Redacted memorandum – Firm's clients, Plaintiff 1 and Plaintiff 2, brought derivative action, direct action, and defamation action against majority shareholders and officers

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IN THE COURT OF THE ***** JUDICIAL DISTRICT IN AND FOR ***** COUNTY, STATE OF UTAH	
PLAINTIFF 1 AND PLAINTIFF 2, PLAINTIFFS, VS. DEFENDANT 1, DEFENDANT 2, DEFENDANT 3, DEFENDANT 4, DEFENDANT 5, DEFENDANT 6, DEFENDANT 7, DEFENDANT 8, AND DOES I-XXX, DEFENDANTS. NOMINAL DEFENDANT 1, A DELAWARE CORPORATION; NOMINAL DEFENDANT 2, A UTAH CORPORATION; AND NOMINAL DEFENDANT 3, A DELAWARE CORPORATION, NOMINAL DEFENDANTS.	MEMORANDUM IN OPPOSITION TO MOTION TO DISMISS ALL CLAIMS AGAINST NOMINAL DEFENDANT 3, OR, IN THE ALTERNATIVE, IN SUPPORT OF PENDING MOTION FOR LEAVE TO CONDUCT DISCOVERY CIVIL NO. ***** JUDGE: ******

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Plaintiffs hereby respectfully submit the following memorandum in opposition to Nominal Defendant Nominal Defendant 3's *Motion to Dismiss All Claims Against Nominal Defendant 3*, and in support of Plaintiffs' motion for leave to conduct discovery previously filed on ***** **, 20** as part of Plaintiffs' *Motion to Deny Motion to Dismiss Derivative Claim as to Defendant 1 Due to Named Movants' Lack of Standing, or, in the Alternative, for Leave to Conduct Discovery*.

FACTUAL BACKGROUND

This case involves a company originally owned by Plaintiff 1 ("Plaintiff 1"), that was known as *****. Plaintiff 1 sold ***** to a group of investors, reserving a 5% minority interest and remaining as president of the company as described in the paragraphs 30-38 of the verified amended complaint:

> 30. Plaintiff 1 is a minority owner of nominal defendant, Nominal Plaintiff 1, a closely held Delaware corporation (at times herein called "**Nominal Plaintiff 1**").
>
> 31. Plaintiff 1 holds an approximate 5% minority share of nominal defendant Nominal Defendant 3 (at times herein called "**Nominal Defendant 3**"), a closely held Delaware corporation.
>
> 32. Nominal Defendant 3 is a holding company of nominal defendant Nominal Plaintiff 2, a closely held Utah Corporation (herein at times called "**Nominal Plaintiff 2**"), and also a holding company of, Nominal Plaintiff 1, among other things. Nominal Defendant 3 holds, or should hold, 100% of the shares of Nominal Plaintiff 2 and thereby hold 100% of Nominal Plaintiff 1. Nominal Plaintiff 1, Nominal Plaintiff 2, and Nominal Defendant 3 are all closely held corporations.
>
> 33. Through his approximate 5% share of Nominal Defendant 3 and said corporation's 100% ownership of Nominal Plaintiff 2, and of Nominal Plaintiff 1, Plaintiff 1 holds an approximate 5% share in Nominal Plaintiff 2 and Nominal Plaintiff 1, among other things.
>
> 34. Nominal Plaintiff 1 was originally incorporated in 20** by Nominal Defendant 3 in Delaware under the name of *****, Inc., but its name was subsequently

changed to Nominal Plaintiff 1, with Nominal Plaintiff 1 doing business as *****, Inc. As used herein "Nominal Plaintiff 1" includes all time periods and activities under its original and current name.

35. Before acquiring his 5% shares in Nominal Defendant 3 and Nominal Plaintiff 1, Plaintiff 1 founded, 100% owned, and operated a business known as ***** d/b/a and *****, LLC. Among other things, Plaintiff 1's business possessed equipment, know-how, customers, business connections, and good will developed by Plaintiff 1.

36. Plaintiff 1's *****, LLC business, among other things, provided ******* services and materials.

37. In 20**, Plaintiff 1 sold *****, LLC to Nominal Plaintiff 2, the wholly owned subsidiary of Nominal Defendant 3. Upon information and belief, the business was then transferred into Nominal Plaintiff 1.

38. *****, LLC had been conducting business in buildings in *****, ***** County, Utah ("the Buildings"). The Buildings were owned, and remain owned, by Plaintiff 2 ("Plaintiff 2"), a Utah limited liability company 100% owned by Plaintiff 1. The Buildings had, and have, ***** permits necessary to conduct the business. To continue to conduct business Nominal Plaintiff 1 leased the Buildings from Plaintiff 2 at the rental of $**,*** per month.

In selling his company, Plaintiff 1 had reasonable expectations as alleged in paragraph 39 of the verified amended complaint:

39. As part and parcel of selling *****, LLC, Plaintiff 1 expected, among other things,

A. to be paid approximately $**,***,*** (subject to escrow reductions to clear up a **% majority interests in a company (***** Utah, LLC) owned **% by *****, LLC and for other adjustments;

B. to invest $**,***,*** of proceeds of his sale of *****, LLC, in Nominal Defendant 3 for approximately 5% (approximately **,*** shares) of Nominal Defendant 3;

C. to be, and to continue to be, an approximately 5% holder of Nominal Defendant 3, Nominal Plaintiff 2, and Nominal Plaintiff 1;

D. to be, subject to the terms of an employment contract, president and chief operating officer of Nominal Plaintiff 1;

E. to be, among other things, paid $***,*** per year base salary in equal biweekly installments, or the equivalent of $**,***.**/month, as president of Nominal Plaintiff 1, and to have other benefits and rights under an employment contract, including severance rights equal to at least one year's base salary;

F. to enter into contracts with Nominal Defendant 3 and Nominal Plaintiff 2, including but not limited to, an asset purchase agreement, a share purchase agreement, a participation agreement; to enter into an executive services agreement with Nominal Plaintiff 1; and, via Plaintiff 2, to enter into a lease agreement with Nominal Plaintiff 1 for Nominal Plaintiff 1 to lease the Buildings. Herein at times the contracts and lease agreement referred to in this paragraph are jointly called "the Contracts";

G. to be part owner of an ongoing venture to market and provide ***** and to engage in other business opportunities;

H. to (through Plaintiff 2) lease to Nominal Plaintiff 1, the Buildings, with Nominal Plaintiff 1 to pay 1) annual base rent of $***,*** payable in equal monthly installments of $**,***, 2) maintenance and repairs, 3) property insurance, 4) property taxes; and 4) holdover rents of $**,*** per month.

I. to be owed fiduciary duties of utmost good faith by management and controlling shareholders of Nominal Defendant 3, of Nominal Plaintiff 2, and of Nominal Plaintiff 1:

i. to be treated equally;
ii. to be free of frustration of reasonable expectations of involvement;
iii. to be free of freezouts, squeeze outs and other forms of shareholder oppression;
iv. to be free of negligent mismanagement;
v. to be free of breaches of fiduciary duties;
vi. to be free of waste or misappropriation of corporation assets; and/or
vii. to be free of misappropriation of corporate opportunities.
viii. to have the Contracts performed by Nominal Defendant 3, Nominal Plaintiff 2, and Nominal Plaintiff 1 in good faith and with fair dealing.

Plaintiff 1 is, and was, owed contractual and fiduciary duties by the majority shareholders of the three nominal defendants, including Nominal Defendant 3. Paragraph 40 of Plaintiff 1's complaint alleges breaches of these duties:

40. Nominal defendant Nominal Plaintiff 1, Nominal Plaintiff 2, and Nominal Defendant 3, by and through wrongful actions of the defendants herein, breached their contractual duties and fiduciary duties owed to Plaintiff 1, and oppressed Plaintiff 1's 5% interests, and defendant breached said fiduciary duties, by:

A. Wrongly withholding extensive monthly salaries or portions of monthly salaries from Plaintiff 1;

B. Wrongly withholding lease payments owed under the lease for the Buildings and withholding other amounts owed under the lease for property taxes and other obligations;

C. Falsely and unilaterally posturing to wrongly assert modification of the lease agreement.

D. Wrongly coercing Plaintiff 1 to lower Plaintiff 1's pay under the executive services agreement;

E. Wrongly terminating Plaintiff 1 and falsely claiming to have terminated Plaintiff 1 for cause;

F. Wrongly withholding from Plaintiff 1 his one-year severance salary;

G. Wrongly diverting income, capital, assets and opportunities belonging to Nominal Plaintiff 1 to other ventures and obligations not part of Nominal Plaintiff 1, and, by thereby making Nominal Plaintiff 1 unable to pay lease rents and other payments to Plaintiff 2 and unable to pay salary to Plaintiff 1;

H. Wrongly slandering Plaintiff 1 and stating that Plaintiff 1 had embezzled $***,***;

I. Wrongly blocking Plaintiff 1 from access to company records, including, but not limited to, copies of the Contracts and financial and transactional records;

J. Wrongly oppressing Plaintiff 1 to squeeze out Plaintiff 1;

K. Wrongly oppressing Plaintiff 1 by suing Plaintiff 1 in case number ***** and doing other acts alleged in order to commandeer the Buildings and their ***** permits.

L. Deliberately or negligently mismanaging nominal defendants.

M. Other abusive actions to be proved at trial.

As alleged at paragraph 32, "Nominal Defendant 3 holds, or should hold, 100% of the shares of Nominal Plaintiff 2 and thereby hold 100% of Nominal Plaintiff 1. Nominal Plaintiff 1, Nominal Plaintiff 2, and Nominal Defendant 3 are all closely held corporations." However, nominal defendants Nominal Plaintiff 1 and Nominal Plaintiff 2 in their motion on behalf of Defendant 1 to dismiss Plaintiff 1's derivative claim, contend that Plaintiff 1's 5% interest has disappeared, and that accordingly, Plaintiff 1 does not have standing to bring derivative claims against Nominal Plaintiff 1 and Nominal Plaintiff 2.

In its memorandum in support of its motion to dismiss, nominal defendant Nominal Defendant 3 does not address the disappearance of Plaintiff 1's 5% interest alleged by Nominal Plaintiff 1 and Nominal Plaintiff 2. At paragraph 11 of its background facts Nominal Defendant 3 misrepresents paragraph 32 of the verified amended complaint, stating that Nominal Defendant 3 is a *minority* shareholder of Nominal Plaintiff 2, whereas paragraph 32 alleges, "Nominal Defendant 3 holds, or should hold, 100% of the shares of Nominal Plaintiff 2 and thereby hold 100% of Nominal Plaintiff 1."

At paragraphs 43-45 of the verified amended complaint, Plaintiffs allege that defendants, including officers of Nominal Defendant 3, retaliated against Plaintiff 1 because Plaintiff 1 prevented defendants from looting a million dollars from Nominal Plaintiff 1 that was owed to employees and creditors of Nominal Plaintiff 1; wrongfully terminating Plaintiff 1, slandering Plaintiff 1, oppressing Plaintiff 1's minority interest, and squeezing out Plaintiff 1.

ARGUMENT

I. Plaintiffs' Individual Breach of Fiduciary Duty Claims Are Direct Claims and Not Derivative Claims.

Plaintiffs' second cause of action against officers of Nominal Defendant 3 and others for breaches of fiduciary duties are direct claims arising from injuries individual to Plaintiff 1 identified at paragraphs 40-45 of the verified amended complaint.

A. Individual injuries May Be Asserted as Direct Claims in Actions Whether or Not the Entity Is A Closely Held Corporation.

Plaintiffs object to Nominal Defendant 3's assertion that "Any fiduciary duty owed to shareholders of a corporation is owed to the shareholders collectively and not individually." This statement from *Pond v. Equitable Life and Cas. Ins. Co*., 872 P.2d 1070, 1072 (Utah Ct. App 1994), was an oversimplification/misstatement of the Supreme Court's ruling in *Richardson v. Arizona Fuels Corporation*, 614 P.2d 636, 638-40 (Utah 1980). In *Richardson*, the Supreme Court found that the plaintiffs' fiduciary duty claims were claims common to all shareholders collectively. The court stated, "The distinction between a fiduciary duty owed to the corporation as a whole as opposed to the stockholders collectively does not appear to be one of substance *in this case*." *Id.* at 640 (emphasis added). Before so ruling, the Supreme Court had quoted 16 Fletcher, *Cyclopedia of the Law of Private Corporations* § 5911 (rev. perm. ed 1979),

> [I]f the injury is one to the plaintiff as a stockholder and to him individually, and not to the corporation, as where the action is based on a contract to which he was a party, or on a right belonging severally to him, or on a fraud affecting him directly, it is an individual action.

Id. at 639. Hence, contrary to the Court of Appeals' blanket statement in *Pond*, stockholders *can* directly assert individual fiduciary duty claims. In *GLFP, Ltd., v. CL Management, Ltd*, 2007 UT App 131, the Court of Appeals stated at note 3:

> In *Arndt v. First Interstate Bank of Utah*, 1999 UT 91, 991 P.2d 584, the Utah Supreme Court noted that "[t]he injury alleged in *Aurora Credit* [*Services Inc. v. Liberty West Development Inc*., 970 P.2d 1273 (Utah 1998),] was suffered uniquely by Aurora Credit and therefore was much more direct than is a typical derivative claim." *Arndt*, 1999 UT at P21, 991 P.2d 584 . . . . Thus, Aurora Credit's injury was unique because there were no other shareholders that could have been injured by the wrongful acts of the controlling shareholder. . . . a specialized injury to the plaintiff.

(Emphases added.) In *Warner v. DMG Color, Inc.*, 2000 UT 102, P13, 20 P.3d 868, the Supreme Court stated, "A shareholder may sue in his individual capacity in a direct action when he can 'show that he . . . was injured in a manner distinct from the corporation."

Further, at least until the corporate entity may be disregarded,[1] Nominal Defendant 3 is a Delaware corporation, subject to Delaware law.[2] In *Tooley v. Donaldson, Lufkin & Jenrette, Inc*., 845 A.2d 1031, 1039 (Del. 2003), the Delaware Supreme Court state, "The proper analysis has been and should remain that stated in *Grimes* [*v. Donald*, 673 A.2d 1207, 1213 (Del 1996)], *Kramer* [*v. Western Pacific Industries, Inc*., 546 A.2d 348, 352 (Del 1988)], and *Parnes* [v. *Bally Entertainment Corp*., 722 A.2d 1243, 1245 (Del 1999)]. That is, a court should look to the nature of the wrong and to whom the relief should go.[3] The stockholder's claimed direct injury

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[1] *See* point I.C., *infra*.
[2] Because Nominal Defendant 3 is a Delaware corporation, its internal affairs are governed by Delaware law. *McDermott v. Lewis*, 531 A.2d 206, 215-217 (Del. 1987); *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S.611, 621 (1983), *superseded in part* by statute, citing Restatement (Second) of Conflict of Laws § 302, Comments *a* and *e* (1971).
[3] In *Grimes*, as in Plaintiffs' second cause of action herein, the plaintiffs were not seeking to recover any damages for injury to the corporation and the relief was to go to the plaintiffs.

must be independent of any alleged injury to the corporation.[4] The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she could prevail without showing injury to the corporation."[5] Plaintiffs' second cause of action meets all of these requirements. Plaintiff 1 seeks damages and equitable relief for himself, his injury is independent of any alleged injury to Nominal Defendant 3, and the duties breached were personally owed to him, as enumerated in paragraph 40 of the verified amended complaint.

B. Simultaneous Direct Claims and Derivative Claims Are Sanctioned under Utah Close Corporation Case Law.

In *Angel Investors, LLC, v. Garrity*, 2009 UT 40, 216 P.3d 944, and in *McLaughlin v. Schenk*, 2009 UT 64, 220 P.3d 146, the Supreme Court dramatically ruled to protect minority shareholders suffering injuries in close corporation settings. Both rulings allowed the minority shareholder to bring individual direct claims as well as derivative claims. In *Angel Investors* the court ruled that " [i]n light of the greater vulnerability to malfeasance that is present in closely held corporations, we hold that the sole dissenting shareholder in a closely held corporation qualifies as a class of one for derivative standing when that shareholder (1) seeks by its pleading

[4] In *Parnes*, as in Plaintiffs' second cause of action herein, the stockholders directly attacked the fairness of the action and alleged an injury to the stockholders, not to the corporation.

[5] In *Kramer*, the court stated that the plaintiff must challenge the validity of the action itself, "usually by charging the directors with breaches of fiduciary duty . . ." 722 A.2d, at1245. This is what Plaintiffs have done here. In *Lachman v. Bell*, 353 F. Supp. 37, 40-41 (U.S. Dist So. N.Y. 1972), applying Delaware law, the court recognized a direct action claim stating,

> Thus, we have a claim that the defendant [shareholder/officer] had the *de facto* power to unmake the original transaction. This combination of conflict of interest and the alleged *de facto* power to resolve the conflict in his own interest defines the fiduciary duty of which the defendant is said to have committed a breach. *See Guth v. Loft Inc*., 23 Del. Ch. 255, 5 A.2d 503 (1939). If, without justification, Bell harmed the plaintiff, a direct action, in addition to a derivative action, will lie. [citations omitted, underlined emphasis added].

to enforce a right of the corporation and (2) does not appear to be similarly situated to any other shareholder." 2009 UT 40 at P22. The court further ruled that the minority shareholder could bring a derivative action while simultaneously bringing a direct claim for monetary damages against the close corporation, where the defendants could not prove that the relief sought in the derivative and direct actions were incompatible. *Id.* at P30.

In *McLaughlin*, as in *Aurora*, the Supreme Court sanctioned a minority shareholder bringing a derivative action along with a direct action against corporate officers for breaches of duties owed to minority shareholders. 2009 UT 64 at P15. The court ruled that shareholders in closely held corporations owe their coshareholders fiduciary obligations of utmost good faith, *Id.* P22-P23, and then ruled that a shareholder violates his duties when he thwarts another shareholder's reasonable expectations of benefits derived from his ownership.[6] *Id.* at P24. The court noted that a wrongful sqeezeout may involve termination of an officer in a manner that "effectively frustrate[d] the minority stockholder's purpose in entering on the corporate venture and also denied him an equal return on his investment." *Id.* at P25. In its discussion the court strongly factored whether the terminated officer was a founder of the business, as is the case here with Plaintiff 1. *Id.* at P26. In *McLaughlin*, the terminated officer minority interest holder/officer was allowed to bring his direct claim against the majority officers, but, not being an original owner, lost on summary judgment. *Id.* at P38. As will be shown in the next section these rulings sanction Plaintiffs' derivative and direct claims against Nominal Defendant 3.

[6] Plaintiff 1's reasonable expectations are enumerated in paragraph 39 of the verified amended complaint. Breaches of the related fiduciary duties are alleged at paragraphs 40-45.

C. Plaintiffs' Direct Action, as Well as Their Derivative Action, against Nominal Defendant 3 Is Governed by Utah Law.

The foregoing clearly applies to Nominal Plaintiff 2, a Utah corporation governed by Utah law. Nominal Plaintiff 2 had/has a small number of shareholders, no ready market for the corporation stock, and active shareholder participation in the business,[7] and thus qualifies as a close corporation under *McLaughlin v. Schenk*, 2009 UT 64, P15, 220 P.3d 146. For reasons to now be shown, Nominal Defendant 3's status as a Delaware corporation should not block remedies available to Plaintiff 1 through Nominal Plaintiff 2 under *Angel Investors* and *McLaughlin*.

In the 20** three-way transaction, Plaintiff 1 transferred all of his Utah company's assets into Nominal Plaintiff 2, a Utah Corporation and Nominal Defendant 3 became 100% owner of Nominal Plaintiff 2, with Plaintiff 1 receiving 5% of Nominal Plaintiff 2 (and also of Nominal Plaintiff 1), through his 5% interest in Nominal Defendant 3. Under the three-way transaction, the business assets continued to be in ***** County, Utah, held by Utah corporation Nominal Plaintiff 2. Business operations continued to be headquartered in ***** County, Utah, although now operated through Nominal Plaintiff 1. Plaintiff 1, until the squeezeout, continued to be the company's chief operating officer, as president of Nominal Plaintiff 1. Although accomplished through multiple instruments and entities, the overall transaction culminated in Plaintiff 1's Utah company remaining a Utah company anchored through Nominal Defendant 2.

Courts may cut through interrelated three-way transactions to get to justice. In *Shafir v. Harrigan*, 879 P.2d 1384, 1392 n.16 (Utah Ct. App 1994), involving a § 1031 exchange, the

[7] Particularly including Plaintiff 1 as president and operating officer until the squeezeout began.

Court of Appeals noted without disapproval that the district court did not adopt the Harrigan's lack-of-privity argument and allowed the Schafirs' contract claims against the Harrigans to proceed.[8] Here the Court should disregard privity and apply the alter ego doctrine to prevent the Nominal Defendant 3 corporate form from sanctioning a fraud, promoting an injustice, or causing an inequitable result. *Norman v. Murray First Thrift & Loan Co.*, 596 P.2d 1028, 1030 (Utah 1979). Among other things, this will bring Nominal Defendant 3 under the Utah close corporation rulings protecting minority owners through direct as well as derivative actions.

II. Plaintiffs Were Excused from Making Demand under the *Aurora* Close Corporation Exception, or, Demand Was Excused as Futile.

Plaintiffs' were excused from making demand under the *Aurora* close corporation exception and/or under futility. In *Aurora*, the Supreme Court adopted a closely held corporation exception to the demand requirement. Although in 2006 in *Dansie v. City of Herriman*, 2006 UT 23, P16, 134 P.3d 1139, the court stated it was open to reconsidering this exception, the court has yet to do so. However, the court's 2009 rulings in *Angel Investors* and *McLaughlin* protecting minority shareholders indicate that the Court would continue to except minority shareholders in closely held corporations from the need to make a demand.

As discussed at point I.C., above, the 20** transaction centered upon Plaintiff 1 transferring his Utah company's assets into Nominal Plaintiff 2, a Utah corporation, with Plaintiff 1 remaining as chief executive officer and with operations continuing in ***** County,

[8] The court in *Redwing Carriers, Inc., v. Tomlinson*, 399 F.2d 652, 655 (5th Cir 1968), similarly ruled finding that the several transactions were interdependent and part of a unified transaction. The situation here is unlike that in *Colonial Leasing Corp. v. J.W.C.R. Corporation*, 1999 UT 91, P34, 977 P.2d 541, where the lessee negotiated directly with an independent leasing company. Here Nominal Defendant 3 was, became, and remains intimately tied into an interdependent, unified transaction.

Utah. Under the reasoning and authorities cited (*Shafir*, *Redwing Carriers*, *Norman*), the Court should disregard Nominal Defendant 3's status as a Delaware corporation and apply the *Aurora* closely held corporation exception through Nominal Plaintiff 2 to find that no demand was necessary. Upon finding that Plaintiffs were excused under *Aurora*, the Court would not need to address futility.

However, if the Court were to consider futility, the Court should carefully consider Plaintiffs' pleadings. Plaintiff 1 has in paragraphs 62-63 of his amended verified complaint made particularized statements under Rule 23A(a)(4) & (5) that prima facie show that demand upon Nominal Defendant 3 would be futile. These statements have not been contradicted by any sworn statement of Nominal Defendant 3:

> 62. 23A(a)(4). Plaintiff 1 has for several years fruitlessly attempted to protect his 5% interests as he served as an officer of Nominal Defendant 1 and as he expected to receive the benefits set forth in paragraph 39 above, incorporated by this reference as particulars, and as his interest was oppressed. Having purportedly been terminated for cause, defamed, excluded from Nominal Plaintiff 1's operations and sued, Plaintiff 1 has not attempted to obtain the desired action from Nominal Defendant 3, as Nominal Defendant 3 is controlled by the same, or substantially the same, group of directors and officers who control Nominal Plaintiff 1.
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> 63. 23A(a)(5) Plaintiff 1 has not obtained the action or not made the effort because Nominal Defendant 3, under the control of Defendants, 1) has already aided and abetted Nominal Defendant 1's bad faith oppression of Plaintiff 1's 5% interests, breaches of contractual and fiduciary obligations owed to Plaintiff 1, wrongful termination of Plaintiff 1 for cause, defamation of Plaintiff 1, and Nominal Defendants 1's filing suit against Plaintiffs in Civil No. ***** in this Court, rendering the making of demands for desired action useless and excused as futile; and 2) has in so acting breached its own fiduciary duties owed to Plaintiff 1. Plaintiffs incorporate paragraphs 30-45, above in particular in support of this assertion.

These verified statements more than create a reasonable doubt that, as of the time the complaint was filed, the board of directors of Nominal Defendant 3, a Delaware corporation,[9] could have properly exercised independent and disinterested business judgment in responding to a demand. *Hamilton Partners, L.P. v. Englard,* 11 A.3d 1180, 1201 (Del. Ch. 2010), quoting *Rales v. Blasband,* 624 A.2d 927 (Del. 1993).[10] Indeed Plaintiffs' statements and the facts herein show that Nominal Defendant 3 directors and controlling shareholders are antagonistic, adversely interested, oppressively pursuing a course inimical to the rights of other shareholders, and/or involved in the transaction attacked. *Delaware & Hudson Company, v. Albany & Susquehanna Railroad Company*, 213 U.S. 435, 447, 449 (1909). As Nominal Defendant 3 has not countered Plaintiffs' verified allegations with any verified counter allegation, Nominal Defendant 3 has failed to present a controverted issue to the Court.

III. The Court Should Deny Nominal Defendant 3's Rule 12(b)(6) Motion to Dismiss Plaintiffs' Third through Seventh Causes of Actions.

Nominal Defendant 3 lacks standing to bring its motion because Nominal Defendant 3 is not a defendant to Plaintiffs' claims for breaches of Plaintiff 1's employment contract, breaches of the lease agreement, defamation, intentional infliction of emotional distress, and alter ego.

[9] Section 16-10a-740, Utah Code, ("Section 740"), does not apply to Nominal Defendant 3, because Nominal Defendant 3 is a Delaware corporation with its internal affairs governed by applicable Delaware law. *See supra*, n 1.

[10] This is the Delaware test for futility applicable to Nominal Defendant 3, a Delaware Corporation. The two exceptions recognized in *Dansie* for Utah corporations, P28, are not *the* Delaware test. However, the identified exceptions, 1) express statement to not pursue the claim, and 2) risk of further injury to the corporation from alerting the officers of awareness of their wrongdoing, could be relevant factors to the Delaware test. Here there is great reason for concern that advanced notice regarding Plaintiffs' intent to sue regarding the "disappeared" 5% interest would have risked further harm to the corporation.

Further, Plaintiffs' pleadings would withstand a rule 12(b)(6) challenge by a defendant having standing to challenge the pleadings.

A. The Motion Should Be Denied as to Causes of Action Three Through Seven because Nominal Defendant 3 Lacks Standing.

Nominal Defendant 3 is a nominal party to Plaintiffs' first cause of action wherein Plaintiff 1 derivatively sues defendants on behalf of Nominal Defendant 3 and prays for relief in favor of Nominal Defendant 3 in the related prayer. In Plaintiffs' second cause of action for direct relief, Plaintiff 1 requests, *inter alia*, dissolution of Nominal Defendant 3. However, in no other causes of action do Plaintiffs request any relief for, or against, Nominal Defendant 3. The prayers in the third through seventh causes of action specifically ask for relief against "defendants" and do not mention "nominal defendants." Accordingly, the Court should disregard points III through VIII of Nominal Defendant 3's memorandum because nominal defendants have no standing to contest Plaintiffs' third through seventh causes of action on the merits or by rule 12(b)(6).

The motion insofar as it relates to claims other than Plaintiffs' first two causes of action is in reality a stealth motion by *Nominal Defendant 3's directors and officers*, who attempt to misuse Nominal Defendant 3 to present *their* motions. While Nominal Defendant 3's directors and officers would have standing, to do so *they* must openly acknowledge that *they* are before the court and that *they* are the real parties in interest to the motion. Nominal Defendant 3 "cannot raise the claims of third parties who are not before the court." *Provo City Corporation v. Thompson*, 2004 UT 14, P9, 86 P.3d 735.

B. Plaintiffs Have Adequately Pleaded Facts for Their Defamation, Emotional Distress, and Alter Ego Claims.

Without waiving their standing objection, Plaintiffs further respond to points V, VI and VII of Nominal Defendant 3's memorandum. Rule 8(a), U. R. Civ. P. requires only "a short and plain (1) statement of the claim showing that the party is entitled to relief; and (2) a demand for judgment for specified relief." Yet, in Points V, VI, and VII of its brief, Nominal Defendant 3 erroneously demands dismissal because Plaintiffs have not "allege[d] any facts *sufficient to establish*" their claims. Mem. Supp. Mot. Dismiss, at 11 (emphasis added). However, Plaintiffs' amended complaint is not to be judged by a hyper-technical "sufficiency" standard.

> A rule 12(b)(6) motion to dismiss admits the facts alleged in the complaint but challenges the plaintiff's right to relief based on those facts. . . . When determining whether a trial court properly granted a rule 12(b)(6) motion to dismiss, we accept the factual allegations in the complaint as true and consider them and all reasonable inferences to be drawn from them in a light most favorable to the plaintiff. . . . In light of the standard of review, we state the facts in a light most favorable to the party against which the rule 12(b)(6) motion was brought. . . .

St. Benedicts Dev. Co. v. St. Benedict's Hosp., 811 P.2d 194, 196 (Utah 1991). "[T]hese principles are applied with great liberality in sustaining the sufficiency of allegations stating a cause of action." *Williams v. State Farm Ins. Co*., 656 P.2d 966, 970 (Utah 1982), emphasis added.

Nominal Defendant 3 misinterprets the applicable case law for pleading defamation by ignoring *Zournadakis v. Uintah Basin Medical Center, Inc*., 2005 Utah App 325, P4, 122 P.3d 891. In *Dennett v. Smith*, 445 P.2d 983, 984 (Utah 1968), the complaint contained nothing more than conclusory statements. In distinguishing *Dennett*, the Court of Appeals in *Zournadakis* expressly rejected Nominal Defendant 3's sufficiency argument, stating, "However, there is no

Utah law directly requiring that the complaint also allege with complete specificity when, where, to whom, the alleged defamatory statements were made in order to withstand a motion to dismiss for failure to state a claim." 2005 UT Ct. App. 325, P4.

Plaintiffs have set forth more than adequate facts. The Fifth, Sixth and Seventh causes of action at paragraphs 113-137 of Plaintiffs' amended complaint allege all of the respective elements necessary for Plaintiffs' defamation, emotional distress and alter ego claims.[11] Incorporated into these allegations by reference are paragraphs 30-45 of the amended complaint where Plaintiffs have provided highly detailed allegations regarding facts underlying the respective claims; to wit: Defendants had been looting Nominal Plaintiff 1 and oppressing Plaintiff 1's interest. Defendants intended to loot from Nominal Plaintiff 1 over a million dollars in funds received from a contract, although the company owed creditors over a million dollars (about $***,*** of which was owed to Plaintiffs for accrued and unpaid rent). Before defendants could loot the funds, Plaintiff 1 caused the million dollars of payables to be paid. This enraged defendants, who then falsely accused Plaintiff 1 of embezzlement, wrongly terminated Plaintiff 1's employment contract, and otherwise continued their scheme to crush Plaintiff 1. Plaintiffs allege at paragraphs 43 and 44 of the amended complaint:

> 43. Nominal Plaintiff 1, acting in concert with the other defendants herein, wrongfully retaliated against Plaintiff 1 because Plaintiff 1's payment of bona fide obligations of Nominal Plaintiff 1 had prevented Nominal Plaintiff 1 and the other defendants herein from further looting the company to further oppress Plaintiff 1's interests, and in order to commandeer the Buildings and ***** permits.

[11] Nominal Defendant 3 does not challenge that Plaintiffs have sufficiently pleaded the necessary elements of causes of action.

> 44. Nominal Plaintiff 1, acting in concert with the other defendants herein, wrongfully stated to its insurance company that Plaintiff 1 had embezzled the $***,*** and caused its insurance company to send threatening correspondence to Plaintiff 1. Nominal Plaintiff 1, acting in concert with the other defendants herein, has published to third parties said false allegations of embezzlement by Plaintiff 1.

Plaintiffs' facts at paragraphs 30-45 have provided sufficient facts for Plaintiffs' defamation, emotional distress, and alter ego claims. Any real concern regarding clarity should be made by a motion for more definite statement, rather than a motion to dismiss. *Zournadakis*, 2005 UT Ct. App. 325 at n. 1.

IV. In the Alternative, Plaintiffs Should Be Granted Leave to Conduct Discovery.

If, despite Plaintiffs' uncontroverted showings, Nominal Defendant 3 were directly or indirectly allowed to controvert any of Plaintiffs' causes of action, or if the Court were to find any factual inadequacy, Plaintiffs should be allowed to conduct related discovery on all three nominal defendants, including Nominal Defendant 3.[12] Discovery would uncover what has happened to Plaintiff 1's 5% interest, which Nominal Plaintiff 1 has alleged has simply disappeared. It would reveal actions and transactions between nominal defendants in support of Plaintiffs' claims, particularly claims involving the application of equity and choice of law. Discovery would show that officers of Nominal Defendant 3 were in cahoots with majority shareholders of Nominal Plaintiff 1 and Nominal Plaintiff 2, are hostile to Plaintiff 1, and accordingly, that demand for Nominal Defendant 3 to sue defendants, including Southfield's officers, would have been futile. Discovery would also produce facts showing that demand was

[12] Plaintiffs have so moved in their *Motion to Deny Motion to Dismiss Derivative Claims as to Defendant 1 Due to Named Movants Lack of Standing, or, in the Alternative, for Leave to Conduct Discovery*, filed ***** **, 20**.

excused under the *Aurora* close corporation exception. Discovery would further allow Plaintiffs to address any alleged lack of factual sufficiency of any of its pleadings.

CONCLUSION

Nominal Defendant 3's motion to dismiss should be denied in all respects. In the alternative, Plaintiffs should be granted 90-days leave to conduct discovery and to, within 20 days thereafter, file their additional response regarding relevant issues.

Dated **th day of *****, 20**.

Hanks & Mortensen, P.C.

___/s/Paul W.Mortensen_____
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J. Brady Kronmiller
Attorneys for Plaintiff 1
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