10-10-2007

Order on Motion to Dismiss (JAMES & JACKSON LLC)

Alice D. Bonner
Superior Court of Fulton County

IN THE SUPERIOR COURT OF FULTON COUNTY
STATE OF GEORGIA

JAMES & JACKSON LLC, individually and derivatively on behalf of MBC, GOSPEL NETWORK, LLC., Plaintiffs, v. EVANDER HOLYFIELD, JR., WILLIE E. GARY, CECIL FIELDER, LORENZO WILLIAMS, THOMAS WEIKSNAR, CHAN ABNEY, LORI METOYER-BROWN, and RICK NEWBERGER, Defendants.	Civil Action No.: 2006CV124372

ORDER ON MOTION TO DISMISS

Counsel appeared before the Court via telephone conference on September 6, 2007, to present argument on Defendants' Motion to Dismiss. Having reviewed the record of the case, the briefs (including supplemental briefs filed on September 20 and 21, 2007) filed on this Motion, and the arguments of the parties, this Court finds as follows:

I. Facts

Plaintiff James & Jackson LLC ("J&J") is a founding member of MBC Gospel Network LLC ("MBC") (a/k/a, "The Black Family Channel"), a Delaware limited liability company. J&J consists of four members: Alvin James, Marlon Jackson, Matthew Harden Jr., and Gregory Thorpe. Willie Gary LLC is the other owner of MBC. Willie Gary LLC has twenty-three members including Defendants Evander Holyfield, Jr., Willie E. Gary, Cecil Fielder, Lorenzo Williams, Chan Abney, Lori Metoyer-Brown, all of whom were on the management board of MBC and all of whom are owners in Programming Acquisitions LLC ("Programming Acquisitions"). Defendant Rick Newberger was the

CEO of MBC and is an owner of Programming Acquisitions. Defendant Thomas Weiksnar was on the management board of MBC and is also an owner in Programming Acquisitions.

Plaintiff pleads a series of facts in the complaint relating to the alleged mismanagement and merger of MBC. First, pursuant to the Amended and Restated Operating Agreement of MBC Gospel Network LLC ("Operating Agreement"), MBC was reorganized in 1999 with Willie Gary LLC owning 80% and J&J holding a 20% "non-dilutable" interest in the company. Second, Willie Gary LLC initiated an action against J&J in Delaware Court of Chancery to dilute J&J's interest in MBC. Plaintiff alleges in its verified complaint that the Delaware Chancery Court recommended a "judicial dissolution of MBC with a competitive auction of MBC's assets." Third, on April 10, 2006, Plaintiff alleges that Defendants announced the proposed merger between MBC and Programming Acquisitions LLC. By April 26, 2006, the merger was completed with a $1 cash-out value to MBC's members. Fourth, Plaintiff asserts that the merger was not the result of an arm's length transaction because Defendants failed to form an independent special committee to review/approve the transaction, hire independent counsel for the minority interests, or hire an independent financial expert to conduct a valuation of MBC. Fifth, Plaintiff alleges a series of breached duties and obligations on behalf of the Defendants, including a breach of the terms of the Operating Agreement relating to Willie Gary LLC's obligation to provide capital contributions. Plaintiff alleges that Willie Gary LLC had an obligation to fund all future capital needs of MBC, but that when Willie Gary LLC supplied such funds, they were mischaracterized as loans instead of contributions.

II. Standard

A party seeking a motion to dismiss brought under OCGA § 9-11-12(b)(6) for failure to state a claim upon which relief can be granted must demonstrate that Plaintiff's allegations in the complaint disclose with certainty that the claimant would not be entitled to relief under any state of provable facts

asserted in support thereof. Common Cause/Georgia v. City of Atlanta, 279 Ga. 480, 481 (2005). The internal affairs of a corporation, such as actions involving officers and directions, shall be regulated by the law of the state of incorporation. Diedrich v. Miller & Meier & Assoc., Architects & Planners, Inc., 254 Ga. 734, 735 (1985).

III. Venue

As a threshold matter, the Court will address Defendants' arguments relating to improper venue as raised in oral argument on September 6, 2007, and in their supplemental brief filed September 20, 2007. Under the Georgia Civil Practice Act, 12(b) defenses, including improper venue, must be raised at or before the time of pleading. O.C.G.A. § 9-11-12(b). Such defenses may be raised in the pleadings or in a separate motion. "If a party makes a motion under this Code section but omits therefrom any defense or objection then available to him which this Code section permits to be raised by motion, he shall not thereafter make a motion based on the defense or objection so omitted..." O.C.G.A. § 12(g); see also,12(h); Orkin Exterminating Co. v. Morrison, 187 Ga. App. 780 (1988) (requiring a defendant to assert the defense of improper venue in the responsive pleadings).

Defendants filed nine (9) separate answers, each on December 8, 2006. Included in their answer, each Defendant listed as its first defense Plaintiff's failure to state a claim upon which relief could be granted. Additionally, on December 8, 2006, Defendants filed a joint motion to dismiss for failure to state a claim upon which relief can be granted. The supporting memorandum of law, filed on December 11, 2006, cited Plaintiff's failure to meet the demand requirement for a derivative suit as the basis for their 12(b)(6) motion. Not until September 6, 2007, was the defense of improper venue raised. While it is true that 12(b) defenses and objections can be consolidated into a single motion, the Court finds that adding new 12(b) defense ten (10) months after the initial response and motion to

dismiss was filed ignores the notice and timing requirements set forth in O.C.G.A. § 9-11-12. Thus, the issue of venue is not properly before this Court.

IV. Derivative vs. Direct Claims

Defendants argue in their supplemental brief that Count One (Breach of Fiduciary Duty), Count Three (Aiding and Abetting Breach of Fiduciary Duty), and Count Four (Conspiracy to Breach Fiduciary Duties) brought on behalf of J& J are not direct, but are derivative claims.

State law determines whether a cause of action is direct or derivative. "Georgia applies the law of the state of incorporation to derivative actions..." Hantz v. Belyew, 194 Fed. Appx. 897, 900 (11th Cir. 2006). In this case, Delaware is the state of incorporation.

The distinction between direct and derivative claims is determined by the Court's two-prong analysis of (1) who suffered the alleged harm, and (2) who would receive the benefit of any recovery. Tooley v. Donaldson, 845 A. 2d 1031 (Del. 2004) (adopting a two-part test for distinguishing direct from derivative claims and abandoning the "special injury" and "equal affect upon shareholders" analysis relied upon in earlier cases).

Additionally, the Delaware Courts have recognized that claims can be both derivative and direct such as where, in a traditional derivative action, the injury falls disproportionately upon a minority shareholder. Rhodes v. Silkroad Equity LLC, 2007 WL 2058736 (Del. Ch., July11, 2007); see also Gentile v. Rossette, 906 A. 2d 91 (Del. 2006) (allowing derivative claims to be brought as individual, direct claims where the majority shareholder sold the corporation assets which drove down the value of the corporation thus increasing the majority shareholder's value and voting power and decreasing the minority shareholder's value and voting power). The Delaware Courts have recognized a direct harm to a minority shareholder where the economic value of a company was extracted and voting power was

redistributed away from the minority shareholder to the majority shareholder. Gentile v. Rossette, 906 A. 2d at 99-100; see also, Rhodes, 2007 WL 2058736 at *5.

In Rhodes, the Court allowed the breach of fiduciary duty claims raised by the minority shareholder against the majority shareholder to proceed as direct claims because the defendants "as controlling shareholder would not have suffered harm to the same extent and proportions as the plaintiff." 2007 WL 2058736 at *5. The Court characterized the breach of fiduciary duty claims as "facilitating their [majority shareholders] efforts to drive out the plaintiffs at a bargain price...[thus] the fiduciary duty claims alleged in the complaint can be brought as direct claims." Id.

As in Rhodes, J&J was the minority and only other shareholder in MBC at the time that the merger was approved. MBC, through the control of Defendants, approved and finalized the cash-out merger with Programming Acquisitions, which was owned and controlled by Defendants, for $1. Thus, as in Rhodes, the Willie Gary LLC, the majority shareholder in MBC, acting through its interested directors who are the named Defendants in this suit, approved the merger with Programming Acquisitions in a transaction that drove down the value of MBC and extracted the economic value of the company from J&J, the minority shareholder.

In Gentile, the plaintiffs claims arose form a self-dealing transaction in which the CEO and controlling stockholder issued himself stock at an inflated rate in exchange for forgiving the corporation's debt owed to him. 906 A.2d at 93. The result of the transaction was to decrease the minority shareholder's economic value and voting power in the corporation. In Gentile, the Delaware Supreme Court recognized that the same set of facts gave rise to two different types of injuries: the first to the corporation and the second to the minority shareholder. See, id. at 99-100. In this case, the alleged harm to MBC is the undervaluation of the $1 cash-out merger and the specific harm allegedly suffered by J&J was the disproportionate harm suffered by it, the minority shareholder as a result of

the cash-out merger. Additionally, like in Gentile, J&J, the minority shareholder of MBC, allegedly suffered a unique harm resulting from "a breach of a fiduciary duty owed to them by the controlling shareholder, namely, not to cause the corporation to effect a transaction that would benefit the fiduciary at the expense of the minority stockholders." Id. at 103.

Distinguishing derivative from direct claims in this case is a difficult analysis for the Court because both types of claims share common facts (the cash-out merger). The Gentile and Rhodes cases, however, demonstrate a line of cases where Delaware Courts recognize claims as being both derivative and direct. Because J&J pled facts alleging a redistribution of economic value and control to the majority shareholder as well as a breach of fiduciary duties owed to them by the interested directors, Plaintiff pled sufficient facts to withstand Defendants' Motion to Dismiss for failing to state a claim for a direct action.

V. Standing to Raise Derivative Claims

Second, Defendants argue that as a result of the cash-out merger that extinguished MBC, Plaintiff lacks the standing to bring derivative claims on MBC's behalf in Count Two (Breach of Fiduciary Duty), Count Three (Aiding and Abetting Breach of Fiduciary Duty), and Count Four (Conspiracy to Breach Fiduciary Duties). In order to have standing to bring a derivative claim, the plaintiff must be "a member or an assignee of a limited liability company interest at the time of bringing the action and...at the time of the transaction of which the plaintiff complains..." 6 Del. C. § 18-1002 (2007).

The effect of a merger is normally to deprive a plaintiff, a member of the merged company, the standing to bring a derivative suit. Lewis v. Ward, 852 A.2d 896, 899 (Del. 2004); see also, Lewis v. Anderson, 477 A.2d 1040 (Del. 1984). Two exceptions, however, are recognized to the post-merger derivative claim standing rule which allows a plaintiff to bring a derivate suit on behalf of a merged company: (1) if the merger itself is the subject of a claim of fraud, or (2) if the merger is in reality

"merely a reorganization" that does not affect plaintiff's ownership in the business. Kramer v. Western Pacific Industries, Inc., 546 A.2d 348, 354 (Del. 1988), citing, Lewis v. Anderson, 477 A.2d at 1046. The fraud exception must be pled with particularity. Lewis v. Ward, 852 A.2d at 905.

MBC, the entity on whose behalf Plaintiff brings this suit, was extinguished when the merger with Programming Acquisitions was completed on April 26, 2006. Thus, if Plaintiff has standing to bring a derivative claim on behalf of MBC, it must do so within one of the two above-stated exceptions.

In the complaint, Plaintiff alleges that the Delaware Chancery Court in November, 2005, ordered a corporate dissolution and auction as the means to dilute its interest in MBC. Plaintiff also alleges that five months later Defendants formed Programming Acquisition for the purpose of completing, then Defendants subsequently approving, a cash-out merger of MBC for $1 without ensuring independent approval or valuation for the merger. While the complaint states that the "sole purpose" of the merger was to "wipe out J&J's non-dilutable interest for a grossly unfair price," the facts alleged by Plaintiff are sufficient to establish that they may also have been done to eliminate Plaintiff's legal recourse, such as a derivative action.

Accordingly, Plaintiff pled facts in its complaint sufficient to raise the fraudulent merger exception to the standing requirement in order to survive Defendants' Motion to Dismiss.

VI. Demand Requirement for Derivative Actions

The issue of whether or not Plaintiff satisfied the demand requirement for a derivative action, while originally pursued by the Defendants and briefed by both parties, was not argued before the Court and appears to have been abandoned. Regardless, the issue shall be addressed in this Order.

Defendants originally sought a partial motion to dismiss Plaintiff's derivative claims arguing that Plaintiff did not sufficiently meet the demand requirement for derivative action. In order to bring a derivative action, a plaintiff must first make a demand upon the board of directors of the company on

whose behalf Plaintiff seeks recovery, or, in the alternative, if such demand is not feasible, the plaintiff must plead with particularity why demand was excused. Del. Ch. Ct. R. 23.1 ("In a derivative action brought by 1 or more shareholders or members to enforce a right of a corporation ... the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law. The complaint shall also allege with particularity the efforts, if any, made by plaintiff to obtain the action the plaintiff desired from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort); see also, Brehm v. Eisner, 746 A. 2d 244 (Del. 2000).

The demand requirement is excused if a plaintiff pleads particularized facts that create a reasonable doubt as to (1) the majority of the directors are disinterested and independent or (2) the complained of action was a valid exercise of reasonable business judgment. Brehm, 746 A.2d at 254. The presumption is that a board of directors acts correctly and the burden is on the plaintiff to plead otherwise. Id. (holding that the sufficiently plead particularized facts are required to establish excused demand in a derivative action). Demand futility is recognized where the majority of the board is comprised of interested directors. Aronson v. Lewis, 473 A.2d 805, 809 (Del. 1984); cf, Brehm v. Eisner 746 A.2d 244 (finding that the plaintiff failed to plead sufficient facts to establish connection between the defendant and the board of directors necessary to undermine the presumption in favor of the board).

Here, Plaintiff alleged in its complaint that the Defendants were the individual owners of the majority shareholder, Willie Gary LLC, were on the management board of MBC that approved the merger transactions, and are the owners of Programming Acquisitions, the company into which MBC was merged. Additionally, Plaintiffs alleged in its complaint that the merger was an interested party

transaction, but that Defendants did not establish an independent committee to review the merger, did not hire an independent expert to value the company, and did not hire counsel to represent the minority shareholders in the mergers. Thus, this Court finds that the Plaintiff has pled sufficient facts to satisfy the demand futility requirement for derivative actions by creating reasonable doubt that a majority of the directors were disinterested and independent.

In accordance with the above-stated reasons, this Court hereby **DENIES** Defendant's Motion to Dismiss.

SO ORDERED this 10th day of October, 2007.

Alice D. Bonner

ALICE D. BONNER, SENIOR JUDGE
Superior Court of Fulton County
Atlanta Judicial Circuit

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