satisfy Its Burden Of Proof Because It Did Not Cite And Submit Any Evidence To Even Try To Show The Absence Of Disputed Issues Of Material Fact.

*Zapata* is clear that the SLC must satisfy the same burden of proof as on summary judgment motions, *i.e.*, demonstrate that there are no disputed issues of material fact on any of the relevant issues. *Zapata*, 430 A.2d at 780. To obtain summary judgment, of course, the moving party (here the SLC) *must submit evidence* establishing the purported undisputed facts claimed to result in judgment for the moving party as a matter of law. *See, e.g., Hoyle v. Mueller*, 1990 WL 18299, at *3 (Del. Super. Fed 13, 1990) ("That moving party *must insure* that the record contains enough evidence to justify the granting of the motion [and] [i]f he fails to submit sufficient evidence, the non-moving party need not introduce any evidence."). The failure to submit sufficient evidence to satisfy that burden must result in the denial of the summary judgment motion. *See id.; See also Openwave Sys, Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, No. Civ. A. 2690, 2007 WL 704943, at *2 (Del. Ch. March 5, 2007) (Lamb, VC). As this Court explained in *Openwave Systems*, "[s]ummary judgment will not be granted when the record reasonably indicates that a material fact is in dispute *or* 'if it seems desirable to inquire more thoroughly into the facts in order to clarify the application of the law to the circumstances.'" *Id.* (*quoting in part Ebersole v. Lowengrub*, 180 A.2d 469, 470 (Del. 1962)). (Emphasis added)

Here, Jeffrey consciously failed to submit *any* evidence in support of the Motion. The Motion instead makes a variety of bold assertions and a handful of citations to the Report. The

Report is not evidence, of course, but rather hearsay if not double or even triple hearsay at that. Even the Report does *not* cite to specifically to the evidence that it claims as support for each of its myriad careful, attorney-crafted statements of purported facts or conclusions. Tellingly, the Report incredibly is not even signed by Jeffrey or SLC Counsel.

By submitting no evidence to the Court in support of its Motion or Report, the SLC has failed altogether to follow the holdings in *Zapata* and cannot meet its burden of proof. This is not just a procedural issue. It is substantive to its core, just as it is on summary judgment. *See, e.g., Rowe v. Everett*, C.A. No. 1967-S, 2001 WL 1019366, at *5-6 (Del. Ch. Aug. 22, 2001) (noting that a party must submit a factual record sufficient to support summary judgment before the burden shifts to the nonmoving party to submit evidence that raises a factual issues for trial). It likewise cuts to the heart of the very unique process carefully crafted and approved in *Zapata*. Jeffrey has sought to effectively shift the burden of proof *from him* over to Martha and her counsel to "prove the SLC wrong." And Martha is supposed to accomplish this without the benefit of knowing what evidence the SLC contends purportedly supports a given factual allegation, statement or conclusion in the Report because the SLC refused to specifically cite the evidence supporting its factual matters. That is not only unfair but entirely unjust, and it would never be permitted on summary judgment. It therefore cannot be permitted here, given the clear mandates of *Zapata* as well as fundamental fairness and due process.[4/]

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4/ The SLC cannot avoid its failure to submit evidence by pointing to the discovery ordered by this Court. The discovery was *compelled* over staunch opposition from Jeffrey and SLC Counsel who argued vehemently that such discovery was neither *necessary nor appropriate* under *Zapata*. Having failed, they cannot now rely upon what this Court compelled them to do as somehow a remedy for their failure to specifically cite and also submit the supporting evidence. The SLC and its counsel did not need to know what discovery (if any) would be compelled in order for them to cite and submit – in the first instance when they filed their Memorandum – the evidence that they contend shows their *Zapata* burden is satisfied. Any such evidence always has been in their control, and discovery had no bearing on their conscious refusal to submit it to the

### B. The SLC and SLC Counsel Also Consciously Destroyed Highly Relevant And Discoverable Evidence.

The SLC's failure to cite and submit its evidence is even more glaring in this case. The SLC and its counsel tout in the Report that their "investigation" purportedly included interviews of 18 persons with relevant information. Report at 13. The Report also asserts, repeatedly albeit conclusorly, that its purported "factual" conclusions and resulting determinations are based substantially upon those interviews. But Jeffrey and SLC Counsel consciously destroyed highly relevant, material and discoverable evidence of what was actually asked and disclosed in those interviews, by destroying their handwritten and contemporaneous notes from their so-called investigation.

Jeffrey and S. Mark Hurd ("Hurd") admitted that they consciously destroyed their witness interview notes. (Ex. B at 39-41; Ex. C at 73-75)[5/] Hurd testified that he also informed his associate, Jay Moffitt ("Moffitt"), that it was Hurd's practice to destroy his notes, which not surprisingly resulted in Moffitt destroying his interview notes. (*See* Ex. C at 88-90) Since he was not deposed, there is no specific testimony as to what happened to Mr. Spark's interview notes; but since none were produced, the only conclusion is that his interview notes also were destroyed.[6/]

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Court as *Zapata* mandates. Neither the law, logic or common sense support in any event that merely providing discovery somehow may take the place of the SLC's specific citations to evidence to support each and every factual statement and resulting factual *and* legal conclusion.

5/ The deposition transcripts of Brian Jeffrey and S. Mack Hurd are, respectively, Ex. B and Ex. C.

6/ We know that Mr. Sparks took notes during the interview of Martha since we saw him do so. He no doubt did so at the other interviews he attended as well. But no interview notes from Mr. Sparks were produced, confirming that whatever notes he took during interviews were destroyed just like those of Hurd, Moffitt and Jeffrey.

It is axiomatic that a party who is aware that evidence might be relevant to a pending or future litigation has an affirmative duty to preserve that material. *See, e.g., Sears, Roebuck and Co. v. Midcap*, 893 A.2d 542, 552 (Del. 2006) (where the court held that a party has a duty to preserve material if it knows that the item in question is relevant to a legal dispute or if it was otherwise under a legal duty to preserve it); *Brandt v. Rokeby Realty Company*, No. C.A. 97C-10-132-RFS, 2004 WL 2050519, at *11 (Del. Super. Ct. Sept. 8, 2004) (citing *In re Wechsler*, 121 F.Supp.2d 404, 415 (D. Del. 2000)); *Mosel Vitelic Corp. v. Micron Tech., Inc.*, 162 F.Supp.2d 307, 310-311 (D. Del., 2000).[7/] The SLC was created for the sole purpose of investigating claims asserted in this litigation and thus its entire existence was dependent upon this pending litigation and a duty to investigate, create a record, and report to the Court.

The SLC and SLC Counsel knew or certainly should have known that their interview notes were relevant and discoverable. The Delaware Supreme Court established in *Zapata* that discovery into an SLC investigation may be ordered to facilitate the inquiry into the issues of independence, good faith and reasonableness. *Zapata*, 430 A.2d at 788; *accord Kaplan v. Wyatt*, 499 A.2d 1184, 1192 (Del. 1985). This Court likewise explained that "the inherent equitable discretion of the Court of Chancery [is] to tailor discovery to a given set of facts." *Sutherland*, 2007 WL 1954444, at *3. Delaware law is actually quite specific on this very point. *Kindt v. Lund*, No. C.A. 17751, 2001 WL 1671438, at *2 (Del. Ch. 2001). In *Kindt*, the Court held that

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7/ *See also Shamis v. Ambassador Factors Corp.*, 34 F.Supp.2d 879, 888-89 (S.D.N.Y. 1999) (holding that a party has a duty to preserve evidence if the party "knew or should have known that the destroyed evidence was relevant to pending, imminent, or reasonably foreseeable litigation"); *William T. Thompson Co. v. Gen. Nutrition Corp.*, 593 F.Supp. 1443, 1455 (C.D. Cal. 1984) (holding that "[w]hile a litigant is under no duty to keep or retain every document in its possession once a complaint is filed, it is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to discovery of admissible evidence, is reasonably likely to be requested during discovery, and/or is the subject of a pending discovery request.").

the SLC was obligated to produce "all transcripts, notes, and summaries of witness interviews conducted by the Committee" as well as "all documents reviewed and relied upon by the Committee, including all drafts of the Report and memoranda and opinions procured by the advisors to the Committee." *Id*. Still additional authorities pre-dating the SLC's appointment and investigation here confirm that the interview notes were relevant and discoverable. *See also Rosenthal v. Morris*, C.A. No. 4-03CV-141-Y, 2005 WL 3625255, at *4 (N.D. Tex. Nov. 23, 2005); *Strougo v. Padegs*, 1 F.Supp.2d 276, 282 (S.D.N.Y. 1998) (applying Delaware law and holding the court held that plaintiff in discovery could inspect, among other things, the notes of interviews and drafts of the SLC report). SLC Counsel thus had a duty to advise Jeffrey accordingly and insist that he, and they, all preserve their interview notes.

There is no question that the destroyed interview notes were highly relevant:

- Numerous factual findings and conclusions were based upon the interviews either substantially or entirely. All that is left are the attorney-drafted, carefully vetted "summaries" that say almost nothing (indeed, they cover only about 23 pages of typed material, including non-substantive introduction in each). Those canned and sanitized summaries cannot and do not take the place of the contemporaneous interview notes.

- Hurd testified to the importance of the notes. He admitted that there were any number of factual conclusions or allegations in the Report that were based on statements purportedly made in the interviews but that were *not* reflected in the attorney-crafted, sanitized interview summaries. (Ex. C at 73-76). If such statements were important enough to be put in the Report, then certainly they must have been in the interview notes -- if in fact those statements were made. Only the consciously destroyed notes would tell.

- Jeffrey testified several days after Hurd that *all* material factual information from the interviews was included in the sanitized interview summaries. (Ex. B at 41-42). If true, then how (as Hurd testified) did factual statements or conclusions allegedly derived from the interviews be in the Report and yet cannot be tracked specifically and unequivocally to the interview summaries? If true, then why did the Report not cite specifically to each such interview summary as evidence to support each such conclusion? And if true, then why the direct conflict between Hurd's and Jeffrey's testimony regarding whether all material facts from the interviews were in the interview summaries?

- Still further questions are raised by the conflicting testimony regarding how the summaries were prepared. Hurd testified that he created them for himself, in the normal course after interviews, and finalized them on his own (save for one, which he had his associate Moffitt prepare). (Ex. C at 79). Jeffrey testified that Hurd's drafts of the summaries were first circulated to him and the summaries finalized only after he made comments. (Ex. B at 40-41). Jeffrey also admitted to then destroying any written notes or comments he made on the drafts. (Ex. B at 40-41). Hurd said nothing about first circulating drafts to Jeffrey and instead was clear that he prepared the summaries from his notes alone (because his notes were not usable). (Ex. C at 94) These conflicting stories just raise more questions about the accuracy or veracity of statements about the interviews, the content of (or omissions from) the interview summaries, and thus the critical importance of the destroyed interview notes.

Their is no doubt that interview and other notes were the best – if not the only – evidence of what was asked and may have been actually said in the interviews. Those notes also were the *only* potential evidence for the repeated, bald assertions that Jeffrey allegedly was an "active participant" in each interview.[8/]

Furthermore, the destroyed interview notes should also have been produced in the discovery ordered by this Court. That discovery called for production of "all documents" reviewed by the SLC in the course of its investigation. *See Sutherland*, 2007 WL 1954444, at *2. The interview notes admittedly were reviewed, and in deed relied upon, to prepare the sanitized interview summaries ultimately produced. Hurd also admitted the Report contained factual allegations, statements or conclusions from one or more of the interviews that are *not*

8/ Jeffrey testified that his participation in all of the interviews was "similar" to his participation in the interview of Martha and Dwight Jr. (Ex. B at 103). In the latter interview, however, Jeffrey asked at most two or three questions and took only a few scant notes that resulted in him turning only one page on his pad. That is hardly "active participation" in a lengthy interview with Plaintiff. In fact, the interview was led by SLC Counsel and appeared to be conducted for the sake of saying in the Report that it was done and little more (though the Report and so-called summary contain, notably, a number of misrepresentations about what was said as well as omitting other things that were said).

contained in the sanitized summaries but, *if true*, certainly must have been in the destroyed interview notes he reviewed during the investigation. Ex. C at 73-74.

By destroying their interview notes, Jeffrey and SLC Counsel have obstructed Martha from performing a complete and appropriate review of the Report and Motion. They also have obstructed this Court's ability to review and pass on the Report and Motion. The only proper and just result for those conscious actions is for the Motion to be denied. That conduct inherently taints the process carefully established in *Zapata*. It also calls into question the credibility and integrity of statements in the Report purportedly based upon the interviews. At a minimum, the Court should draw adverse inferences against the SLC on its Motion, which necessarily will require that the Motion be denied (given Jeffrey's burdens of proof). *See Mosel Vitec Corp.*, 162 F. Supp. at 313-314 (holding that counsel's destruction of draft opinion letters amounted to spoliation and was sanctionable by striking client's advice of counsel defense, though the court instead chose to instruct the jury to draw adverse inferences from counsel's destruction of the draft opinion letters).

## III. THE SLC FAILED TO PROVE, AS IT MUST, ITS INDEPENDENCE AND GOOD FAITH.

Under *Zapata*, the threshold inquiry for the Court is the SLC's independence and good faith. As explained in *Fuqua*, the standard is even higher where, as here, there is a single member SLC – the SLC member then must, "like Caesar's wife, be above reproach." *Fuqua*, 502 A.2d at 936. In other words, if there is *any* question about the SLC member's independence or good faith – even one that later might prove unfounded – then that member fails the independence and good faith requirement. Notably, Jeffrey and SLC Counsel always understood from the outset the higher standards imposed upon them since Jeffrey was a one-person SLC. (Ex. C at 19). They sought to avoid those higher standards by, early on, seeking a second

member for the SLC. Jeffrey first sought a compatriot, but when he failed SLC Counsel *went to the Defendants' litigation counsel at Skadden* to ask defendants Perry and Todd for a possible second member. (Ex. B at 30-32).

Substantial issues abound regarding Jeffrey's independence and good faith. First, there are the questions raised by Jeffrey's conscious destruction of the highly relevant and discoverable witness interview notes. Jeffrey's conscious destruction of that evidence has obstructed Martha and this Court from a proper and fair inquiry into the Report, its conclusions and determinations. All of these questions and issues are magnified because Jeffrey's charge was to investigate and create a record justifying his conclusions. Jeffrey acted in a way that he knew or certainly should have known would obstruct and frustrate the *Zapata* process he was specifically chosen to pursue and complete. His actions are thus flatly inconsistent with any requisite degree of "care, attention and sense of individual responsibility to the performance of one's duties" that the Nominal Defendants' Opening Brief cites as the so-called hallmarks for "proof" of the SLC's requisite independence. *See* OB at 21. The conscious destruction of interview notes by Jeffrey and SLC Counsel likewise rebuts the bald contention that Jeffrey's independence somehow is shown – much less "conclusively demonstrated" (*see* OB at 21-22) – by the girth of the Report, particularly since the Report lacks specific evidentiary citations to support the statements in it.

But there are still additional bases for questioning Jeffrey's independence. Among them is that Jeffrey had a prior relationship with at least one of the Defendants. While that point is acknowledged (*see* OB at 21), the problem is that Jeffrey has once again consciously failed to submit any evidence on the issue. So all that we know is that Jeffrey knew Mark socially while Mark and his wife lived in Little Rock, Arkansas, where Jeffrey still lives and works; and further

that Jeffrey did substantial accounting work for Mark's wife, preparing quarterly and other financial statements for her antique business over some unknown period of time. The extent of that work still remains a mystery – Mr. Sparks said at the Stay Hearing it was "like a $150.00 matter" (Ex. A at 32) and the Report and Motion baldly states it was "de minimis." (Report at 9 n.2; OB at 21). Neither Martha nor the Court can really know the truth because Jeffrey and SLC Counsel consciously failed to provide any evidence on the pre-existing personal and business relationships between Jeffrey and Mark and his wife. That was so despite: (1) the evidence was wholly within their power and control to adduce and submit; (2) this Court's admonishments to Mr. Sparks that it was relying upon his word that no potential conflicts of interest existed; and, (3) knowledge that Mr. Sparks improperly characterized the prior work as "like a $1150.00 matter" ten years ago.

Jeffrey's prior relationship contradicts the resolutions appointing him to the SLC, since those resolutions state that he had *no* personal or business relationship of any kind with any of the Defendants. Equally troubling was Jeffrey's "flip-flop" in sworn answers to interrogatories about communications between him and any of the Individual Defendants pre-dating his engagement for the SLC. The original sworn answer was unequivocal that there were no such communications; but then, weeks later on the evening before Jeffrey's deposition, an amended answer was made and served without prior notice that conveniently backed-off and stated instead that Jeffrey "did not recall" any such communications. (*See* Exs. D and E). Jeffrey likewise changed his sworn answer that he communicated with the Individual Defendants at the meeting where he was appointed.

There is also Jeffrey's very financial interest in this matter and resulting motive and bias in favor of the Defendants. That interest and motive derive from two sources: (1) his negotiated

compensation to be paid his $250 hourly rate, and (2) the purported retention of Jeffrey's firm to do purported "clerical work" at their hourly billing rates.[9/] Jeffrey's compensation is substantial. As of March 26, 2007, his time individually has resulted in fee billings of some $64,000. (Ex. F.) Who knows what has been billed or paid for his time subsequent thereto. Even after this Court ordered discovery on time and billing records for Jeffrey, JPMS and SLC Counsel, Jeffrey and SLC Counsel objected and withheld any such records after the date of the Report ostensibly because they were irrelevant. It is indisputable that those already substantial amounts have and continue to increase. Just like a retained expert or consultant whose job and personal financial motive is to provide the work and opinions for which he is being paid to produce, that interest and bias are increased because of the additional fees paid to Jeffrey's firm, JPMS. Those fees were represented -- both in the Report and when discovery into them was being opposed -- to be for so-called clerical work. Well, the fees from that "clerical work" resulted in another $25,000 in additional billings for Jeffrey and his firm.[10/] The total amount billed by Jeffrey and his firm as of March 26, 2007, was therefore over $85,000. And that is *not* of course even the full fee, since Jeffrey undoubtedly continues to bill for every hourly increment of time he spends on this engagement. Particularly for an accounting firm in Little Rock, Arkansas, there is little doubt

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9/ This contradicts the assertion that the SLC purportedly hired only independent advisors. *See* OB at 21. The retention of JPMS Cox, PLLC ("JPMS") is not even mentioned there and there is no question that JPMS is not independent.

10/ The substantial additional fees paid to JPMS also look like a *quid pro quo*. Jeffrey and SLC Counsel retained JPMS during the investigation but without Court approval and despite the obvious conflict. They have sought to minimize that issue by characterizing JPMS' work as "clerical" – but to the tune of some $25,000? Jeffrey and MNAT no doubt will claim that JPMS personnel spent substantial time reviewing documents to create spreadsheets regarding use of the company jet. The Report admits, however, that Jeffrey and Hurd were given a prepared, comprehensive spreadsheet of plane usage *at the start* by Chris Jones. *See* Report at 37-38. At best, conveniently eschewing efficiency, JPMS apparently went off and "recreated the wheel" by endeavoring to make their own similar spreadsheet (and maybe a few deviations). But all that "work" did nothing to advance the investigation, since it merely put all the same data in just a different format. It did of course also allow JPMS to create additional fees for JPMS and thus Jeffrey.

but that those large (and still increasing) fees provide Jeffrey with a substantial and unacceptable bias in favor of the Defendants who are approving the payments to Jeffrey and his firm.

Quite significantly, then, there is the secret financial relationship and further motive and bias provided by Jeffrey's *other billable work* for Dardanelle and Southwest. Jeffrey and SLC Counsel baldly claim that "apart from his status as a director, [Jeffrey] does not have a business relationship or other affiliations with the Companies or the Individual Defendants." OB at 21. False. Jeffrey admitted under oath that following the Report he had attended certain store inventories for which he billed Dardanelle at his normal JPMS hourly rate. (Ex. B at 35-36). Jeffrey also admitted that *during the investigation* he discussed with his counsel performing such billable work for Dardanelle and Southwest, and his counsel stated there would be no problem with such a future relationship and financial ties with the Defendants. (Ex. B at 37-38). Jeffrey and SLC Counsel failed to disclose that relationship in the Report or otherwise. They also *actively concealed* it despite the Court's admonitions at the Stay Hearing about disclosure of any potential conflicts of interest or independence issues. Jeffrey and SLC Counsel did so by opposing discovery into time and billing records post-dating the filing of the Report that they knew would have revealed that ongoing relationship, steadfastly arguing they all were "irrelevant" because the investigation was concluded. Those records were very relevant and both Jeffrey and SLC Counsel knew it.

In light of all the foregoing, the Court must conclude that Jeffrey has failed to carry his substantial evidentiary burden of proving his independence and good faith. There is nothing that Jeffrey or SLC Counsel credibly can say or submit at this time to overcome the substantial questions which exist on Jeffrey's independence. The submission on reply of any documents or "evidence" will merely confirm an unjustifiable lack of candor by Jeffrey and SLC Counsel. It

would also amount to a tacit admission of having failed to carry their heavy *Zapata* evidentiary burden on this fundamental issue, and raise issues of credibility. For these threshold reasons, then, the Motion must be denied. *See In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 931 (Del. Ch. 2003) (holding that SLC motion to terminate must be denied where facts regarding affiliations between SLC members and defendants were such as to call into question or at least raise material issues of fact regarding the independence and good faith of the SLC, regardless of the merits).

## IV. THE SLC FAILED TO DEMONSTRATE THAT THERE ARE NO MATERIAL ISSUES OF FACT REGARDING WHETHER ITS INVESTIGATION WAS REASONABLE OR WHETHER THERE ARE REASONABLE BASES FOR ITS CONCLUSIONS AND RESULTING DETERMINATION.

Jeffrey and SLC Counsel trumpet their "requests" for documents, the so-called "responses" and subsequent "review" of documents and witness interviews. Yet neither the Report nor the Motion offer anything substantive as support to conclude that the SLC has met its substantial burden of proof here. Neither the Report nor the Motion even describe or discuss in any detail or meaningful way what was requested *or* reviewed, much less what if anything was done to *actually* confirm that the production of documents from anyone were complete. And there most certainly is no *evidence* establishing that Jeffrey requested, received and reviewed all of the documents that were relevant to his investigation much less what was actually said in any witness interviews (since all the interview notes were knowingly destroyed).

The foregoing matters are not discussed in any detail for the same reasons that the Report and Motion do not cite evidence to support anything. The SLC does not want to be specific and support what it states. Doing so would force it to be honest, commit to a position and thus be open to potential criticism and rebuttal. But citing evidence is precisely what *Zapata* mandates. It is inconceivable that the vague and unsupported statements on these issues or any others can

suffice as proof of anything, much less that a thorough investigation was done and reasonable bases were adduced for the SLC's conclusions. Indeed, as discussed below, even the minimal evidence available to Martha reveals substantial flaws in the SLC's investigation and the purported bases for its conclusions.

### A. The SLC Failed To Conduct A Reasonable Investigation Or Reach Reasonable Conclusions Regarding The Self-dealing Employment Agreements.

One of the core claims asserted by Plaintiff is for remedies concerning the self-dealing employment agreements between (1) each of Dardanelle and Southwest and Perry, and (2) Dardanelle and Todd (the "Employment Agreements"). Each of Perry and Todd were officers and directors as well as parties to the Employment Agreements; and, in a choreographed *quid pro quo* of contemporaneous votes on February 11, 2004, they each voted to approve the Employment Agreements for themselves and for each other. (*See* Exs. G and H.) There is thus no question the Employment Agreements were self-dealing transactions, and the SLC does not try to contend seriously otherwise.

The SLC's so-called "investigation" of these claims was little more than interviewing Perry and Todd and then accepting at face value their self-serving statements that the Employment Agreements purported to just "memorialize[d]" alleged oral agreements put in place before Dwight Sr. died. (Report at 100; OB at 11). Perry and Todd's statements are totally biased. A point the SLC, of course, does not even mention much less consider.

Contradictory evidence all but leaps out of the record. Jeffrey and SLC Counsel had an employment agreement between Dardanelle and Dwight Sr. dated June 17, 2002 (the "Dwight Sr. Agreement"). (Ex. I). That agreement is materially different than the Employment Agreements on fundamental points. The Dwight Sr. Agreement notably did not contain: (1) provisions for the perquisites of free accounting services from Cimarron or use of the jet at

company expense; (2) provisions for any, much less two years of payments *in the event of termination for cause*; or, (3) provisions allowing for the right to compete with the Companies. *See id.* The Dwight Sr. Agreement in fact provided specifically for possible termination "for cause" and also included a "*non*-competition" provision. (*Id.* at ¶¶ 3, 6).

The SLC does not even mention the Dwight Sr. Agreement *except* to criticize Martha's good-faith belief and allegation that no written employment agreements existed before Perry and Todd's Employment Agreements. (*See* Report at 82, fn. 46.) But while Martha did not know otherwise, Jeffrey's attack confirms that he and his counsel were aware of and simply ignored the evidence of clear and material contradictions between the Dwight Sr. Agreement and the Employment Agreements. The sanitized witness summaries for Perry and Todd further confirm (by omission) that they were neither asked for nor provided any explanation for those material contradictions. It is incomprehensible how Dwight Sr. had an employment agreement providing less compensation and perquisites, prohibiting competition and providing for possible termination for cause, and yet Perry and Todd received substantially more, could freely compete with the Companies and got two full years of compensation if terminated for cause. The SLC's failure and refusal to acknowledge, investigate and even mention much less explain those contradictions are undeniable and inexcusable flaws in the purported "investigation" of these claims, and confirms the investigation was a whitewash.

Yet another glaring omission is the SLC's failure to investigate and consider the process (or really lack thereof) by which the Employment Agreements were approved. While admitting that "process" is a critical aspect of the applicable entire fairness analysis, the Report merely states that "the process was not robust" without further explanation. (*See* Report at 103.) The

reason is that the SLC did not want to acknowledge there was no process whatsoever, save for circulation and execution of the unanimous consents by the Defendants.

It is undisputed, for example, that the Employment Agreements were approved on the very same day that Perry and Todd *first* conveniently removed Martha without notice as a director of Southwest. Martha's secret removal is not even acknowledged by the SLC much less factored into its consideration of the process element. That is so despite that the removal clearly was done to allow the Employment Agreements to be "approved" without 50% of Dardanelle's stockholders knowing about them. The timing of her removal also is undeniable, compelling evidence that the Defendants knew they were committing actionable wrongdoing and were seeking to do so without interference. Even the Court emphasized Martha's removal and contemporaneous approval of the self-dealing Employment Agreements in ruling that the facts regarding the Employment Agreements supported that there were credible bases to believe that possible wrongdoing had occurred. *See Sutherland v. Dardanelle Timber, Co.*, No. Civ. A. 671-N, 2006 WL 1451531, at *11. (Del Ch. May 16, 2006).

Also absent, for example, is any acknowledgement of the material contradictions between Mark's purported statements during his interview (as reflected in the vetted Hurd summary) and Mark's sworn deposition testimony in the Kansas City books and records case.[11/] The interview summary suggests in conclusory fashion that Mark spoke with a number of people about the

11/ The Report states that Martha and her counsel suggested review of the Kansas City books and records litigation materials solely with respect to Mark's independence. (Report at 88 fn. 49). False. That statement is even impeached by Hurd's own summary from the interview of Martha, which contains no such statement. (*See* Ex. K). Martha and her counsel suggested the Kansas City discovery materials were relevant for a number of reasons, including the *evidence* provided by the sworn deposition testimony from Mark *and others* the SLC interviewed. The false statement is just a transparent attempt to provide cover for the SLC's conscious failure to consider in its investigation relevant materials suggested by Martha.

terms and considered what they said before approving the Employment Agreements; but his sworn deposition testimony many months earlier confirms that all he really did was to talk with Perry and accept what Perry told him about what was appropriate. (Ex. at J at 127-128). Jeffrey conveniently ignored that impeachment, however, as well as how it affected the credibility of things he was told by the biased Defendants about the Employment Agreements.

Given its perfunctory investigation regarding the Employment Agreements, it is not surprising that the SLC's conclusions are flawed and lack reasonable bases. For example, Jeffrey testified his conclusions were based on the analysis that the entire fairness standard did *not* apply to the Employment Agreements *as a whole*. (Ex. B at 212-213). Jeffrey admitted that, based upon counsel's advice, he should and did consider the "compensation" provisions as a "transaction" for the entire fairness analysis, apart from the balance of the Employment Agreements which somehow did not amount to a "transaction" for purposes of the entire fairness analysis. (*Id.* at 212). Under further questioning, Jeffrey finally admitted that he personally understood the approval of each of the Employment Agreements constituted a "transaction." (Ex. B at 213). Nonetheless, in reaching his conclusions he ignored his own beliefs and instead employed the artificial and nonexistent construct offered by his counsel that only the compensation portions of the Employment Agreements were subject to entire fairness review. *Id.*

Just as flawed are Jeffrey's conclusions that Martha's claims on the Employment Agreements are not "ripe" as to the provisions allowing unfettered competition with Dardanelle and Southwest and continued compensation even if terminated for cause. (Report at 111.) Jeffrey offered this as an explanation for the "unique" entire fairness he employed, as discussed immediately above. (Ex. B at 211-212.) The ripeness argument and conclusion are no more

credible than the contrived attempt to parse separate provisions of the Employment Agreements into separate "transactions" for purposes of an entire fairness analysis. *None* of the cases cited by Jeffrey and SLC Counsel are apposite; they virtually all address circumstances where a potential future action (*e.g.*, a vote) *had not yet occurred*. One case that involved a completed transaction actually contradicts the SLC's position. *In re Digex S'holders Litig.*, 789 A.2d 1176, 1206 (Del. Ch. 2000) (holding that claim was ripe where the vote complained of had already occurred). Here, the votes on the Employment Agreements had occurred and thus the Employment Agreements became (and Jeffrey understood them to be) binding obligations of the Companies. (Ex. B at 213) Whether Perry and Todd had been terminated by or competed intentionally with the Companies misses the point—those provisions were an integral part of the Employment Agreements and binding on the companies following the votes to approve the agreements. Notably, when pressed on the ripeness issue Jeffrey tellingly admitted that he and SLC Counsel discussed how "it gave them another argument" that the Employment Agreements were not wrongdoing. (Ex. B at 242). Jeffrey in effect admitted what should already be clear: he and his counsel were not conducting an investigation, they were looking for arguments to make against Martha's claims.[12]

Even more compelling evidence came, again, from Jeffrey's sworn testimony. Jeffrey grudgingly admitted, only after the questions were posed to him *repeatedly* because he refused to answer directly, that even he *did not believe* the competition and severance provisions were

12/ This point is likewise confirmed by a memo from Perry to Steve Scott forwarding documents regarding Dwight Sr. (Ex. S.) Perry's memo state, quite tellingly, that Bryan asked for any evidence of Dwight Sutherland, Sr.'s involvement in the Del Rio, Texas location." *See id.* Ironically, this same "evidence" that was forwarded by Perry was used and relied upon by the SLC in the Report. Yet, this purported evidence of Dwight, Sr.'s active involvement in the company just so happens to include a document signed on the date that he took his own life (which Jeffrey did not even know).

"reasonable." (Ex. B at 198-200). That sworn testimony, from a director of Dardanelle and Southwest, conclusively impeaches any conclusion that the Employment Agreements were entirely fair to the companies. Jeffrey nonetheless ignored his own opinions and omitted any discussion of them in the Report.

Ultimately, even the Report effectively admits the Employment Agreements were not entirely fair to the Companies because of at least the competition and severance provisions. It does so by stating that those provisions should be modified in the interests of "good corporate governance." Report at 112. If the SLC believed in good faith that those provisions were entirely fair to the Companies, however, then there of course was no reason that they needed to be changed. This conclusion was merely a careful way to avoid concluding in the Report that approval of the self-dealing Employment Agreements constituted meritorious claims for self dealing and breaches of fiduciary duties by the Defendants.[13/]

Martha's claims on the Employment Agreements have always had substantial merit. That is why Jeffrey and SLC Counsel consciously ignored the Dwight Sr. Agreement as well as Mark's sworn testimony in the Kansas City action. That is also why Jeffrey was convinced by his counsel to undertake an unnatural and false "construction" of the Employment Agreements so they could somehow segment their entire fairness analysis and disingenuously rely on an inapposite "ripeness" argument – all to avoid concluding that the Employment Agreements constituted meritorious, actionable breaches of fiduciary duty. Jeffrey's approach is a quite

13/ Jeffrey testified that the Employment Agreements have been amended to address his concerns about the competition and severance provisions. (*See* Ex. B at 202). For reasons Jeffrey could not explain, those amendments were not made for months following his Report. (*Id.*) There is no doubt that those "amendments" (whatever they are) were made solely because of this litigation and the recognition by Jeffrey of the merit in Martha's claims that the Employment Agreements were not entirely fair and constituted actionable wrongdoing.

obvious artifice constructed to achieve the Defendants' goal of having their SLC find that they committed no wrongdoing. The SLC's conclusion regarding the claims on the Employment Agreements should be rejected as the sham that it is.

### B. The SLC Failed To Conduct A Reasonable Investigation Or Reach Reasonable Conclusions Regarding The Cimarron Accounting Expenses.

Another core claim was that Dardanelle and Southwest paid for accounting and related services provided by Cimarron to, or for the direct benefit of, one or more of the Individual Defendants. The Court will recall that Cimarron is an affiliate of Dardanelle (which owns 25% of Cimarron) and provided accounting, clerical and administrative services to Dardanelle, Southwest and other Sutherland family companies. *See also* Report at 16. Cimarron did so at a cost, however, and indeed submitted bills and then received payment from Dardanelle, Southwest and others for Cimarron's services.

Martha alleged, for example, that Dardanelle and Southwest "absorbed" and thus paid the quite substantial costs and expenses for accounting or other services by Cimarron related to Choctaw Racing ("Choctaw"). Choctaw was owned by Dwight Sr. and Perry before Dwight Sr.'s death, and after Dwight Sr.'s death was owned by Perry alone. All Cimarron services for Choctaw thus were for Perry's direct benefit, and provided with his full knowledge and consent.[14/] Among those costs were substantial services related to an IRS audit of Choctaw which stemmed from 2000 through at least 2004.

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14/ The SLC apparently seeks to try and minimize the benefits Perry received for such services while Dwight Sr. was alive. It does so by characterizing Perry's ownership interest in Choctaw as minimal, based upon its review of K-1 Statements. (Report at 56 n.35) As Jeffrey admitted, however, the information from the K-1 Statements does not establish Perry's actual ownership interest in Choctaw during the period before Dwight Sr.'s death. (Ex. B at 167-168) Jeffrey surely could have ascertained the accurate information had he wanted to do so, so the key question is why did he instead rely on anecdotal information and speculate about Perry's ownership interest? Furthermore, the focus on Perry's ownership interest in Choctaw misses the

The Motion argues these claims have no merit because "[t]he SLC determined that Choctaw has been billed for the accounting work performed by Cimarron." OB at 9. (citing Report at 53-54). That statement is false. The SLC apparently relies for support on the handful of bills for relatively minor amounts that were directed to Choctaw and then paid by it over the last five or so years. The SLC ignores, however, the evidence that there were other Cimarron services for Choctaw that were paid for, or "absorbed," by Dardanelle and Southwest, including for the substantial IRS audit of Choctaw.

The SLC's investigation on these claims was intentionally superficial. The SLC claimed for example that Martha stated the Cimarron services of which she complained were provided by just one person, Connie Campfield. (*See* Report at 56.) That is also false. Martha never made any such claim or allegation.[15/] But that mischaracterization allowed Jeffrey and his counsel to limit artificially the purported investigation on this issue by focusing almost exclusively on Ms. Campfield. She is a relatively junior Cimarron person who certainly would be guarded (to say the least) of saying anything that could lead to personal liability for Perry or Mark (who represent, respectively, the operational heads of two of the four Sutherland family branches that own 25% each, and thus control, Cimarron). The myopic focus on Ms. Campfield was therefore a fundamental flaw in the SLC's investigation of this claim.

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point entirely – whether it was .0001% or 99% while Dwight Sr. was alive, using or knowingly allowing company funds to be used to pay Choctaw expenses is a breach of fiduciary duty by Perry for which Perry is personally liable.

15/ Also false is the statement that Martha claimed Ms. Campfield spent all of her time on Choctaw matters. *See* Report at 51. Hurd's own summary of the interview with Martha impeaches these purported assertions by omission, since there are no such "statements" reflected in that interview summary. *See* Ex. K.

Where the SLC needed to focus is on the undisputed evidence that Dardanelle and Southwest historically had "absorbed" – and thus paid for – accounting services for Choctaw and other entities for years. That evidence was provided conclusively by the March 17, 2004 letter from David Dotson (a senior Cimarron accountant) that announced a "change" from the way Cimarron services were to be billed and paid for entities including Choctaw relating to Dwight Sr.'s family. (Ex. L.) That letter was sent just days after Martha had made her first informal request for company books and records, evidencing an attempt to begin a cover-up of the substantial payments Dardanelle and Southwest previously had been making to Cimarron for services to Choctaw and other entities. The SLC's explanation of that letter merely repeats the story proffered at the Defendants' instance in the Section 220 action – namely, it was an attempt to make a "more fair" allocation of payments for accounting services between Choctaw and other Dwight Sr. family entities by basing them on "actual charges" rather than "estimated charges." (Report at 52.) What the SLC ignored, and indeed failed to investigate, is the admission in that letter that charges for Choctaw and other entities *admittedly* had been "absorbed" and thus paid historically by Dardanelle and Southwest. That is precisely what Martha alleged.

The SLC also simply failed to investigate the substantial amount, and cost, of the Cimarron services to Choctaw in general and for the IRS audit in particular. Regarding the former, the SLC merely relied upon a general statement from Ms. Campfield that she did work for Choctaw but also spent time on other matters. (Ex. at M.) That proves nothing other than to knock down the SLC's straw man (and false) argument, *i.e.*, that Martha's claim was Ms. Campfield spent all of her time on Choctaw matters. Notably absent from that interview summary and the Report is any meaningful discussion or investigation regarding the *amount* of work Ms. Campfield did in the normal course on Choctaw matters, historically and through the

present. (*Id.*) The SLC's failure to question Ms. Campfield in detail on such matters and to report all those details was inexplicable. What that did, though, was to allow the SLC to ignore what Ms. Campfield would have said – which is that historically she did substantial (though not exclusive) work for Choctaw on a routine basis. She did so because the Choctaw horseracing operation generated a quite substantial amount of paperwork in the ordinary course, including ownership (*e.g.*, purchases and sales), operations (*e.g.*, racing and distributions), and maintenance (*e.g.*, boarding, feeding, etc.), with resulting substantial recordkeeping and bookkeeping for *each* of the many individual horses that were part of that operation over the years.[16/] The failure to ask Ms. Campfield about such matters meant that the SLC failed to obtain information that would support Martha's claims that Dardanelle and Southwest had – as the March 2004 Dotson letter confirmed – "absorbed" the cost of Cimarron services that were not reflected in the small periodic bills that Choctaw was sent and paid. The SLC similarly failed to investigate the other Cimarron personnel performed services related to Choctaw, much less the extent of those services.

The SLC simply ignored still other critical evidence regarding the amount of time (in hours and billed amounts) spent by Cimarron personnel on Choctaw matters. The Report relies exclusively upon Ms. Campfield's alleged statements that her time sheets purportedly were kept in a way that would not reflect a determination of her time spent on Choctaw versus other matters. *See* Report at 55; Ex. M. Yet, the SLC incredibly did not obtain and review Ms.

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16/ Discovery from the SLC shows that Choctaw purchased some 50 new race horses over the last three or so years before Dwight Sr. died, which would be in addition to the many horses already owned prior to those purchases. (Ex. N.) The amount of administrative work associated with such a large number of thoroughbred race horses by definition was substantial and time-consuming, as Ms. Campfield would have confirmed had she been asked.

Campfield's time sheets or records. More importantly, the SLC did not obtain and review *any* Cimarron time sheets or records for any other Cimarron personnel who performed work for Choctaw, Dardanelle, or Southwest. If the SLC had been properly motivated to investigate and discover the truth, it would have investigated Cimarron's timekeeping procedures, its recordkeeping, and its billing records and procedures. All of these are directly relevant here, as Jeffrey, an accountant, obviously knew. The actual time sheets or records are critical evidence particularly given Ms. Campfield's statements.

No reasonable and good faith investigation of these claims could fail to inquire into all of these quite relevant and material matters. That is particularly so when the undisputed evidence is that Cimarron kept detailed time records reflecting actual time spent by Cimarron personnel; and from those records bills were generated and sent for payment. The Report itself acknowledges the point, but does not explain the patent inconsistency with the alleged inability to find records reflecting actual time spent by Cimarron on all Choctaw matters. The Report likewise fails to explain why the SLC did not obtain time records relating to the Cimarron services and time billed to Dardanelle and Southwest. A review of those records could also have shown whether services for Choctaw had nonetheless been billed to and paid (or "absorbed") by Dardanelle or Southwest.

We asked each of Hurd and Jeffrey in their depositions where the Cimarron time records were. Their testimony merely confirmed that the investigation on these claims was unreasonable:

- Hurd denied that the time records were requested, testifying that "we did not conclude that we needed copies of the Cimarron time sheets." (Ex. C at 132-133). When pressed, Hurd became defensive and evasive and rather than just admitting they never asked for or reviewed Cimarron's time records, he retreated into the safe-haven of "I don't recall" what we did. (*See id.*) This was elementary discovery on claims like these, particularly given Ms. Campfield's alleged

statements. The SLC did not ask much less press for production of the relevant time records because they did not want to know what they might show.

- Jeffrey testified, in stark contrast to Hurd, that they purportedly *did ask* for the Cimarron time records. (Ex. B at 164). Jeffrey further testified that they allegedly were told – by whom though, we do not know because Jeffrey conveniently did not say – that those records allegedly were "not available" because of "a new computer system." *Id.* Yet, neither Jeffrey's testimony nor anything else acknowledges any consideration of or follow-up on that defense.

This testimony raises more substantial questions. How can Hurd and Jeffrey have such different recollections on this fundamental topic? The sworn testimony from each of them impeaches the other. None of the sanitized Hurd interview summaries contain any reference to any request for the time records much less response like "they do not exist any more." Such a material point surely would have been documented by Hurd *if* they in fact been requested as Jeffrey swore under oath. The Hurd summary of David Dotson's interview actually suggests that detailed daily time sheets are kept by hand **and** still exist. (*See* Ex. O at 1)

Significantly, those summaries also reflect no meaningful inquiry by Jeffrey or SLC Counsel into, much less explanation of, the timekeeping procedures employed by any and all Cimarron personnel (and not just Ms. Campfield) during the relevant time. Jeffrey and SLC Counsel certainly should – and really must – have investigated vigorously that claim with respect to the time sheets and records and timekeeping procedures. They also should have inquired in detail of other Cimarron personnel besides Ms. Campfield on *all these* topics, but did not (given the omission of any indications from the Hurd interview summaries). That such matters were not addressed is incredible, and undercuts completely the so-called investigation on this claim. *See Electra Inv. Trust PLC v. Crews*, No. 15890, 1999 WL 135239, at *5 (Del Ch. Feb. 24, 1999) (holding that SLC's failure to contact accounting firm to see why it would not issue an opinion on company financial statements was "a fundamental and simple inquiry [that] constitute[d] a failure to pursue adequately and independently the facts necessary to its investigation.").

The amounts involved were no doubt substantial. The amount of work associated with the routine Choctaw day-to-day administrative matters is discussed briefly above. There is also the IRS audit of Choctaw that Martha did not learn about until Dwight Sr. died in October 2003. That audit lasted at least four or so years and involved several years worth of tax returns involving Choctaw.[17/] An audit such as that neither does, nor did, cost a mere $60,000 or so as the SLC implies (for the total of the attorney and outside accountant bills). (*See* Report at 56.) The SLC's reference to those bills is pure misdirection. It is intended to distract the Court from the fact that the SLC did *not* investigate reasonably the amount of time spent on the audit by Cimarron personnel, the billed cost of that time and who ultimately paid those substantial bills from Cimarron. The SLC's misdirection, and the length of the audit, leads only to the conclusions that there were substantial fees and costs for time by Cimarron personnel spent defending the IRS audit for Choctaw. Together with the SLC's conscious failure to investigate Cimarron time and billing records related to work on the Choctaw IRS audit or other matters, the only conclusion is that all of those fees and costs were "absorbed" and thus paid for by Dardanelle and Southwest. There certainly are not reasonable bases for any conclusions to the contrary, which is what the SLC states and asks this Court to accept. Accordingly, the Court should reject the SLC's conclusions that these claims lack merit and thus should not be pursued.

### C. The SLC Failed To Conduct A Reasonable Investigation Or Reach Reasonable Conclusions Regarding The Exorbitant Costs For The Section 220 Action Defense.

17/ Jeffrey testified that it was "beyond the scope" of his work to understand the length and extent of that IRS audit. (Ex. B at 57-58) Why he thought so is a mystery, particularly since the audit was central in the allegations of the complaint. The reality is that Jeffrey needed only to look at the bills from the attorneys and outside accountants, referenced in the Report, to see the substantial time period covered by the audit.

Another of Martha's core claims was that the Individual Defendants committed waste and breached their fiduciary duties by causing Dardanelle to expend almost $750,000 to defend against Martha's Section 220 action. This Court is familiar with the Section 220 action, and indeed has commented several times about the substantial amounts spent in its "futile" defense. The SLC's investigation and conclusions on this claim were not reasonable for any one or more of several key reasons.

Here again, the SLC Report reads as if it just interviewed Perry and Todd and accepted what they said as true without any further thought or inquiry. The SLC added nothing by simply accepting as true what Robert Saunders had to say since he is of course biased, both individually and professionally. None of them could be expected to say anything that might call into question the amount of fees charged to Dardanelle, the reasonableness of the strategy they pursued, or the bases of the "improper purpose" defense (much less the reasonableness of pursuing it at exorbitant costs to Dardanelle). The statements from those witnesses, however, formed the crux of the SLC's "investigation" of this action.

Notably missing from the SLC's investigation or Report is any discussion of evidence the SLC sought, received or considered to probe the veracity of those witnesses self-serving statements. For example, the SLC neither received nor reviewed any substantive correspondence (letters or emails) between Skadden and Dardanelle or the Defendants regarding the Section 220 action. There was nothing regarding defense strategy, likelihood of success, or potential costs to defend, whether initially or at any time throughout the course of the Section 220 action. Those documents were essential to understand what the real motives and goals were to the costly defense, and whether those motives and goals were Dardanelle's as opposed to the Defendants. In correspondence to the SLC regarding what documents to obtain, Martha specifically identified

such documents as critical to the SLC's investigation of this claim. (Ex. P.) It is inconceivable that no such substantive correspondence existed during the two or so years the Section 220 action was pending. The SLC's failure to receive, review and consider such correspondence from Skadden, Dardanelle or the Individual Defendants is a fundamental flaw that permeates its investigation and conclusions on this claim.

Jeffrey had little to offer when asked at his deposition about the reasonableness of Dardanelle expending $750,000 in defense costs. He testified that he and his counsel discussed the defense fees and costs and "we all recognize that they were high." (Ex. B at 179) He admitted that his counsel never told him what their opinion was regarding the reasonableness of the defense fees and costs and Dardanelle's expenditure of them (*Id*. at 180), though that would seem to be a basic and important inquiry for an SLC to assess this claim. He initially resisted giving his own opinion and instead testified repeatedly that he "understands how" the attorney's fees got so high in defending the Section 220 action. (Ex. B at 182) When pressed for his opinion, Jeffrey finally testified that he thought the defense fees and costs were reasonable, because he "understands how" those fees got to be so high. (*Id*.) But that intentionally misses the point, as does his conclusion that the Defendants purportedly apparently believed that they had a good faith basis for the "improper purpose" defense that they asserted. (*See* Report at 67) There is always going to be a basis "for understanding" how fees and costs got to where they were, and, a defendant will always state that it had a good faith belief in the defenses it asserted.

What Jeffrey should have, but altogether failed to investigate are, for example, the following matters among others:

- How or why directors of Dardanelle and Southwest could possibly justify under any circumstances such extraordinary expenditures when they claimed all along, and steadfastly, that there was no actionable wrongdoing and that the documents Martha requested would prove that to be true;

- How or why directors of Dardanelle or Southwest could possibly justify under any circumstances such extraordinary expenditures when they knew and admitted all along that the documents Martha requested were not burdensome or therefore expensive to produce;

- How or why the cost for asserting the "improper purpose" defense, even if that defense was completely successful, could be justified under any circumstances when the cost of just producing the requested documents was *exponentially less* than the fees and costs to defend; and

- How or why the defense fees and costs could be justified given the foregoing and the tenuous financial conditions of the Companies.

Rather than address these obviously important points, Jeffrey simply turned a blind eye in his investigation of this claim to what those extraordinary and unnecessary defense costs meant to the Companies. Martha made detailed allegations in her complaint about the deteriorating financial condition of Dardanelle and Southwest over the last several years, including the substantial net losses that each had suffered as well as the consistently increasing debt the companies had incurred at the direction of the Defendants. Jeffrey did not deny those allegations or seek to credibly contradict them in the Report because he could not do so.[18/] The $750,000 in defense costs thus contributed only to worsen the weak financial conditions of the companies and thus injure Dardanelle's stockholders. The Report is conspicuously silent on this point as are the interview summaries for Perry, Todd and Robert Saunders.

The SLC also ignored that Dardanelle obtained no material benefit from those extraordinary expenditures. Jeffrey and Hurd testified there were two benefits to Dardanelle: it

18/ The Report did cite to the Companies' minimal "increase in earnings from yard operations" for the last several years and suggest weakly that those figures rebutted Martha's allegations about the poor and deteriorating financial condition of the companies over the last several years. *See* Report at 21. The income from yard operations alone ignores the other quite substantial expenses from company operations that have and continue to result in the Companies' net operational losses for the last several years -- including for example "miscellaneous expenses," "travel and entertainment expenses" and "interest expenses" from their substantial and increasing debt. When asked about the cited portion of the Report, Jeffrey retreated from the written statements about what those figures meant and testified instead that the chart was only intended to show that "there are prospects for increased revenue." (Ex. B at 93.)

succeeded in limiting somewhat the amount of documents produced to Martha and it exercised its statutory right to defend against an allegedly improper demand. (Ex. B at 186; Ex. C at 221-222) But neither was a meaningful benefit to Dardanelle. Since *all* of the documents Martha demanded in the Section 220 action admittedly were not burdensome to produce, Dardanelle had nothing to gain and only $750,000 or more to lose by litigating for two years to "reduce somewhat" the amount of documents it might produce. And the claim that Dardanelle had a right to defend misses the point entirely – Dardanelle had nothing meaningful to gain by exercising that right. Given the SLC's assertions, Dardanelle, the corporation, stood to gain *only* by avoiding the substantial time and expense in defending the Section 220 action and making full disclosure to Martha in response to *either* her informal demands for records in March 2004 or her formal demand for records in July 2004. The only ones who stood to gain anything by refusing disclosure and causing Dardanelle to defend at such extraordinary costs were the Defendants for their personal but unknown motives.

These points underscore in compelling fashion the flaws in the SLC's application of the law to the facts in reaching the conclusions that Martha's waste and breach of fiduciary duty claims relating to the Section 220 action lacked merit. With respect to the latter claims, they have substantial merit that is even under the business judgment analysis that was the sole but, Martha submits improper, legal standard applied by the SLC. (*See* Ex. B at 210) The foregoing discussion should demonstrate that the Defendants were interested for purely personal reasons and motives in the decision to cause Dardanelle to defend the section 220 action, such that the proper legal analysis is entire fairness. The SLC failed even to consider those claims under the entire fairness standard, however. The evidence suggests only that the breach of fiduciary duty claims would prevail under that standard.

### D. The SLC Failed To Conduct A Reasonable Investigation Or Reach Reasonable Conclusions Regarding The Payment Of Personal Expenses By The Companies.

The SLC's investigation of and conclusions regarding the payment of personal expenses by the Companies were not only unreasonable, but illustrates compellingly the superficial nature of its approach throughout the investigation and a troubling lack of candor in the Report. In effect, what the SLC did was to focus on the handful of specific expenses that Martha and Dwight Jr. could articulate as potentially problematic and then focus on those matters. The SLC conveniently ignored that Martha and Dwight Jr. necessarily have extremely limited bases for knowing about specific personal expenses paid for by the companies because of their limited access to company accounting and related books and records. Jeffrey, on the other hand, had full access to those specific records and despite that access and his charge to perform a reasonable investigation, he failed reasonably to do so.

Martha's claims that personal expenses were paid at the expense of Dardanelle or Southwest. Jeffrey admitted in his deposition that "he knew it was the usual and customary practice for the company to pay bills on certain people's behalf and then to receive a reimbursement or to put things in a loan account temporarily that got paid back." (Jeffrey Dep at 229) This critical admission of the "usual and customary practice" for personal expenses appears nowhere in the Report. That was so despite that Jeffrey admitted that the foundation of Martha's claims on personal expenses was true, namely, that personal expenses were run through and paid by the Companies on a routine basis! *Id.* While he went on to testify that he also "knew" the expenses were allegedly reimbursed, Jeffrey offered no support for that conclusion in his testimony or the Report. *Id.*

The Report states that Jeffrey "reviewed the companies general ledgers" in an attempt to suggest that he did a reasonable investigation regarding the payment of personal expenses by the

Companies. (Report at 14.) The problem is that the Report overstates, substantially, what Jeffrey did. Any fair reading of that statement in the Report suggests that Jeffrey, an accountant, did a reasonably comprehensive review of the general ledgers for all of the years in question. His sworn deposition testimony painted a quite different picture, however.

Jeffrey admitted that his "review of the general ledgers" came late in the investigation, and only after the interview with Martha when it was stressed that such a review was important. (Ex. B at 59-60.) How or why Jeffrey did not determine to review the general ledgers and related back-up documents prior to that – particularly given his admitted knowledge of the custom and practice regarding personal expenses – is not explained in the Report. Jeffrey admitted that he performed his review in a single day over the course of only about five hours (Ex. B at 62-63); he does not recall what general ledgers he reviewed or even the year or years he reviewed (*id*. at 46); part of his "review" time included speaking with Cimarron personnel generally about the ledgers and then later about a report that he wanted them to generate (*id*. at 49); and, he requested and reviewed back-up documentation for *only about 10 entries* from whatever general ledgers he reviewed. (*Id*. at 55-56) Jeffrey further admitted that he does not know whether just those 10 entries constituted an appropriate or statistically significant sampling of the general ledgers for purposes of any analysis. (*Id*.) Jeffrey did not even take notes to document what he reviewed. (*Id*. at 47)

Jeffrey's sworn testimony paints a markedly different picture than what was carefully written into the Report about his purported "review of the general ledgers." Martha submits that Jeffrey's testimony actually impeaches the statements on these points in his Report. Jeffrey's testimony at a minimum reflects a troubling lack of candor in the Report which calls the Report into question.

Jeffrey's testimony establishes that he failed to investigate reasonably Martha's claims regarding personal expenses paid for at company expense. Jeffrey plainly has no basis for even knowing the amounts involved in that admitted "custom and practice." He also has no basis for concluding that the "usual and customary practice" resulted in personal expenses being repaid by anyone to the Companies. Indeed, his "investigation" on personal expenses inexplicably missed two payments totally $95,000 by Dardanelle to a Leo King for work done on Perry's home. (*See* Ex. B at 229; App Ex. Q) Jeffrey testified that he did not recall ever seeing those documents despite that they were produced in the discovery from the SLC. (Ex. B at 228) Quite significantly, those very same documents rebut conclusively the conclusion in the Report that Perry received no such benefits at company expense regarding his home, except for the right to purchase materials at cost. (*See* Report at 118)[19/]

The foregoing leaves no doubt that the SLC failed to investigate reasonably or adduce reasonable bases for any conclusions that there is no merit in Martha's claims about personal expenses paid for by the companies. That is particularly so given the many hundreds of thousands of dollars reflected for just the "miscellaneous" or "travel, meals and entertainment" expenses on the Dardanelle and Southwest financials during the years covered by the SLC's investigation, which are easy places for such personal expenses to categorized. The SLC's conclusions regarding these claims therefore must be rejected.

### E. The SLC Failed To Conduct A Reasonable Investigation Or Reach

19/ Those documents also rebut Jeffrey's attempt to cut short his "review" of general ledger's by having a Cimarron employee run a report of all checks made payable to Perry, based on Perry's "vendor number." (Ex. B at 50-51) Jeffrey admitted that report would not have reflected the payments made by the Companies on Perry's behalf to Leo King, because the report he asked for would not show such payments to third parties. (*Id.*) Yet, such payments to third parties of Defendants' personal expenses – like the Leo King payments – is at the core of Martha's claims about personal expenses.

**Reasonable Conclusions Regarding The Ownership, Use And Costs Of The Private Jet.**

Martha also alleged claims for breaches of fiduciary duty against the Defendants arising out the ownership, use and substantial related costs associated with Southwest's ownership of an interest in a private jet. Jeffrey's investigation and conclusions regarding these claims resemble how he approached and addressed Martha's claims about personal expenses paid for by the companies. The Report includes a variety of conclusory assertions intended to create the appearance that these claims lack merit. But following discovery, the SLC's assertions lack meaningful support.

As a threshold matter, for example, there is the question of whether Dardanelle and Southwest should even own the jet. The companies paid $1.88 million for Southwest's 50% ownership interest in the current jet (the "Jet" or "CJ 1"). (Report at 24) Jeffrey admitted in his deposition that the CJ 1 is a "significant asset" of the companies and that its ownership is therefore something that "needs to be monitored" and "assessed" on a constant basis. (Ex. B at 250) Missing from the Report, however, is any evidence to support the assertion that the Jet properly should ever have been purchased in the first place, much less that Southwest should have continued to own it through and including the present.

The Report asserts that ownership of the Jet is supported by the "executive time" that is saved in connection with using it to travel to various store locations. (Report at 46) Jeffrey admitted in his deposition, however, that he performed no analyses regarding those matters. (Ex. B at 135) He further admitted that he had no information with which to assess the amount of business use that was contemplated for the Jet when it was purchased. (*Id*. at 144) There was, however, undisputed evidence that the jet Southwest owned immediately prior to its purchase of the CJ 1 was used a mere 2-3% of the time for trips related to Southwest's retail

lumber business in contrast to substantial use for personal trips. Report at 29. The evidence thus supported only the conclusion that when the CJ 1 was purchased there was no meaningful business, as opposed to personal motivation and purpose for doing so. The Report simply glosses over or ignores these points. It does not even offer any explanation much less evidence to support why Southwest even purchased its interest in the CJ 1.

Despite admitting that the ownership of the Jet was something to be monitored and assessed on an ongoing basis, Jeffrey failed to perform a reasonable investigation on those issues. Jeffrey admitted that he performed no analyses of the business versus personal use of the Jet in the time period immediately following its purchase despite that such analyses could have been relevant. (Ex. B at 147-148) He likewise admitted that he performed no such analyses for subsequent time periods despite that those analyses would have been relevant. (*Id*.) As the justification for continued ownership, the Report states merely that the business usage of the Jet by Dardanelle and Southwest has exceeded the personal usage based upon an analysis of the "aggregate miles" attributable for each since the Jet was purchased. (Report at 105) Jeffrey admitted, however, that his analysis did not track the changes in the amount of purported business versus personal usage over time and did not address whether the business usage had increased materially subsequent to Martha's requests from company records—despite that such analyses would have been relevant to his investigation and conclusions. (Ex. B at 136-137). Based upon the SLC's documents and its own standards for assessing personal versus business use, the number of store visits and thus also mileage flown for "business" appear to have increased substantially after Martha made her informal request for documents and through 2006. The number of store visits appear to have gone up from 22 in 2004 to 34 in 2006 and the related miles from approximately 15,000 in 2004 to 22,300 in 2006. Those increases were no doubt

intended to, and did of course alter dramatically the kind of superficial "aggregate miles" analysis done by the SLC. The SLC should have, but instead failed to investigate and consider these material points.

The SLC also failed to investigate reasonably and consider the quite substantial costs to Dardanelle and Southwest from the ownership and use of the CJ 1. Jeffrey sought to minimize the costs to the companies by echoing the Report and focusing on the "net cash flow" line item on the companies' financials (s*ee* Report at 48; Ex. B at 187), which conveniently was the same argument that the Individual Defendants made in the Section 220 action. Jeffrey ultimately admitted that he knew of the flaws in that approach.

Jeffrey admitted, for example, that he did not even know how Southwest paid the initial $1.88 million purchase price for the CJ 1. (Ex. B at 72-73) Conceding that the Companies were in a net borrowing position -- which means they needed to borrow funds on a regular basis to continue operations -- Jeffrey acknowledged that there was inherently an additional cost to the companies (which he did not try to quantify) from the interest associated with either borrowing to pay for the CJ 1 or using cash that required borrowing for other company operations. (*Id*. at 73-75) Jeffrey likewise failed to consider that the net borrowing position of the Companies has worsened over time, with debts as of 2006 totaling some $14 million and a concomitantly higher "cost of funds" to the companies from owning the CJ 1. (*See* Ex. B at 73-74)

Jeffrey also ignored that the "net cash flow" line item admittedly did not include substantial additional costs to the Companies for ownership of the CJ 1. (Ex. B at 72) Those included a variety of carrying costs, maintenance costs, depreciation and other expenses. (*Id*.) Jeffrey both admitted that those costs were not included in the "net cash flow" line item and that *he knew* they were not included. (*Id*. at 71-72) Jeffrey thus proffered the identical argument

made by the Defendants in the Section 220 action, knowing as they did that the "net cash flow" line item did not include all of the costs associated with the CJ 1.

There were also the less obvious costs to the companies from use of the CJ 1. Jeffrey admitted for example that Southwest and Dardanelle in effect "subsidized" *every* use of the CJ 1, whether that use was by Perry or Todd or anyone else. (Ex. B at 128) The reason is that the amounts paid for someone to use the CJ 1 was not the actual cost for operating it (*Id.*); rather, the amount billed and paid for the use was substantially less than the actual operating costs for the flight (because of the way that FAA regulations limit the billings under the Timeshare Agreement). When Perry used the CJ 1 for business, the Companies paid the billed rate under the Timeshare Agreement but then also absorbed the unbilled costs for the "subsidy"; and the same was true when Perry would use the CJ 1 for personal reasons, though additional costs were incurred for the paycheck "gross-ups" to cover the amount of taxable income attributed for that personal use. (*See* Ex. B at 154; Report at 82, 102)

In short, Jeffrey does not know what the costs are, or have been, to the Companies from the ownership and use of the CJ 1. He does not know because he did not reasonably investigate them, particularly given his admissions regarding all of the foregoing. Jeffrey does however know that the "net cash flow" line item he and the Defendants have argued equals the "costs" to the companies for the CJ 1 in any given year, despite the SLC's and the Defendants' assertion that it does. These known flaws permeate all of Jeffrey's analyses regarding the CJ 1 and all of the related conclusions. That Jeffrey nonetheless proffered that "net cash flow" line item as something materially different than what it represents raises yet further questions about his candor to this Court and good faith in the investigation.

Had he made a reasonable effort to investigate, Jeffrey would readily have found that the information he needed to assess the real costs to Southwest was available to him. For example, Sutherland Lumber & Home Center produced its own breakdown of its costs for ownership of its half of the CJ 1. (*See* Ex. R) That total for 2001 through 2006 was approximately $1.9 million. (*Id*.) That amount for some reason apparently did not take into account Home Center's 50% of the pilot's salary, which would increase the total expense to well over $2 million. That base amount of costs would be the same for Southwest's 50% interest in the CJ 1, and would amount to a minimum average yearly cost of approximately $400,000 per year. But the total costs for Southwest and Dardanelle actually would exceed that $400,000 yearly average because of: (i) the salary "gross ups" historically given when personal use resulted in income being attributed to the user of the CJ 1 (s*ee* Report at 82; Ex. B at 102); and, (ii) the substantial amounts that Southwest and Dardanelle paid to Home Center for use of the CJ 1 during the time it has been owned. (*See* Report at 38) The average yearly cost to Dardanelle and Southwest easily approached $500,000 for the last five years. That is a far cry from the SLC's absurd claim that the costs to Southwest and Dardanelle are equal to the "net cash flow" line item on the financials – which would mean the costs for 2005 totaled only $2,300!

The foregoing establishes that Martha's claims relating to the purchase, continued ownership and use of the CJ 1 are quite substantial. That is so despite the SLC's attempt to characterize the amounts at issue as relatively minor and thus a reasonable expense – but without a meaningful or good faith investigation. The SLC's conclusion that these claims lack merit should be rejected for these reasons alone, regardless of the standard applied to review these claims. The SLC's conclusion should also be rejected because of the SLC's flawed application of the law to the facts. Despite the obvious personal interests in the decisions to purchase and

thereafter continue to own the CJ 1 and use it for personal reasons at company expense, Jeffrey refused to consider these claims under the entire fairness standard. (*See* Ex. B at 234) This is yet another an entire fairness claim in this case, however, given the nature of the claims and the supporting facts.

### F. The SLC Failed To Conduct A Reasonable Investigation Or Reach Reasonable Conclusions Regarding The Statute Of Limitations Issues.

The Motion asserts that a substantial basis for the SLC's conclusions involves a three year statute of limitations generally applicable to Martha's claims. OB at 10; Report at 95-97. The Report does reference various principles of tolling but concludes that they would be inapplicable. *See id.* The SLC apparently failed, however, to consider whether a statute of limitations would be tolled by virtue of the Section 220 action and the Defendants' staunch defense of it. (*See* Report at 95-97.)

Delaware law does, however, recognize that the statute of limitations will toll for the time during which a Section 220 action pended. *See Technicorp Int'l II, Inc. v. Johnston*, No. Civ. A. 15084, 2000 WL 713750 (Del. Ch. 2000); *Orloff v. Schulman*, No. Civ. A. 852-N, 2005 WL 3272355, *1 (Del.Ch. 2005). In *Orloff*, several shareholders of a closely held corporation filed a derivative complaint alleging breach of fiduciary duty and waste claims. *Id.* at *1. Prior to filing the derivative complaint, one of the shareholders instituted a section 220 action, seeking books and records from the corporation. *Id.* at *2. The defendants moved to dismiss several of the counts based on laches, because the most recent of those claims had accrued more than five years before the plaintiff filed suit. *Id.* at *9. The court declined to apply laches or the analogous statue of limitations, because the plaintiff's had pled "sufficient facts to show that they could not have brought these claims without the information gathered during the Section 220 action in 2004." *Id.* at *10. In making its decision, the Court noted that even though one of the plaintiffs

had been on the board of directors, laches would not apply because the complaint alleged that she "was mislead in her directorial capacity, and that she was intentionally excluded from the affairs of [the corporation]." *Id.* at 10. Therefore, the court reasoned that laches should not apply, because given those fact the plaintiffs "would have been unable, exercising normal diligence to extract sufficient information from [the corporation] and the defendants to bring this complaint at an earlier date." *Id.*

The same reasoning and result should obtain here, which the SLC would have known had it considered this law and the relevant facts. While Martha may generally have suspected that Perry and Todd were engaging in some self-dealing, she could not obtain sufficient information to file a derivative complaint until her 220 action was complete. Her testimony would show, just like the plaintiffs in *Orloff*, that she was kept in the dark by the defendants and her efforts to obtain more information regarding Southwest and Dardenelle were repeatedly rebuffed. The Defendants' staunch defense of the Section 220 action continued that pattern. During that case, t hen, at a minimum, any statute of limitations would be tolled.

## V. THE COURT SHOULD EXERCISE ITS INDEPENDENT BUSINESS JUDGMENT AND DENY THE MOTION.

The foregoing discussion should confirm for this Court that it should deny the Motion under the first prong of the *Zapata* review. It also should confirm that, as stated earlier, the unique context for and facts of this case warrant this Court simply exercising its discretion under *Zapata* to deny the Motion. This conclusion is further supported by the number of glaring errors, omissions, misstatements, contradictions and lack of candor by the SLC in the Report. Martha agrees that this Court is – and must be -- the "essential key in striking the balance." The Court understood from as far back as the Stay Hearing that this was an extreme use of a single member SLC. The discovery this Court properly forced the SLC to provide has revealed significant and

indeed troubling questions about how this SLC process has unfolded. The Court's independent business judgment should not permit this unfair and tainted SLC process to shut the door on the claims alleged Martha in this case, and thus 50% of Dardanelle's common stockholders.

## CONCLUSION

For all of the foregoing reasons, this Court should deny the Nominal Defendants' Motion and grant Plaintiff such other and further relief as the Court deems just.

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