IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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

MEMORANDUM OPINION

Submitted: July 11, 2007
Decided: February 14, 2008

Norman M. Monhait, Esquire, Jessica Zeldin, Esquire, ROSENTHAL, MONHAIT & GODDESS, P.A., Wilmington, Delaware, *Attorneys for Plaintiffs*

Donald J. Wolfe, Jr., Esquire, Brian C. Ralston, Esquire, POTTER ANDERSON & CORROON LLP; Karen Wildau, Esquire, W. Scott Sorrels, Esquire, Stacey Godfrey Evans, Esquire, POWELL GOLDSTEIN LLP, Atlanta, Georgia, *Attorneys for Defendants*

PARSONS, Vice Chancellor.

This is an action by six shareholders of First Niles Financial, Inc. ("First Niles" or the "Company") against certain officers and directors of First Niles (collectively "Defendants") for breach of fiduciary duties in connection with a decision not to sell the Company and a reclassification of the Company's shares. The action is currently before the Court on Defendants' motion to dismiss for failure to state a claim under Court of Chancery Rule 12(b)(6), and for lack of personal jurisdiction as to two of the Defendants under Rule 12(b)(2).

Applying *TW Services, Inc. v. SWT Acquisition Corp.*[1] to the Board's decision to terminate the Sales Process and reject a merger offer, I find Plaintiffs have not alleged sufficient facts to overcome the presumption of business judgment.

Regarding the reclassification, I find a majority of the Board may have been interested or not independent when it decided to effect a reclassification of some of the Company's common stock, but that a majority of the unaffiliated shareholders ratified the reclassification. Contrary to Plaintiffs' claims, I also hold the ratification was made with full disclosure under Delaware law, and was thus sufficient to give the Board's decision the benefit of the business judgment rule. Thus, for the reasons stated in this Opinion, Defendants' motion to dismiss is granted in all respects.

---

[1] 1989 Del. Ch. LEXIS 19 (Mar. 2, 1989).

I. Background and Procedural History[2]

A. The Parties

Nominal Defendant First Niles is a Delaware corporation headquartered in Niles, Ohio. First Niles is a unitary holding company, formed as a result of the demutualization of Home Federal Savings and Loan Association of Niles (the "Bank"), with no significant operations apart from those of the Bank. The Bank operates a single branch in Niles and is a federally chartered stock savings association. "Its principal business consists of attracting retail deposits . . . and investing those funds primarily in permanent and construction loans secured by first mortgages on one- to four-family residences."[3]

Plaintiffs, shareholders Leonard T. Gantler and his wife, Patricia A. Cetrone, John and Patricia Gernat, and Paul and Marsha Mitchell, collectively own 121,715 First Niles shares.[4] Gantler was a First Niles director from April 16, 2003 until April 26, 2006. He is a certified public accountant.

Defendant William L. Stephens was Chairman of the Board, President and CEO of both First Niles and the Bank, and has been employed by the Bank since 1969. As of September 30, 2006, he beneficially owned 109,652 shares, or 7.9% of the outstanding

---

[2] Unless otherwise indicated, the facts are drawn from well-pled allegations in Plaintiff's First Amended Verified Complaint ("Complaint") and certain documents the Complaint incorporates by reference.

[3] Compl. ¶ 7.

[4] Gantler and his wife beneficially own 49,626 shares of common stock, or about 3.6% of the shares outstanding.

First Niles common stock.[5] Stephens was a participant in the Company's Employee Stock Ownership Plan ("ESOP"), and was to receive a 32,000 share distribution upon retirement.

Defendant P. James Kramer has been a director of First Niles and the Bank since 1994. Kramer chairs the Audit Committee and sits on the Nominating and Compensation Committees. He beneficially owned 4,781 shares, and received $13,300 in compensation for being a director in 2005. Kramer is president of William Kramer & Son, a heating and air conditioning company in Niles, which provides such services to the Bank.

Defendant William S. Eddy has been a director of First Niles and the Bank since 2002. Eddy beneficially owned 1,149 shares. Eddy is a doctor of osteopathic medicine in Niles.

Defendant Daniel E. Csontos has been a director of First Niles and the Bank since April 20, 2006. Csontos has been a full-time employee of both institutions, serving as compliance officer and as corporate secretary since 1996 and 2003, respectively. He owned 12,456 shares, held within the ESOP.

Defendant Robert I. Shaker became a director of First Niles and the Bank on January 4, 2006, after former director Ralph A. Zuzolo passed away. Shaker is an attorney with Shaker & Shaker LLP in Niles, Ohio. He serves on First Niles' Audit, Compensation and Nominating Committees, and owned 17,708 First Niles shares.

---

[5] First Niles, Proxy Statement, at 38 (Nov. 17, 2006) (hereinafter "Reclassification Proxy" or "Proxy"). The Court takes judicial notice of several facts under D.R.E. 201(b)(2), including the Defendants' share ownership listed in the Reclassification Proxy, because they are not subject to "reasonable dispute."

Defendant Lawrence Safarek is the Treasurer and Vice President of First Niles and the Bank. He owned 89,962 shares, 26,000 of which are held by the ESOP.[6]

Zuzolo was a director and corporate board secretary of First Niles and the Bank until his death on August 22, 2005, and is not named as a party in this action. He was a principal of the law firm Zuzolo, Zuzolo & Zuzolo as well as CEO and sole owner of American Title Services, Inc. ("American Title"), a real estate title agency in Niles, Ohio. Zuzolo's law firm provided legal services for First Niles. American Title provided title services in almost all of the Bank's mortgage closings.

B. Facts

1. The potential sale of First Niles

In August 2004, the First Niles Board, consisting of Stephens, Kramer, Eddy, Zuzolo, and Gantler, authorized initiating a process to sell the Company (the "Sales Process"). The Board retained an investment bank, Keefe, Bruyette & Woods (the "Financial Advisor"), and legal counsel to assist in that Process.

At the next Board meeting, however, Stephens, Csontos, and Safarek (collectively, "Management") proposed abandoning the Sales Process. Instead, they advocated privatizing the Bank, changing it from a federal to a state-chartered savings bank, and reincorporating it in Maryland. The Board took no action on Management's proposal and continued with the Sales Process. The Financial Advisor contacted six financial institutions approved by the Board.

---

[6] This includes 31,148 options. *See* Reclassification Proxy at 38.

On December 10, 2004, Stephens received bid letters from Farmers National Banc Corp. ("Farmers"), Cortland Bancorp ("Cortland"), and First Place Financial Corp. ("First Place"). Farmers stated it had "no plans to retain the current First Niles board." [7] The Board did not pursue Farmer's offer. Cortland's offer of $18 per First Niles share, 49% in cash and 51% in stock, represented a 3.4% premium over First Niles' share price. Cortland indicated it would terminate all First Niles board members, but offered to consider them for board service in the future. Cortland also offered to honor the severance obligations to Stephens, Csontos, and Safarek. First Place's offer was a stock for stock transaction valued at $18 to $18.50 per share, or a 3.4% to 6.3% premium, and did not indicate whether First Place would retain the First Niles Board.

At the next regularly scheduled Board meeting on December 20, 2004, Stephens addressed the bids. The Financial Advisor stated all three bids were within a range supported by its financial models, and the stock-based offers would be better than retaining First Niles shares. Notwithstanding the Financial Advisor's advice, the Board took no action. At the same meeting, Stephens further detailed Management's privatization proposal.

On January 4, 2005, First Place reminded Stephens of its bid. On January 18, the Board directed the Financial Advisor and Management to proceed with due diligence for First Place and Cortland.

---

[7] Compl. ¶ 32.

Thereafter, the Financial Advisor met with Stephens and Safarek and they reviewed Cortland's due diligence requests. Stephens and Safarek agreed to provide the materials Cortland requested, and scheduled a due diligence session on February 6, 2005. When Cortland failed to receive the materials by February 3, it canceled the February 6 meeting and demanded the submission of all due diligence materials by February 8. Having still received no materials, Cortland withdrew its bid on February 10.[8] Management did not communicate the due diligence difficulties to the Board until after Cortland's withdrawal.

Separately, First Place made its due diligence requests on February 7, 2005, and requested a review session the following week. Stephens initially did not provide the due diligence materials and resisted setting a date with First Place, stating there was other more pressing business at the Bank. Upon Cortland's withdrawal from the Sales Process, however, Stephens consented to a due diligence session with First Place.

First Place began its due diligence review on February 13, 2005, and submitted a revised offer to First Niles on March 4. As compared to its original offer, the revised offer had an increased exchange ratio, but due to First Place stock's decline, represented a lower implied price of $17.25 per share. However, the revised offer represented an 11% premium over First Niles stock price. The Financial Advisor found the revised offer to

[8] The Financial Advisor attributed Cortland's withdrawal to "the inordinate amount of delay on the part of . . . management getting/ not getting information . . . ." *Id.* ¶ 43.

be within an acceptable range and to exceed the mean and median comparable multiples for transactions involving thrift banks with assets less than $225 million.

Stephens waited until the Board's regularly scheduled meeting on March 7 to inform them of First Place's revised offer.[9] The Financial Advisor suggested First Place might increase the exchange ratio, but the Board did not discuss the offer at that time. Stephens stated the Board would consider the offer at its next scheduled meeting. After the Financial Advisor noted First Place probably would not wait two weeks for a response, however, Stephens suggested a special meeting on March 9 to discuss the revised offer.

On March 8, First Place increased its offered exchange ratio to provide an implied value of $17.37 per share. At the special meeting on March 9, Stephens disseminated a memorandum from the Financial Advisor positively describing First Place's revised offer. Without any discussion or deliberation of First Place's offer, Stephens called the vote and the Board voted 4 to 1 to reject the offer. Only Gantler voted in favor of it. After the vote, Stephens discussed Management's privatization plan, and charged legal counsel with investigating that plan.

2. The Reclassification

On April 18, 2005, Stephens furnished to the Board a document entitled "First Niles Financial, Inc. Privatization Proposal" (the "Privatization Proposal" or "Proposal"). The Proposal recommended reclassifying the shares of holders of 300 or fewer common

---

[9] First Niles' Financial Advisor and outside counsel for the Sales Process attended the meeting.

shares into preferred shares on a one-to-one basis (the "Reclassification").[10] The new preferred shareholders would lose their voting rights, except in the case of a proposed sale of the company, receive higher quarterly dividends, and have the same liquidation rights as common stock. The Proposal claimed the Reclassification was the best privatization method because, among other reasons, it allowed maximum flexibility for future capital management activities, such as open market purchases and negotiated buy-backs. Also, First Niles could accomplish the Reclassification without having to buy back any shares in a fair market appraisal.[11]

On April 20, 2005, the Board appointed Zuzolo to chair a committee to investigate a number of issues related to the Reclassification. In particular, the committee was charged with examining the details of: "reincorporating the Company in a state other than Delaware; (2) changing the Bank's charter from a federal charter to a state charter; (3) deregistering from NASDAQ; and (4) delisting."[12] Zuzolo, however, passed away on August 22, before any other directors were appointed to the committee or the committee reported anything to the Board.

First Niles' outside counsel, Powell Goldstein LLP, orally presented the Reclassification to the Board on December 5, 2005, but provided no written materials.

---

10 The Reclassification involved two separate transactions: (1) an issuance of Series A Preferred Stock, and (2) a reclassification of First Niles common stock held by shareholders with fewer than 300 shares. *See* Reclassification Proxy at 15.

11 The Privatization Proposal was not attached to the Complaint. *See* Compl. ¶¶ 59-61 (describing the Privatization Proposal).

12 *Id*. ¶ 63.

After the presentation, the Board voted 3 (Eddy, Kramer, and Stephens) to 1 (Gantler) to have Powell Goldstein "go forward with a stock reclassification program in order to deregister from the SEC, and its requirements."[13]

On June 5, 2006, the Board determined the Reclassification was fair to both the reclassified shareholders who would receive the Series A Preferred Stock, and to those who would continue to hold First Niles common stock.[14] On June 19, 2006, the Board voted unanimously to amend the Company's Charter to reclassify each share of common stock held by holders of 300 or fewer shares into one share of Series A Preferred Stock. The Board also unanimously approved the new terms for the preferred stock: senior dividend rights to the common shares; certain rights upon liquidation, dissolution or winding up of the Company; and no voting rights except in connection with certain proposals for change of control transactions.[15]

3. Reclassification Proxy and Shareholder Vote

The Board submitted its preliminary proxy to the Securities and Exchange Commission on June 29, 2006, and amended it on August 10 ("Preliminary Proxy"). Plaintiffs initiated this action after the amended filing, alleging misstatements and omissions in the Preliminary Proxy relating to the Reclassification. After addressing a

---

13 *Id.* ¶ 67.

14 *See* Reclassification Proxy at 15. By this time, Shaker and Csontos had joined the Board. Shaker replaced Zuzolo on January 4, 2006, and Csontos filled Gantler's position on April 20, 2006. At all relevant times from June 2006 on, the Board consisted of Stephens, Kramer, Eddy, Shaker, and Csontos.

15 For a more detailed discussion of the Reclassification, *see* Reclassification Proxy at 1-6.

number of the disclosure deficiencies identified in Plaintiffs' initial complaint, the Board submitted its Reclassification Proxy to the shareholders on November 16, 2006. The Proxy asked shareholders to "vote on the Articles of Amendment providing for the reclassification of each share of First Niles common stock held by record holders of 300 or fewer shares into one share of Series A Preferred Stock."[16] Plaintiffs filed their amended complaint on November 20, which alleged, among other things, the Reclassification Proxy still contained material misstatements and omissions.

In the Reclassification Proxy, the Board stated the Reclassification would enable First Niles to "save significant legal, accounting and administrative expenses relating to our public disclosure and reporting requirements under the Securities Exchange Act."[17] The Board described the benefits of deregistration as including estimated savings of $142,500 per annum from a reduction in the number of common shareholders, $81,000 annually in Sarbanes Oxley related compliance costs, and $174,000 from avoiding a one-time consulting fee for constructing a system to document and report the Company's internal control structure.[18] The estimated costs of deregistration included $75,000 in expenses relating to the Reclassification, low liquidity for the reclassified and common shares, and the loss of some investor protections under the federal securities law.[19] The Proxy also listed a series of alternative transactions considered by the Board, including a

---

16 *See* Proxy Card attached to Reclassification Proxy.

17 Reclassification Proxy at 11.

18 *Id.* at 15-17.

19 *Id.* at 18.

cash-out merger, a reverse stock split, an issuer tender offer, expense reduction, and a business combination.[20]

The Company's stockholders approved the Board's Reclassification decision on December 14, 2006, and it became effective on December 20, 2006.[21] Of the 1,384,533 shares outstanding and eligible to vote,[22] 793,092 shares, or 57.3%, were voted in favor of the Reclassification, and 11,060 votes abstained.[23]

C. Procedural History

Plaintiffs' Complaint, as amended on November 20, 2006, asserts three separate claims. In Count I, Plaintiffs allege Defendants Stephens, Kramer, Eddy, Csontos, and Safarek breached their fiduciary duty of loyalty to the shareholders when they rejected First Place's offer and abandoned exploration of a potential sale of the Company. Count II alleges all the individual Defendants breached their fiduciary duty by submitting a materially false and misleading proxy to the shareholders regarding the Reclassification. Count III avers Defendants breached their duty of loyalty when they effected the

---

20 *Id.* at 13-14.

21 *See* First Niles, Rule 13e-3 Transaction Statement (Amend. No. 4 to Schedule 13e-3) at 2 (Dec. 20, 2006). The Court takes judicial notice of the results of the transaction under D.R.E. 201(b)(2).

22 *See* Reclassification Proxy at 34.

23 *See* Br. in Support of Defs.' Mot. To Dismiss Plfs.' Am. Compl. ("DOB") Ex. B (Certif. of Inspector of Election as to the Adoption of Proposals, Dec. 14, 2006). Plaintiffs' answering brief and Defendants' reply brief on the motion to dismiss are referred to as "PAB" and "DRB," respectively. The vote tallies are admissible as facts not subject to "reasonable dispute" under D.R.E. 201(b)(2).

Reclassification. Plaintiffs seek equitable relief in the form of rescission of the Reclassification, as well as compensatory damages, attorneys' fees and costs.

Defendants have moved to dismiss the Complaint in its entirety. Defendants urge the Court to dismiss Counts I and III because Plaintiffs cannot overcome the presumption of the business judgment rule. Specifically, they argue Plaintiffs have failed to sufficiently allege a majority of the Board lacked independence or were interested in the challenged decisions. Defendants further contend their decisions not to sell First Niles and to reclassify its stock do not support a claim for breach of fiduciary duty as a matter of law. In addition, Defendants seek dismissal of Count III because the shareholders ratified the decision to reclassify First Niles' stock. Defendants argue Count II should be dismissed on the ground that the challenged disclosures in, and omissions from, the Reclassification Proxy do not render it false or misleading. Defendants also have moved to dismiss Counts I and III as to Safarek and Csontos and Count III as to Shaker because those Defendants were not directors during the challenged votes and did not participate in those votes, and in the case of Csontos and Shaker, for lack of personal jurisdiction under Court of Chancery Rule 12(b)(2).

II. ANALYSIS

The standard for dismissal under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief may be granted is well established. A court will grant the motion only if it concludes, after accepting all well-pled factual allegations of the complaint and drawing all reasonable inferences in favor of the nonmoving party, the "plaintiff would not be entitled to recover under any reasonably conceived set of

circumstances susceptible of proof."[24] A court need not accept every interpretation of the allegations proposed by the plaintiff; instead, a court will accept those "reasonable inferences that logically flow from the face of the complaint."[25] Mere conclusions, however, will not be accepted as true without supporting specific allegations of fact.[26] Additionally, on a motion to dismiss, a court may consider documents that are "integral to or are incorporated by reference into the complaint," [27] as well as facts subject to judicial notice.[28]

A. Count I: The Sales Process

Plaintiffs allege Defendants Stephens, Kramer, Eddy, Csontos, and Safarek breached their duties of loyalty and care as directors and officers of First Niles, when they (1) sabotaged the due diligence process, (2) rejected the First Place offer, and (3) terminated the Sales Process.[29] According to Plaintiffs, these Defendants took the challenged actions to preserve their positions as directors and officers. Plaintiffs argue that as a result of Defendants' breaches, Plaintiffs "were not able to receive a value-

---

[24] *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002)).

[25] *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001).

[26] *See In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 326 (Del. 1993) (citing *Haber v. Bell*, 465 A.2d 353, 357 (Del. Ch. 1983)).

[27] *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999) (citing *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 69-70 (Del. 1995)).

[28] *Gen. Motors*, 897 A.2d at 170.

[29] Compl. ¶¶ 84-85.

maximizing bid for their First Niles' stock . . . ."[30] Defendants respond that Plaintiffs have failed to overcome the business judgment rule.[31] Arguing unlawful entrenchment, Plaintiffs contend the business judgment presumption is inapplicable under *Unocal*; alternatively, Plaintiffs assert a majority of the Board was interested and lacked independence.[32]

There is no dispute Defendants Stephens, Kramer, and Eddy were directors during the Sales Process. Defendants argue Safarek and Csontos are not proper defendants under Count I because neither of them was a director at the time of the vote to reject the First Place offer. Csontos further argues he was not an officer under 10 *Del. C.* § 3114(b), and should be dismissed under Rule 12(b)(2) because the Court does not have personal jurisdiction over him.[33] Before turning to the merits of Count I, I briefly address the specific defenses raised by Csontos and Safarek.

1. The claims against Csontos and Safarek as to the Sales Process

a. Csontos' 12(b)(2) motion

On a motion to dismiss under Rule 12(b)(2), the plaintiff has the burden to show a basis for the Court's jurisdiction over the nonresident defendant.[34] "Generally, the court

---

30 *Id*. ¶ 85.

31 *See* DOB at 2; DRB at 6.

32 PAB at 23-24 (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)).

33 *See* Defs.' Mot. to Dismiss at 1; DOB at 33-34; DRB at 28.

34 *Albert v. Alex. Brown Mgmt. Servs.*, 2005 Del. Ch. LEXIS 133, at *50 (Aug. 26, 2005).

will engage in a two-step analysis: first determining whether service of process on the nonresident is authorized by statute; and, second, considering whether the exercise of jurisdiction is, in the circumstances presented, consistent with due process."[35] The court may consider the pleadings, affidavits, and any discovery of record.[36] "If, as here, no evidentiary hearing has been held, plaintiffs need only make a *prima facie* showing of personal jurisdiction and the record is construed in the light most favorable to the plaintiff."[37]

Plaintiffs' contention Csontos was an officer of the Company is unsubstantiated and conclusory. Csontos was First Niles' and the Bank's chief compliance officer and corporate secretary. An employee is not considered an officer for personal jurisdiction purposes merely because her title includes the word, "officer." Under 10 *Del. C.* § 3114(b), an officer includes: (i) the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer, or chief accounting officer; (ii) someone identified in public filings because she was one of the most highly compensated executive officers; or (iii) someone who has consented in writing to be identified as an officer. The Complaint provides no basis for a reasonable inference that Csontos satisfied any of Section 3114(b)'s three prongs when the actions to terminate the Sales Process were taken: (i) he is not alleged to have held one of the

---

35 *Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 326 (Del. Ch. 2003) (citing *LaNuova D & B, S.P.A. v. Bowe Co.*, 513 A.2d 764, 768-69 (Del. 1986)).

36 *Ryan v. Gifford*, 935 A.2d 258, 265 (Del. Ch. 2007).

37 *Id.* (quotation omitted).

enumerated positions; (ii) there is no reference in the Complaint to a public filing identifying him as an executive officer;[38] and (iii) there is no allegation of a written agreement identifying Csontos as an officer of First Niles. Thus, as to Count I, Csontos is properly dismissed for lack of personal jurisdiction.

b. Safarek's fiduciary duties as an officer

There is no dispute Safarek, as treasurer and vice president of First Niles, was an officer. "Corporate officers and directors . . . stand in a fiduciary relation to the corporation and its stockholders."[39] "The fiduciary duties an officer owes to the corporation 'have been assumed to be identical to those of directors.'"[40] As an officer, Safarek owed fiduciary duties of loyalty and care to First Niles and its shareholders.

Plaintiffs' claim based on the rejection of the First Place offer and termination of the Sales Process relates to Safarek only insofar as he allegedly sabotaged the Sales Process.[41] The Complaint, however, fails to allege sufficient facts for this Court to reasonably infer Safarek acted in bad faith (*i.e.*, disloyally) or was grossly negligent (*i.e.*, acted with a culpable lack of due care).

---

38 Plaintiffs have not referenced any corporate document, like the Company's bylaws or certificate of incorporation, to show Csontos is or was an officer. *Compare* First Niles, Proxy Statement at 4 (Mar. 18, 2005) (Csontos is not included in list of executive officers) *with* First Niles, Proxy Statement, at 5 (Mar. 24, 2006) (Csontos is included in list of directors and executive officers because of his position as a "Director Nominee").

39 *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

40 *Ryan*, 935 A.2d at 269 (quoting *In re Walt Disney Co. Deriv. Litig.*, 2004 Del. Ch. LEXIS 132, at *14 (Sept. 10, 2004)).

41 *See* PAB at 40.

Plaintiffs' strongest allegation of sabotage relates to the Cortland bid. The Board first instructed Management to proceed with the due diligence on January 18, 2005; a due diligence session with Cortland was scheduled for February 6. On February 3, upon learning that no information would be "immediately forthcoming," Cortland canceled the February 6 meeting, and pushed back to February 8 the due date for submission of all materials to them.[42] When that deadline passed, Cortland withdrew its offer on February 10, 2005. While the Financial Advisor attributed Cortland's withdrawal to an "inordinate amount of delay on the part of . . . management . . . not getting that information to Cortland,"[43] Plaintiffs advance no specific facts or argument as to how causing a delay of a matter of days, or at most a couple of weeks, conceivably could be a breach of Safarek's fiduciary duty to the single branch, local Bank involved in this dispute. Defendants' motion to dismiss is therefore granted as to Safarek under Count I.[44]

---

42 Compl. ¶ 42

43 *Id.* ¶ 43.

44 Plaintiffs make no distinction between Stephens and Safarek with respect to their alleged sabotaging of the Sales Process; thus the Court's analysis for Safarek applies equally to Stephens. Furthermore, Plaintiffs have not shown any facts or made any argument for this Court to reasonably infer the other Defendants under Count I, Kramer and Eddy, took any action to sabotage the due diligence process. Defendants' motion for this aspect of Count I, therefore, is granted as to Kramer and Eddy as well.

2. The *Unocal* standard of review is inapplicable

Plaintiffs, citing *Unocal v. Mesa Petroleum Co.*,[45] argue for heightened scrutiny of the Sales Process because Defendants allegedly undertook the following "entrenching" activities: sabotaging due diligence, rejecting the First Place offer, and terminating the Sales Process.

"Enhanced judicial scrutiny under *Unocal* applies 'whenever the record reflects that a board of directors took defensive measures in response to a perceived threat to corporate policy and effectiveness which touches upon issues of control.'"[46] Such enhanced scrutiny is applicable "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ."[47] "In order for the board's defensive actions to survive this enhanced judicial scrutiny, the board must establish: (1) that it had reasonable grounds to believe that the hostile bid for control threatened corporate policy and effectiveness; and (2) that the defensive measures adopted were reasonable in relation to the threat posed."[48]

Unocal, therefore, "starts from the premise that the transaction at issue was defensive."[49] Here, there is no allegation of a hostile takeover attempt, or any threatening

---

45 493 A.2d 946 (Del. 1985).

46 *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 71 (Del. 1995) (quoting *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1372 n.9 (Del. 1995)).

47 *Unocal*, 493 A.2d at 954.

48 *Chesapeake Corp. v. Shore*, 771 A.2d 293, 330 (Del. Ch. 2000) (citing *Unocal*, 493 A.2d at 955; *Unitrin*, 651 A.2d at 1373).

49 *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989).

action that could cause this Court reasonably to consider Defendants' action as "defensive."[50] Instead, the Sales Process was initiated by the Board and there is no allegation of any external threat or motivation. Thus, I find the *Unocal* standard of heightened scrutiny inapplicable.[51]

3. The business judgment rule applies to the Board's decision to terminate the Sales Process

"The affairs of Delaware corporations are managed by their board of directors, who owe to shareholders duties of *unremitting* loyalty."[52] Officers and directors are protected by the business judgment rule, "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[53] It applies when a decision of the directors is questioned, and the analysis is primarily a process inquiry. "Courts give deference to directors' decisions reached by a proper process, and

---

50 *See Kahn v. MSB Bancorp, Inc.*, 1998 Del. Ch. LEXIS 112, at *7-8 (July 16, 1998) (local savings bank's board's rejection of merger offers was not defensive action under *Unocal*).

51 To support the application of *Unocal*, Plaintiffs rely on *Chrysogelos v. London*, 1992 Del. Ch. LEXIS 61, at *20 (Mar. 25, 1992), and *Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144, at *24-25 (Dec. 18, 2002) for the proposition that entrenching activities can be sufficient to deny fiduciaries the presumption of the business judgment rule. *See* PAB at 23. Neither of these cases, however, applied the *Unocal* standard of review. For a more detailed discussion of *Chrysogelos*, see footnote 75 *infra*.

52 *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 2007 Del. Ch. LEXIS 120, at *10 (Aug. 15, 2007) (citing *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998)).

53 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

do not apply an objective reasonableness test in such a case to examine the wisdom of the decision itself."[54]

The burden is on the party challenging the decision to establish facts rebutting the presumption.[55] Generally, that party must allege sufficient facts from which the court could reasonably infer (1) a majority of the individual directors were interested or beholden or (2) the challenged transaction was not otherwise the product of a valid exercise of business judgment.[56] If a plaintiff fails to rebut the business judgment rule, "a court will not substitute its judgment for that of the board if the latter's decision can be 'attributed to any rational business purpose.'"[57]

Defendants argue "the decision not to sell the company . . . cannot form the basis of a breach of fiduciary duty, because the directors owed no duty to the shareholders to sell the company."[58] Defendants cite several cases where Delaware courts have held a majority shareholder did not have a duty to sell its holdings merely because doing so would be in the minority shareholders' best interest. This case, however, does not involve a majority shareholder. None of the Defendants owned more than 7.9% of First

---

54 *Brazen v. Bell Atl. Corp.*, 695 A.2d 43, 49 (Del. 1997) (citations omitted).

55 *Aronson*, 473 A.2d at 812 (citing *Puma v. Marriott*, 283 A.2d 693, 695 (Del. Ch. 1971)).

56 *See Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000) (citing *Aronson*, 473 A.2d at 814).

57 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

58 Tr. of argument on Defs.' mot. to dismiss held on July 11, 2007 ("Tr.") at 4.

Niles stock, and collectively they beneficially owned only 17%.[59] In any case, while the Directors may not have had any duty to sell the Company, they still had to satisfy their traditional fiduciary duties. Hence, the Directors' decision not to sell the company is Board action appropriately examined within the business judgment framework.[60]

4. Have Plaintiffs pled sufficient facts as to overcome the business judgment rule?

Upon a showing a majority of directors were interested in a transaction or lacked independence, the board action in question generally would not receive the benefit of the business judgment presumption. Instead, the action would be analyzed under *Weinberger's* less deferential entire fairness standard of review.[61] The facts of this case raise an interesting question, however. The Board action challenged here is a decision *not* to accept a merger proposal by First Place.[62] Consequently, there is no *transaction* to subject to an entire fairness review. Under *Weinberger*, entire fairness has two intertwined components: fair dealing and fair price.[63] How would the Court determine the fair price of a transaction that did not take place? Would the analysis ultimately hinge

---

59 Reclassification Proxy at 38.

60 *See Kahn v. MSB Bancorp, Inc.*, 1998 Del. Ch. LEXIS 112, at *9 (July 16, 1998) (applying a business judgment analysis to a board rejection of a merger offer).

61 *See Weinberger v. UOP*, Inc., 457 A.2d 701, 711 (Del. 1983). Although Plaintiffs do not explicitly ask this Court to apply entire fairness review, they provide no alternate standard. *See* PAB at 23, 35.

62 As previously discussed, Plaintiffs also accuse Management Defendants Stephens and Safarek of "sabotaging" the Sales Process by dragging their feet in responding to due diligence requests by another bidder, Cortland.

63 *See Weinberger*, 457 A.2d at 711.

upon whether the Court found the premium offered by First Place or even Cortland to the Company to be too small? Does it make sense to apply the entire fairness standard to a decision that is arguably less intrusive on shareholders' interests than a defensive action to a hostile takeover subject to the less rigorous scrutiny of *Unocal*?

In my opinion, the entire fairness standard applicable to a board decision made by allegedly interested or beholden directors is inapplicable in the circumstances of this case. One reason is that the determination of fair price is problematic in the absence of a completed transaction.

A second reason is this is not a situation where a board affirmatively interposed itself between the shareholders and a potential acquirer by implementing a defensive measure to an unconditional tender offer, thereby requiring enhanced judicial scrutiny relative to the business judgment rule. As in the *Unocal* line of cases, Plaintiffs base their allegations of self-interest and lack of independence primarily on "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ."[64] First Place offered to do a merger subject to the approval of the First Niles Board. When the Board declined to approve the merger, First Place presumably could have proceeded with an unconditional tender offer for the shares of First Niles.[65] If Defendants opposed the tender offer, they could have taken some form of defensive measure against it. Had they done so, the action would have been subject to

---

64 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

65 Nothing in the Complaint suggests any impediment to First Place's ability to make an unconditional tender offer.

enhanced review under *Unocal*. In fact, First Place did not pursue a tender offer. Thus, all that occurred was the First Niles Board decided not to proceed with the merger proposed by First Place. That decision effectively ended the Sales Process the Board itself had initiated some months earlier. An argument that such a decision should be reviewed for entire fairness strikes me as anomalous in that it would subject the Board's action not to do a merger to more demanding review than a defensive measure adopted for the express purpose of thwarting a hostile tender offer.

Third, a less exacting standard comports with Delaware's broad allocation of power to directors. As one commentator has observed, in spite of the significant potential for conflicts of interest stemming from directors' entrenchment motives and side benefits frequently present when a board acts on a proposed merger, "Delaware corporate law definitively allocates decision-making authority to the board and, moreover, provides both substantive and procedural mechanisms ensuring a substantial degree of judicial deference to the board."[66]

In many respects this case resembles the situation Chancellor Allen addressed in *TW Services, Inc. v. SWT Acquisition Corp.*[67] In *SWT*, an acquiring company sought a preliminary mandatory injunction requiring the target corporation to redeem certain stock

---

66 Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L 769, 789 (2006). Examples of side benefits include: "an equity stake in the surviving entity, employment or noncompetition contracts, substantial severance payments, continuation of existing fringe benefits or other compensation arrangements." *Id.* at 788.

67 1989 Del. Ch. LEXIS 19 (Mar. 2, 1989).

rights in order to enable the acquirer to close its proposed merger and conditional tender offer. The acquirer conditioned its tender offer on, among other things, the target's board redeeming a "poison pill." The target board concluded the offer was not a *bona fide* offer in view of the conditions and determined they had no duty to even address the question whether they should redeem the pill. Chancellor Allen concluded *Unocal's* proportionality test did not apply to the "board's decision not to divert this Company from its long term business plan in order to facilitate or propose an extraordinary transaction designed to maximize current shareholder value."[68]

Regarding the power of a board to reject a public tender offer or practically preclude its completion by adopting (or refusing to redeem) a poison pill stock rights plan, the court stated:

> In *Moran v. Household International, Inc*., 500 A.2d 1346 (Del. 1985), our Supreme Court opined that Delaware corporations were authorized to issue securities of this type, but noted that there could be a self-serving aspect to the use of this power. It held that a board that took such power to itself would be held to a fiduciary standard when called upon to consider releasing the power (by redeeming the pill) in light of all of the circumstances of a particular tender offer. Significantly, the Supreme Court cited the *Unocal* case at this point in its opinion. This court has understood that citation to mean that a decision not to redeem a pill in the face of a hostile tender offer is a defensive step that has to be "reasonable in relation to the threat posed" by such offer.
>
> As a result, the disparity between the legal treatment of these functionally similar forms of change in control transactions -- mergers and public tender offers -- continues. *Should a court be required to review a decision not to pursue*

[68] *Id*. at *4.

> *a merger, it would, in my opinion, ask itself the two fundamental questions that the business judgment form of judicial review requires: did the board reach that decision in good faith pursuit of legitimate corporate interests, and did it do so advisedly?* Supposing that the plaintiff failed to persuade the court that the answer to either question was in the negative, the court would not go on to exercise even the restrained level of substantive review that *Unocal* contemplates. It would not ask whether the decision could be justified as "reasonable" in relation to anything else, as it is to do when the decision is to preclude a tender offer.
>
> This difference in judicial review of decisions not to pursue a merger opportunity and decisions to preclude a hostile tender offer can be rationalized by reference to the different statutory treatment of the board's role with respect to each form of transaction.
>
> The offer of SWT involves *both* a proposal to negotiate a merger and a conditional tender offer precluded by a poison pill. *Insofar as it constitutes a proposal to negotiate a merger, I understand the law to permit the board to decline it, with no threat of judicial sanction providing it functions on the question in good faith pursuit of legitimate corporate interests and advisedly.*[69]

The same logic applies in this case regarding the termination of the Sales Process and the rejection of the First Place offer. First Place made a proposal to negotiate a merger; the Defendant Directors rejected it. Under *SWT*, this Court judges the propriety of those actions by asking two fundamental questions under the business judgment form of review: (1) did the Board reach their decision in good faith pursuit of legitimate corporate interests, and (2) did it do so advisedly?[70] Here, I find that even drawing all

---

69 *Id*. at *36-38 (citations omitted) (emphasis added).

70 Plaintiffs raise the usual arguments for the inapplicability of the business judgment presumption by alleging a majority of the directors who voted on the First Place proposal were either interested in the decision or subject to the control of such an

reasonable inferences in Plaintiffs' favor, the answer to both questions would be affirmative.

SWT's first prong is a determination of whether the Board breached its duty of loyalty. "[I]n most instances, . . . a decision to decline merger discussions will be part of a decision to continue to manage the corporation to enhance long term share value, the board's concern with distinctively corporate concerns of this type is legitimate and the good faith pursuit of them satisfies the first leg . . . ."[71] In *SWT*, the court found the legitimate long-term interests to "include a plausible concern that the level of debt likely

---

interested director. Plaintiffs' argument ultimately rests on the Directors' alleged entrenchment motives. The allegations in the Complaint, however, are not sufficient to support a reasonable inference that the Board was so interested in the decision not to merge or beholden to an interested person as to overcome the presumption of the business judgment rule. In that regard, Plaintiffs allege Defendants wanted to remain directors in order to continue to receive director related compensation. In addition, Plaintiffs contend Stephens wanted to maintain his positions as President, CEO, and Chairman; Kramer wanted to maintain the benefits he received as director; and Zuzolo wanted his title company to continue to provide title services to the Bank. Notably, the Complaint alleges no more direct and material financial interests in the challenged decision or other facts tending to call the decision into question.

As the Delaware courts have recognized, the specter of a potential entrenchment motive is omnipresent in connection with a merger decision. I read *SWT* as saying that in the context of a board's rejection of a merger offer, as opposed to taking a defensive measure against a tender offer, unexceptional entrenchment allegations of the kind made here are insufficient to take the challenged decision out of deferential business judgment review.

[71] *SWT*, 1989 Del. Ch. LEXIS 19, at *38. *SWT's* explication of the duty of loyalty as requiring that directors act in good faith for proper purposes comports with the Supreme Court's recent analysis of the fundamental duty of loyalty. *See Stone v. Ritter*, 911 A.2d 362, 369-70 (2006); *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006).

to be borne by [the target company] following any merger would be detrimental to the long term functioning of the [target company]."[72] Similarly, there is little in the Complaint to suggest the Board acted in bad faith. The Board initiated the Sales Process on its own accord, seemingly as a market check as part of an exploration of strategic alternatives. The Board's stated primary interest was to reduce "the administrative, accounting and legal expenses incurred in complying with the disclosure and reporting requirements under the Securities Exchange Act,"[73] including the Sarbanes-Oxley Act.[74] The Board's later decision to reclassify its shares in lieu of approving a merger is not indicative of bad faith. Plaintiffs have not pled sufficient facts for this Court to infer the Board acted disloyally.[75]

---

72 *SWT*, 1989 Del. Ch. LEXIS 19, at *38.

73 Reclassification Proxy at 15; *see also id.* at 13-14 (listing other alternatives to the Reclassification, including a cash-out merger).

74 Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). Section 404 requires management to establish and evaluate the effectiveness of the company's internal control structure, and auditors to report on management's assessment of such controls, at the end of the fiscal year. *See id.* at § 404, codified at 15 U.S.C. § 7262.

75 *See Stone*, 911 A.2d at 369 (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003), for the proposition that "a director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.").

In line with *SWT*, the court in the Chrysogelos case, cited by Plaintiffs, stated "corporate directors are not free to ignore an acquisition proposal for reasons extraneous to a good-faith, informed business judgment." *Chrysogelos v. London*, 1992 Del. Ch. LEXIS 61, at *19-20 (Mar. 25, 1992). The court further held that if "corporate directors 'manipulate[d] the corporate machinery for the sole or primary purpose of perpetuating themselves in office,'" they would violate their

SWT's second prong, that the Board's termination of the Sales Process be done "advisedly," is a due care inquiry. The only reference in the Complaint to what could be a violation of due care would be the Board's lack of deliberation on terminating the Sales Process. In the context of extensive discussions with, and the receipt of reports from, its Financial Advisor and the involvement of specially retained outside counsel as part of the Sales Process, the facts alleged are insufficient for a factfinder reasonably to infer the First Niles Board did not exercise due care when it terminated the Sales Process.

Thus, the Director Defendants' actions to reject the First Place offer and terminate the Sales Process are entitled to the business judgment presumption. Accordingly, I will grant Defendants' motion to dismiss as to Count I, which relates to those actions.

---

fiduciary duty of loyalty. *Id.* at *20 (citing *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984)). In *Chrysogelos*, the court found the plaintiffs pled sufficient facts to support a claim that a board rejection of an unsolicited merger offer violated the defendant directors' fiduciary duties to the corporation in the Rule 12(b)(6) and 23.1 contexts. *Id.* at *29.

The allegations regarding the directors' entrenchment actions in *Chrysogelos*, however, provided much greater cause for suspicion than the facts alleged in this case. There, the directors: (1) adopted a poison pill rights plan; (2) reduced the triggering ownership threshold of that rights plan in response to an acquirer's initial overture; (3) purchased a sizable block of the corporation's shares at a "substantial premium" two days after the acquirer's formal merger proposal, which was made before the annual shareholders meeting; (4) failed to disclose the acquisition proposal and rejection until after the annual meeting; (5) proposed, but later withdrew, a charter amendment eliminating the shareholders' right to act by written consent, thus preventing removal of the directors by written consent; and (6) approved golden parachutes in the event of a change in corporate control. *See id.* at *26-28. The court found those "circumstances, viewed in combination, create a reasonable doubt that . . . in rejecting the [merger] proposal, the defendant directors were acting for the primary purpose of maintaining themselves in office." *Id.* at *29. The extensive circumstances supporting an inference the directors acted in bad faith in *Chrysogelos* are notably absent in this case.

B. Count III: Did Defendants Breach Their Fiduciary Duty by Approving the Reclassification?

The Board's decision to effect the Reclassification is presumptively protected by the business judgment rule. A stated purpose of the Reclassification was to avoid the requirements of registration with the Securities and Exchange Commission ("SEC"). "Delaware law recognizes a corporate board's ability, in a proper exercise of their business judgment, to cause the corporation to take steps to deregister even if, as an incidental matter, deregistration might adversely impact the market for the corporation's securities."[76]

Plaintiffs allege in Count III all Defendants breached their duty of loyalty by pursuing the Reclassification to obtain "personal benefits not shared equally with, and achieved at the expense of, the unaffiliated shareholders."[77] Defendants respond the Directors were disinterested and independent, but argue in the alternative the Reclassification was ratified by a majority of First Niles' unaffiliated shareholders. Plaintiffs challenge the effectiveness of the shareholder vote pursuant to the Reclassification Proxy, however, because they contend the Proxy's disclosures were inadequate. Before turning to the merits of the parties' claims, I first address a threshold dispute as to which vote of the Company's Board should be evaluated to determine director disinterest and independence.

---

[76] *Wynnefield Partners Small Cap Value L.P. v. Niagara Corp.*, 2006 Del. Ch. LEXIS 119, at *37 (June 19, 2006), *aff'd in pertinent part, rev'd in part on other grounds*, 2006 Del. LEXIS 489 (Sept. 1, 2006).

[77] PAB at 35; *see also* Compl. ¶ 94.

1. Which Board should be evaluated for the business judgment analysis?

Plaintiffs contend the appropriate Board decisions are those made in June 2006 to effect the Reclassification.[78] Defendants disagree, arguing the appropriate date to determine liability is December 5, 2005, when Stephens, Eddy, Kramer and Gantler comprised the Board.[79]

On December 5, 2005, the Board resolved "to have Powell Goldstein LLP to go forward with a stock reclassification program in order to deregister from the SEC, and its requirements."[80] In January 2006, Shaker filled Zuzolo's vacant seat, and in April Csontos replaced Gantler; the Board thereafter consisted of Stephens, Kramer, Eddy, Shaker, and Csontos. In June 2006, the Board took two crucial steps towards implementing the Reclassification when it voted to amend the Company's Charter to allow for reclassification of the shares held by record holders of 300 shares or fewer into Series A Preferred Stock and to approve new terms for the Preferred Stock.

Up until the Board submitted the Reclassification Proxy to the shareholders, it could have decided to forgo the Reclassification.[81] Thus, one appropriate time at which to analyze the loyalty of the Board is when it made its final decision to proceed with the

---

78 *See* Tr. at 45; PAB at 36-37.

79 *See* DOB at 16. By that time, Zuzolo had passed away.

80 Compl. ¶ 67. Gantler voted against this resolution. *Id.*

81 A board must submit a proposed amendment of the certificate of incorporation to the shareholders for a vote, and it will not be effective unless "a majority of the outstanding stock entitled to vote thereon" votes in favor of the amendment. 8 *Del. C.* § 242(b)(1).

Reclassification. The First Niles Board that voted in June 2006 to submit the Reclassification Proxy to the shareholders consisted of Stephens, Kramer, Eddy, Shaker, and Csontos.[82] Because those Directors could be liable for their decision to effect the Reclassification, the discussion that follows focuses on them.[83]

2. Safarek is not a proper Defendant under Count III

Plaintiffs allege no facts from which I can infer Safarek, as an officer, took part in the Board's decisions relating to the Reclassification. Plaintiffs' claim centers on the Board's decision to undergo the Reclassification. "Delaware law clearly prescribes that a director who plays no role in the process of deciding whether to approve a challenged transaction cannot be held liable on a claim that the board's decision to approve that transaction was wrongful."[84] Safarek was not a Director at any relevant time, and there is no allegation he took any action as an officer of First Niles that could subject him to

---

82 Defendants' argument the Court lacks personal jurisdiction over Csontos and Shaker is untenable because both were directors when one or more of the disputed actions regarding the Reclassification were taken. *See* 10 *Del. C.* § 3114(a).

83 A colorable argument also can be made for holding responsible the Board that initially authorized the Company's counsel to go forward with the stock reclassification program eventually implemented. Those directors were Stephens, Eddy, Kramer and Gantler. Because I ultimately find the shareholders validly ratified the Reclassification, I need not determine whether the December 2005 Board breached their fiduciary duty by authorizing counsel to proceed with the planning of it. I note, however, that the December 2005 Board would likely enjoy the presumption of business judgment, because at most, only two of its four directors, Stephens and Kramer, would have been interested or not independent.

84 *In re Tri-Star Pictures, Inc. Litig.*, 1995 WL 106520, at *2 (Del. Ch. Mar. 9, 2005) (citing *Citron v. E.I. du Pont de Nemours & Co.*, 584 A.2d 490, 499 (Del. Ch. 1990); *In re Wheelabrator Techs., Inc. S'holders Litig.*, 1992 Del. Ch. LEXIS 196, at *35 (Sept. 1, 1995); *Propp v. Sadacca*, 175 A.2d 33, 39 (Del. Ch. 1961)).

liability for the challenged Reclassification. Thus, Plaintiffs have failed to allege an adequate legal and factual basis for a claim against Safarek.

3. Can the Court reasonably infer from the Complaint a majority of the Board had a disabling interest in the Reclassification?

The business judgment rule presumption the Board acted loyally regarding the Reclassification is rebuttable by facts establishing the Board was either interested in the outcome of the transaction or lacked the independence to consider objectively whether the Reclassification was in the best interest of the Company and its shareholders.[85]

A director is considered interested when he will receive a personal financial benefit from a transaction not equally shared by the stockholders,[86] or when a corporate decision will have a materially detrimental impact on the director, but not the corporation or its stockholders.[87] The benefit (or detriment) must be "of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders."[88]

---

85 *See, e.g., Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002). Much of Delaware law with respect to director disinterest and independence has been decided within the context of proving demand futility under Rule 23.1, which requires demand excusal be pled with particularity. "[T]he 'reasonable doubt' standard used in a demand futility analysis provides a higher hurdle for a plaintiff than the relatively lenient standard of review pursuant to Rule 12(b)(6)." *In re Primedia Inc., Deriv. Litig.*, 910 A.2d 248, 256 n.13 (Del. Ch. 2006) (citing *In re Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *7 (Del. Ch. Mar. 27, 2002)).

86 *Aronson v. Lewis*, 473 A.2d 805, 812 (1984).

87 *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

88 *Orman*, 794 A.2d at 25 n.50.

"Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[89] "[E]ach director [must bring] . . . her own informed business judgment to bear with specificity upon the corporate merits of the issues without regard for or succumbing to influences which convert an otherwise valid business decision into a faithless act."[90] As Chancellor Chandler noted in *Orman*,

> "Independence" . . . involves an inquiry into whether the director's decision resulted from that director being *controlled* by another. A director can be controlled by another if in fact he is dominated by that other party, whether through close personal or familial relationship or through force of will. A director can also be controlled by another if the challenged director is beholden to the allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or [which] is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively.[91]

---

89 *Aronson*, 473 A.2d at 816.

90 *Id.*

91 *Orman*, 794 A.2d at 25 n.50.

Furthermore, "the determination of whether a particular director is 'beholden' to an allegedly controlling person is not limited to the power to affect the director in the future. One may feel 'beholden' to someone for past acts as well."[92]

For determining disinterestedness and independence, the key issue is "whether the possibility of gaining some benefit or the fear of losing a benefit is likely to be of such importance to that director that it is reasonable for the Court to question whether valid business judgment or selfish considerations animated that director's vote on the challenged transaction."[93] In this regard, the Delaware courts do not apply an objective "reasonable director" test, but rather use a subjective "actual person" standard to determine whether a particular director's interest is material and debilitating or that he lacks independence because he is controlled by another.[94]

With these principles in mind, I turn to whether a majority of the First Niles Board were interested in the matter or were dominated or controlled by a materially interested director when they decided to undergo the Reclassification in June 2006. Plaintiffs aver a disabling condition as to all five members of the Board. Contending only "[t]hree of the five members, Kramer, Eddy, and Shaker, were disinterested and independent,"[95] as to

---

92 *In re Limited, Inc. S'holders Litig.*, 2002 Del. Ch. LEXIS 28, at *27 (Mar. 27, 2002) (citing *In re Ply Gem Indus., Inc. S'holders Litig.*, 2001 Del. Ch. LEXIS 123, at *4 (Sept. 28, 2001)).

93 *Orman*, 794 A.2d at 25 n.50.

94 *Id.* at 24 (citing *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995)).

95 DRB at 3.

the Reclassification, Defendants implicitly concede the inside Directors Csontos and Stephens were interested or not independent.[96] I will now address Kramer, Eddy, and Shaker in turn.

a. Kramer

Plaintiffs characterize Kramer as interested because he received material financial benefits from his position as director; they also contend he lacked independence because he was beholden to Stephens. Because I find Plaintiffs' lack of independence argument stronger, and ultimately persuasive, I need not address Plaintiffs' interestedness argument.[97]

Plaintiffs advance two arguments for why Kramer lacked independence: (1) he was beholden to Management for permitting stock sales to him in violation of First Niles' 1999 Option Plan; and (2) he hoped to obtain future employment at the Bank.

Plaintiffs allege Kramer's stock sales violated the Company's Options Plan and were not properly reported in Form 144 filings.[98] Even if true, Plaintiffs have not alleged sufficient facts demonstrating why Kramer would be beholden to Management for

---

96 Both Stephens and Csontos were employees or officers of First Niles and the Bank.

97 I note, however, that Plaintiffs' contention Kramer was interested because of his continued interest in having the Company buy back his stock probably would be insufficient. *See* PAB at 38. Kramer's relatively insignificant First Niles shareholdings are insufficient for this Court to infer that any liquidity premium he could receive as a result of the Reclassification would be material.

98 Compl. ¶ 22. An insider who is an affiliate for purposes of Rule 144 under the 1933 Securities Act, may be required to file a Form 144 with the SEC in advance of a sale of securities in order to enjoy a safe harbor from being regulated as an "underwriter." *See* 17 C.F.R. § 230.144(h); *see also* 17 C.F.R. § 239.144.

allowing such actions. Plaintiffs have not alleged, for example, that Kramer otherwise faced liability or even that Management knew of the impropriety of Kramer's actions. Thus, they have not alleged facts suggesting, for example, a quid pro quo situation indicative of self-interest.[99]

Plaintiffs further allege, "Kramer has discussed becoming a full-time banker and employed by the Bank if the Reclassification was approved."[100] That an individual is a director's superior, or boss, is "sufficiently material to give reason to doubt [the director's] independence from [that individual]."[101] Similarly, senior executive officers may be beholden to directors controlling their corporations.[102] Defendants attempt to distinguish these cases because they involved current employees rather than future employment. Although the situations are different, the distinction is immaterial. In the case of both current and future employment, an employee or prospective employee is beholden to his superior because of the prospect of future employment. Thus, while borderline, Plaintiffs' allegation is sufficient for this Court to infer Kramer could be

---

99 Delaware courts have found quid pro quo factual situations sufficient to find disabling interests. *See, e.g.*, *In re Nat'l Auto Credit, Inc. S'holders Litig.*, 2003 Del. Ch. LEXIS 5, at *37-38 (Jan. 10, 2003) (allegations of directors who approved excessive CEO compensation in quid pro quo scheme were materially interested in demand excusal and Rule 12(b)(6) contexts); *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 583 (Del. Ch. 2007).

100 Compl. ¶ 9.

101 *Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *9-10 (Del. Ch. Dec. 18, 2002) (demand excusal); *see also Steiner v. Meyerson*, 1995 Del. Ch. LEXIS 95, at *27-30 (July 28, 1995).

102 *See Rales v. Blasband*, 634 A.2d 927, 937 (Del. 1993).

beholden to Management (*e.g.*, Stephens, who presumably would control the Bank's hiring decisions).

Defendants further argue Management (Stephens in particular) is incapable of controlling any of the Directors because Management does not own a controlling interest in First Niles.[103] That defense is untenable; the issue is not whether Stephens or any other member of Management controlled the Company, but rather whether he could exercise control over other Directors. For these reasons, I find Plaintiffs conceivably could prove Kramer was not independent.

b. Eddy

Plaintiffs claim Eddy lacked independence from Stephens because he cast every vote in accord with Stephens. Generally, "routine consensus cannot suffice to demonstrate disloyalty on the part of a director," although, "there may be instances in which a director's voting history would be sufficient to negate a director's presumed independence."[104] Under *Khanna*, Plaintiffs must allege both a pattern of votes evincing control, and a material benefit to the controlled director.[105] The plaintiffs in *Khanna* failed to show a broad pattern of votes demonstrating acquiescence or control or to explain how the directors' alleged acquiescence benefited them.[106] Here, even if

---

103 DOB at 10.

104 *Khanna v. McMinn*, 2006 Del. Ch. LEXIS 86, at *58 n.92 (Del. Ch. May 9, 2006).

105 *See id.* at *57-58. The *Khanna* decision involved the application of Rule 23.1; thus, its requirement of "*particularized* facts showing a pattern of votes" is inapplicable to this case. *Id.* at *57 (emphasis added).

106 *Id.* at *58.

Plaintiffs' bald allegation Eddy voted with Stephens in every vote Gantler attended could support a finding of a pattern of votes evincing control, Plaintiffs failed to allege how Eddy received any material benefit from his alleged acquiescence. Thus, Plaintiffs have not alleged sufficient facts from which one could infer Eddy lacked independent business judgment and was controlled by Stephens.

c. Shaker

The remaining director, Shaker, owned 17,708 First Niles shares during the relevant period. Plaintiffs contend Shaker was interested because "he stood to benefit from the increased liquidity that any stock buy back program would afford him."[107] The Complaint provides no basis to infer Shaker will be treated any differently from other stockholders in terms of the buy-back program -- *e.g.*, there is no allegation the buy-backs were available only to directors and officers. Furthermore, the Complaint does not support an inference that any increase in liquidity, if there is one, would be of material benefit to Shaker. Indeed, as the owner of nearly 18,000 shares, Shaker probably would share the concern of some remaining stockholders, like Plaintiffs, about the likely decrease in liquidity the Reclassification would cause. Accordingly, I find Plaintiffs have not alleged sufficient facts to support an inference of self-interest on the part of Shaker as to the Reclassification.

---

[107] PAB at 38-39. Because there is no allegation Shaker was a participant in the ESOP, the Reclassification presumably would affect him the same way as the other nonparticipant stockholders in terms of the ESOP-related put right. *See also* Reclassification Proxy at 22-23.

Of the five-member Board, Plaintiffs have pled sufficient facts for this Court to infer Stephens, Csontos and Kramer may have been interested or not independent.[108] In that respect, therefore, Defendants cannot claim the benefit of the business judgment rule as to Count III. The only other basis Defendants have advanced to escape enhanced judicial review is their contention that an informed majority of the unaffiliated stockholders approved the Reclassification.

4. Did the Unaffiliated Shareholders Ratify the Reclassification?

Defendants contend the Reclassification was ratified through approval of the unaffiliated shareholders.[109] Plaintiffs argue the shareholder vote was not a valid ratification because a majority of the unaffiliated shareholders did not approve the Reclassification, and the disclosures contained in the Reclassification Proxy were

---

108 Plaintiffs also cite *Hamilton v. Nozko*, 1994 WL 413299 (Del. Ch. July 27, 1994), for the proposition that a deregistration done for an inequitable purpose, to allow a majority to unfairly acquire the minority's shares at a discount, would be disallowed under *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971). *See* PAB at 39. The Complaint does not allege a similarly nefarious purpose for approving the Reclassification. Thus, neither the *Hamilton* nor the *Schnell* decision is applicable to this case.

109 The Reclassification required shareholder approval under 8 *Del. C.* § 242 because it proposed to amend the Company's charter by adding Article Fourteenth, which reclassified some shares of First Niles common stock into preferred stock. *See* Reclassification Proxy at A-2. Shareholder approval is distinct from shareholder ratification. "Shareholder ratification" is the "approval of challenged board action by a fully informed vote of shareholders, *irrespective* of whether that shareholder vote is legally required for the transaction to attain legal existence." *In re Wheelabrator Techs. S'holders Litig.*, 663 A.2d 1194, 1201 n.4 (Del. Ch. 1995) (emphasis added).

insufficient.[110] Plaintiffs further contest the admissibility for purposes of a motion to dismiss of the results of the shareholder election and of the number of shares held by the Defendant Directors as stated in the Reclassification Proxy.

a. Shareholder ratification standard

"When uncoerced, fully informed, and disinterested stockholders approve a specific corporate action, the doctrine of ratification, in most situations, precludes claims for breach of fiduciary duty attacking that action."[111] "[W]hen most of the affected minority affirmatively approves the transaction, their self-interested decision to approve is sufficient proof of fairness to obviate a judicial examination of that question."[112] Shareholder ratification, in the context of an interested director transaction, "revives the powerful presumptions of the business judgment rule as the applicable standard of review for the challenged conduct."[113]

---

110 *See* Tr. at 69-70.

111 *Sample v. Morgan*, 914 A.2d 647, 664 (Del. Ch. 2007).

112 *In re PNB Holding Co. S'holders Litig.*, 2006 Del. Ch. LEXIS 158, at *55 (Aug. 18, 2006). Void acts contrary to public policy or beyond the authority of the corporation, however, cannot be cured by ratification. *See Stroud v. Grace*, 606 A.2d 75, 83 (Del. 1992); *Solomon v. Armstrong*, 747 A.2d 1098, 1114 (Del. Ch. 1999).

113 *See* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 11-4[b][5] (2007) (citing *In re Wheelabrator Techs. S'holders Litig.*, 663 A.2d 1194, 1205 (Del. Ch. 1995)).

Under Delaware law only a *fully informed* shareholder vote in favor of a disputed transaction ratifies board action.[114] The burden rests with Defendants who rely on the shareholder vote to show that all material facts relevant to the transaction were fully disclosed to the shareholders in the Reclassification Proxy.[115]

The court in *PNB Holding*, in the context of a ratification of a merger approved by interested directors, held that the appropriate vote should be a majority of the unaffiliated stockholders' shares eligible to vote, and not merely a majority of the unaffiliated shares that were actually voted.[116] An unreturned proxy vote is akin to passive dissent; to not include a dissenting vote would contravene 8 *Del. C.* § 242, which requires a vote of a "majority of the outstanding stock of the corporation entitled to vote" for charter amendment approval.[117] Thus, for purposes of ratifying an amendment to a charter, Defendants must show that a majority of the unaffiliated shares eligible to vote voted in favor of the Reclassification.

---

114 *See Stroud*, 606 A.2d at 82 (citing *Smith v. Van Gorkom*, 488 A.2d 858, 890 (Del. 1985); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983); *Michelson v. Duncan*, 407 A.2d 211, 224 (Del. 1979)).

115 *See id.* at 84 (citing *Weinberger*, 457 A.2d at 703; *Cahall v. Lofland*, 114 A. 224, 234 (Del. Ch. 1921)).

116 *See PNB Holding*, 2006 Del. Ch. LEXIS 158, at *48-49, 55.

117 *See id.* at *55 (making an analogous argument in the context of Section 251's merger approval requirements).

b. Did a majority of the unaffiliated shareholders entitled to vote approve the Reclassification?

Determining whether a majority of the unaffiliated shares eligible to vote approved the Reclassification involves computing a simple ratio. The denominator is the number of outstanding shares at the time of the vote minus the number of affiliated shares eligible to vote. The numerator is the total number of shares voted in favor of the Reclassification minus the total number of affiliated shares entitled to vote.[118] The calculation then is (total shares cast in favor minus all affiliated shares) / (total shares eligible to vote minus all affiliated shares). The parties disagree, however, on two points related to this calculation: (1) the number of affiliated shares, and (2) the admissibility of any number taken from outside the Complaint on a motion to dismiss.

There is no dispute as to the number of outstanding shares eligible to vote on the Reclassification, and the number of shares voted for the Reclassification. There were 1,384,533 shares outstanding and eligible to vote,[119] and 793,092.4404 shares voted in

---

[118] There is no record before the Court indicating the results of votes cast by the affiliated shareholders. Drawing all inferences in favor of the Plaintiff, however, this Court assumes that *all* affiliated shareholders voted *all* of their shares in favor of the Reclassification. As it is not questioned by either party, the Court assumes, without holding, the affiliated shareholders include all of the Defendants and not just those found to be interested or beholden for purposes of determining the applicability of the business judgment presumption.

[119] Both parties cited to the Reclassification Proxy at 34. *See* Tr. at 70 (Plaintiffs' citation); Letter from Brian C. Ralston, Att'y for Defs., to the Ct. at 1-2 (July 23, 2007) (Defendants' citation).

favor of the Reclassification.[120] Both of these numbers are admissible under D.R.E. 201(b)(2) because they are not subject to reasonable dispute.

The third number needed for the calculation, however, is the crux of the parties' dispute, and frankly, confusion. Throughout their briefing and post-argument submissions to the Court, the parties have not been able to agree on the number of affiliated shares eligible to vote on the Proxy.

The parties initially used 235,708 as the number of shares held by the Defendant Officers and Directors.[121] The Reclassification Proxy states that as of September 30, 2006, the Director Defendants beneficially owned 235,708 shares. Using that figure, only 48.5% of the unaffiliated shares approved the Reclassification, insufficient for ratification. After argument, Defendants noted the Reclassification Proxy explicitly states the 235,708 affiliated shares as of September 30, 2006 include 31,148 and 11,148 options held by Safarek and Stephens, respectively.[122] Nothing in the Complaint or the Proxy suggests those options were exercised and thereby resulted in shares eligible to vote on the Reclassification as of the record date. Subtracting those options yields a total of 193,412 affiliated shares eligible to vote. Use of that number would mean 50.3% of

---

120 *See* Certif. of Inspector of Election as to the Adoption of Proposals, Dec. 14, 2006 *available* at DOB Ex. B. Plaintiffs did not contest these figures; in fact Plaintiffs themselves used this vote count at argument. *See* Tr. at 70 (citing DOB at 19 & n.7).

121 *See* Tr. at 70 (citing DOB at 19 & n.7 (citing Reclassification Proxy at 38)).

122 *See* Reclassification Proxy at 38; Letter from Brian C. Ralston, Att'y for Defs., to the Ct. (July 23, 2007).

the unaffiliated shares voted in favor of the Reclassification. The record date for the Reclassification vote, however, was November 10, 2006, not September 30, 2006.[123] In between September 30 and November 10, 2006, the total number of shares owned by Defendants changed slightly. Regarding the Reclassification vote, as of the record date, the Proxy states, "First Niles' directors and executive officers have the power to vote 194,960 shares . . . ."[124] At that level of share ownership, a majority of 50.28% of the unaffiliated shareholders voted in favor of the Reclassification.

The difference between what Plaintiffs assert and the Reclassification Proxy states for Defendants' shareholdings stems from a difference in interpretation of law and not a factual dispute.[125] Plaintiffs effectively urge the Court to use Defendants' fully diluted shareholdings to determine whether a majority of the unaffiliated shares voted for the Reclassification. Plaintiffs have presented no legal authority, however, and the Court knows of none, for basing the ratification calculation on Defendants' fully diluted number of shares as opposed to their shares actually eligible to vote on the record date. Further, including Defendants' options as Plaintiffs would do is counterintuitive, because

---

123 *See* Reclassification Proxy at 34.

124 *Id.* at 35. Defendants apparently did not notice the difference between the shares eligible to vote on September 30, 2006 and those eligible to vote as of the record date. Thus, it appears they mistakenly asserted the Proxy "incorrectly states . . . the officers and directors had the power to vote 194,960 shares." Letter from Brian C. Ralston, Att'y for Defs., to the Ct. at 2 n.5 (July 23, 2007).

125 The Defendants' shareholdings listed in the Complaint track the fully diluted shareholdings listed in the Reclassification Proxy. *Compare* Compl. ¶¶ 8-13 *with* Reclassification Proxy at 38.

there is no reason to believe Defendants had any right to vote on the Reclassification based on their options. Thus, I reject Plaintiffs' argument as unpersuasive.

Plaintiffs also dispute the existence of a ratification on evidentiary grounds. Citing *In re Santa Fe Pacific Corp. Shareholder Litigation*,[126] they contend Defendants' reliance on the Reclassification Proxy for the number of affiliated shares outstanding is impermissible because it "relies on facts outside the Amended Complaint and, therefore, cannot be resolved on this motion to dismiss."[127]

In *Santa Fe* the Supreme Court held that when "a proxy statement is merely appended to the complaint and relied upon for the disclosure claims, but is not put forth by plaintiffs as an admission of the truth of the facts referred to therein, the defendants may not use it at the pleading stage for purposes other than disclosure issues or perhaps to establish formal, uncontested matters."[128] The Court also noted, however, that "[d]espite the fact that a SEC filing may constitute hearsay with respect to the truth of the matters asserted therein, courts may consult these documents to ascertain facts appropriate for judicial notice under D.R.E. 201."[129] The issue, then, is whether the facts pertaining to the shareholder vote that Defendants rely upon are appropriate for judicial notice under D.R.E. 201.

---

126 669 A.2d 59, 70 (Del. 1995).

127 *See* Letter from Jessica Zeldin, Att'y for Pls., to the Ct. (July 25, 2007).

128 *Santa Fe Pac. Corp.*, 669 A.2d at 70.

129 *Id.* at 70 n.9.

Under Rule 201 this court may take judicial notice of a matter not subject to "reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."[130] In particular, the Supreme Court "has recognized that, in acting on a Rule 12(b)(6) motion to dismiss, trial courts may consider hearsay in SEC filings to ascertain facts appropriate for judicial notice under Delaware Rule of Evidence 201."[131]

In *General Motors*, the Supreme Court upheld this court's decision to take judicial notice of a shareholder ratification vote when there was no allegation in the complaint challenging whether the "conditions necessary to consummate the transaction were actually met" and the opposing party made no allegation the figures in the proxy were incorrect.[132] Notably, the Court dismissed an objection, similar to one made by Plaintiffs here, that the defendant's reliance on its own submission to the SEC was "self-serving."[133]

As in *General Motors*, Plaintiffs have made no allegation there was no vote, or that the vote itself was fraudulent. Plaintiffs also do not deny the accuracy of the share ownership figures listed in the Reclassification Proxy. They make no allegation, for

---

130 D.R.E § 201(b).

131 *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (citing *Santa Fe Pac. Corp.*, 669 A.2d at 70 n.9).

132 *Id.* at 170-71.

133 *See id.*

example, the Proxy inaccurately lists the Director Defendants' shareholdings, or that one or more Defendants had secret control of other blocks of shares. Under D.R.E. 201, Defendants' shareholdings as of the record date, November 10, 2006, are not subject to reasonable dispute.[134] Furthermore, for Plaintiffs to contest only the Defendant Directors' shareholdings would be disingenuous as Plaintiffs rely on other portions of the same Proxy for the total number of shares outstanding.

As stated earlier, the record shows a majority of 50.28% of the unaffiliated shares voted to approve the Reclassification, providing sufficient votes for its ratification. Before this Court can validate the ratification of the Reclassification, however, I must address the myriad disclosure claims relating to the Reclassification Proxy asserted in Count II of the Complaint.

C. Count II: Have Defendants Breached Their Duty of Disclosure?

Plaintiffs claim two types of disclosure violations in the Reclassification Proxy. First, they argue the Proxy's discussion of the Sales Process and First Place bid rejection was materially misleading. Second, Plaintiffs allege various omissions relating to the Reclassification itself.[135]

---

134 In this regard, the Court notes Plaintiffs did not make a books and records demand under 8 *Del. C.* § 220 before filing their Complaint.

135 Plaintiffs' disclosure claim is against all Defendants, including Safarek who was an officer. Plaintiffs contend Safarek is liable for any disclosure violation because he was a "filing person" under the securities laws. *See* PAB at 40-41; Compl. ¶ 89; *see also* Reclassification Proxy at 23 ("Each director and executive officer is deemed a 'filing person' in connection with this transaction."). Defendants did not respond to this argument in their reply brief. Because I find there was no duty of

1. Duty of disclosure standard

It is well-recognized "that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[136] "This fiduciary disclosure obligation involves the affirmative duty to provide information, the duty to be materially accurate and complete with respect to the information that is provided, and the duty to be entirely fair by fully disclosing material information."[137] The information must be disclosed "in a non-misleading manner."[138] "The essential inquiry is whether the alleged omission or misrepresentation is material."[139]

---

disclosure violation, I need not address Safarek's amenability to suit on Count II as a "filing person."

136 *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992); *see also Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 137-38 (Del. 1997); *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996).

Courts have more flexibility in fashioning appropriate relief in response to this type of proxy-related disclosure claim when it is pressed as one for a preliminary injunction before the shareholder vote, as opposed to being brought on many months after, as in this case. *See Globis Partners, L.P. v. Plumtree Software, Inc.*, 2007 Del. Ch. LEXIS 169, at *37-38 (Nov. 30, 2007) (citing *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 208 n.115 (Del. Ch. 2007); *In re Staples Inc. S'holders Litig.*, 792 A.2d 934, 960 (Del. Ch. 2001)).

137 *Feldman v. Cutaia*, 2006 Del. Ch. LEXIS 70, at *31-32 (Apr. 5, 2006) (citations omitted).

138 *Staples*, 792 A.2d at 953 (citing *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998)).

139 *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1277 (Del. 1994).

Delaware has adopted the United States Supreme Court's definition of materiality:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[140]

"[M]ateriality is to be assessed from the viewpoint of the 'reasonable' stockholder, not from a director's subjective perspective."[141]

The burden of demonstrating materiality rests with the plaintiffs.[142] The Delaware Supreme Court has stated:

> To survive a motion to dismiss, the plaintiffs must provide some basis for a court to infer that the alleged violations were material. For example, a pleader must allege that facts are missing from the statement, identify those facts, state why they meet the materiality standard and how the omission caused injury.[143]

"Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information."[144] Similarly, "while directors do not have to provide information that is

---

140 *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (adopting *Northway* standard).

141 *Arnold*, 650 A.2d at 1277.

142 *Nebel v. Sw. Bancorp, Inc.*, 1995 Del. Ch. LEXIS 80, at *15 (July 5, 1995).

143 *Malpiede v. Townson*, 780 A.2d 1075, 1086-87 (Del. 2001) (citation omitted).

144 *Arnold*, 650 A.2d at 1280; *see In re MONY Group Inc. S'holder Litig.*, 852 A.2d 9, 25 (Del. Ch. 2004).

simply 'helpful,' once they take it upon themselves to disclose information, that information must not be misleading."[145]

2. Were there material omissions in the Reclassification Proxy with respect to the Sales Process?

Plaintiffs allege the Reclassification Proxy was materially misleading because it: (a) omits Management's failure to cooperate with Cortland's due diligence requests; and (b) misstates that the Board rejected the First Place bid after careful deliberations when in fact there was no discussion of the First Place bid when it was rejected. Defendants respond by generally denying the Proxy needed to discuss the Sales Process extensively given the purpose of the Reclassification Proxy was to ask for shareholder approval of the Reclassification, and not to approve the rejection of the First Place bid. The issue then is whether the disputed information on the Sales Process was material in a Proxy asking for the approval or rejection of the Reclassification.

a. Failure to comply with Cortland's due diligence requests

The Reclassification Proxy provides brief summaries on the strategic alternatives the Board considered other than the Reclassification. The Sales Process, discussed in the "Business Combinations" section, is but one of several alternatives.[146] The Proxy adequately states the material information necessary to make a determination on the appropriateness of the Reclassification vis-à-vis the listed alternatives. Shareholders could evaluate the merits of those alternatives and the process by which the Board arrived

---

145 *MONY Group*, 852 A.2d at 24-25 (citing *In re Staples Inc. S'holders Litig.*, 792 A.2d 934, 954 (Del. Ch. 2001)).

146 *See* Reclassification Proxy at 13-14.

at its decision. In that context, the additional fact that Cortland withdrew its offer because it had concerns about the timeliness of the Company's response to its request for due diligence does not alter the total mix of information. The Cortland bid represented only a 3.4% premium over First Niles' share price at the time,[147] and less than the 6.75% premium ultimately offered by First Place.[148] Further, the Complaint alleges the time from when Stephens and Safarek agreed to provide materials to Cortland to the time Cortland's withdrew its bid was on the order of a few weeks. The withdrawal occurred less than one week after the date originally scheduled for a due diligence meeting with Cortland. In these circumstances, I fail to see why further disclosure of the Cortland situation would be material.[149]

b. There was no deliberation

Plaintiffs argue the following statement is misleading, "[a]fter careful deliberations, the board determined in its business judgment the [First Place] proposal was not in the best interest of the Company or our shareholders and rejected the

---

147 *See* Compl. ¶ 33.

148 *See* Reclassification Proxy at 13.

149 "[A] board is not required to engage in 'self-flagellation' . . . implicating itself in a breach of fiduciary duty from surrounding facts and circumstances prior to a formal adjudication of the matter. Nonetheless, when a board allegedly breaches its fiduciary duties, we will not uphold shareholder ratification unless the board discloses all material facts relevant to the issue at hand." *Stroud v. Grace*, 606 A.2d 75, 84 n.1 (Del. 1992) (citations omitted). "[E]ven where material facts must be disclosed, negative inferences or characterizations of misconduct or breach of fiduciary duty need not be articulated." *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 143 (Del. 1997).

proposal."[150] The Complaint alleges there was in fact little deliberation. Even assuming that allegation is true, however, Plaintiffs have not shown the challenged statement to be material. It would not alter the total mix of information to say, instead, "after deliberating" or simply omitting that phrase in its entirety. Moreover, the Complaint indicates the Board did receive expert advice from its Financial Advisor relating to the First Place proposal. The fact the Board ultimately rejected an offer its Financial Advisor considered fair does not support an inference of misconduct or no deliberation. Plaintiffs' claim merely attempts to convert what might be a duty of care claim (*e.g.*, the Directors were negligent in not conducting a more fulsome discussion of the First Place proposal) into a disclosure claim.

3. Was there a material omission in the Proxy as to the Reclassification?

Plaintiffs allege the Reclassification Proxy fails to disclose the following: (a) the Reclassification makes future acquisitions of First Niles less likely; (b) the Board planned to switch from a federal to state charter and reincorporate in a state other than Delaware; (c) the impetus behind the Reclassification; and (d) Gantler's vote against proceeding with the Reclassification and the reasons for it. I address these criticisms seriatim.

a. Future bids for First Niles may be less likely

Plaintiffs disagree with the statement, "termination of our status as an SEC-registered company will not have a significant impact on any future efforts by the

---

150 Reclassification Proxy at 14.

Company to raise additional capital or to acquire other business entities,"[151] contending instead that the Reclassification rendered a future acquisition of First Niles less likely.

This aspect of Plaintiffs' Complaint involves a dispute over the substance of the disclosure as opposed to an allegation that a known material fact was omitted. The Board's "duty was simply to make fair disclosure of the material facts in its possession bearing on the fairness of the [Reclassification] it was putting before the stockholders."[152] "Stockholders who disagreed with [the Board's conclusion] had sufficient information to make an informed decision."[153]

The failure to disclose that future acquisitions of First Niles might be less likely is not a material omission. As pled by Plaintiffs, it is not even an omission. Plaintiffs do not allege, for example, the existence of any report by or to Defendants highlighting a decreased likelihood of such a transaction.[154] Instead, Plaintiffs seem to rely on a matter of opinion, rather than fact, in that they note only that a decreased likelihood of future acquisitions could be proven through expert testimony.[155] Thus, this aspect of Plaintiffs' claim is not actionable.

---

151 *Id.* at 12 (quoted in PAB at 44).

152 *See Globis Partners, L.P. v. Plumtree Software, Inc.*, 2007 Del. Ch. LEXIS 169, at *42 (Nov. 30, 2007) (quoting *In re JCC Holding Co. S'holder Litig.*, 843 A.2d 713, 722 (Del. Ch. 2003)).

153 *Id.*

154 In fact, the Reclassification Proxy affirmatively states First Niles does "not have any current plans or proposals to effect any extraordinary corporate transaction such as a merger, reorganization or liquidation." Reclassification Proxy at 19.

155 *See* PAB at 44.

b. Change of charter and reincorporation

Plaintiffs contend Defendants should have disclosed as a "material fact" their "inten[tion] to surrender the Bank's federal charter, an inference supported by the well-pled allegations of the Complaint."[156] Defendants do not contest the materiality of changing the Bank's charter or reincorporating the Company. Instead, they assert that the Restatement Proxy provides sufficient disclosure. The Proxy states Management had no "current plans or proposals to effect any extraordinary corporate transaction such as a merger, reorganization or liquidation; . . . to change materially our . . . capitalization; or otherwise to effect any material change in our corporate structure or business."[157]

Plaintiffs have not shown the existence of any material misstatement or omission in this regard. Plaintiffs' citations to Management proposals and Board discussions on a potential change of charter relate to events that occurred in 2004 and early 2005[158] -- there is no allegation the Board was contemplating such a change when, in November 2006, it filed the Reclassification Proxy.

---

156 *Id.* at 45.

157 Reclassification Proxy at 19.

158 *See* Compl. ¶ 29 (Management discussed such a transaction as part of proposal submitted to the Board on September 7, 2004); *id.* ¶ 36 (discussed as part of proposal submitted to the Board on December 20, 2004); *id.* ¶¶ 62-63 (discussed by Board on April 20, 2005).

c. Impetus for the Reclassification

Plaintiffs argue the Proxy fails to disclose "two critical self-interested rationales" for the Reclassification -- providing greater flexibility to effectuate buy-backs and enhancing the liquidity available to participants in the ESOP Plan.[159]

While they must disclose all material facts, Directors do not have an affirmative duty to state the basis for their decision for or against a proposed shareholder action.[160] If directors choose to state their reasons for recommending a certain action, that statement must be true and not misleading. "Therefore, disclosures relating to the Board's subjective motivation or opinions are not *per se* material, as long as the Board fully and accurately discloses the facts material to the transaction."[161] Nevertheless, the reasons for a board decision may have to be fully disclosed to remedy a materially misleading partial disclosure of those reasons. The issue here is whether Plaintiffs have pled facts that conceivably could support a finding the Proxy's alleged omissions are either materially misleading in their own right, or by virtue of an allegedly partial disclosure.

I answer that question in the negative as to Defendants' nondisclosure of the increased flexibility to effectuate buy-backs under the Reclassification. Plaintiffs' only pertinent factual allegation relates to a Privatization Proposal furnished by Stephens to the Board on April 18, 2005, which noted that a reclassification nearly identical to the

---

159 *See* PAB at 46-47.

160 *See In re MONY Group Inc. S'holder Litig.*, 853 A.2d 661, 682 (Del. Ch. 2004) (citing *Newman v. Warren*, 684 A.2d 1239, 1246 (Del. Ch. 1996)).

161 *Id.* (citing *Newman*, 684 A.2d at 1246; *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1280 (Del. 1994)).

Reclassification later implemented would allow for maximum flexibility in future capital management activities, including negotiated buy-backs.[162] The presentation of this Proposal to the Board in April 2005 does not in and of itself indicate whether the Board's basis for approving the Reclassification in June 2006 included the flexibility to effectuate buy-backs. Moreover, as noted earlier, Plaintiffs have not alleged any reason to believe the buy-backs would be made available only to Defendants, or would be arguably improper (*e.g.*, granted at too high a price) such that an omission regarding potential buy-backs might be material.

Plaintiffs also contend the Proxy contained a material misstatement when it "wrongfully claim[ed] that the put and appraisal rights held by [Defendants] will only be exercisable if the Company is unable to list its stock on either the OTB or the pink sheets."[163] Plaintiffs provide no factual basis for this attack on the Proxy.

In their Complaint, Plaintiffs quote an excerpt of the ESOP stating that when the Company's shares "are not readily tradable on an established market," an employee participant would have the right to require the Company to repurchase the shares at a fair value as determined in an independent appraisal.[164] According to Plaintiffs, "the put and appraisal rights will be triggered even if First Niles stock is traded on these platforms [*i.e.*, the OTB or pink sheets] and under all of the scenarios that the Board envisioned

---

162 *See* Compl. ¶¶ 59-61.

163 PAB at 47.

164 Compl. ¶ 76 (citing ESOP § 8.7 "Put Option"; ESOP § 8.9 "Independent Appraisal").

when it asked shareholders to approve the Ratification."[165] The Complaint, however, provides no factual basis for this contention. I therefore discount it as merely conclusory. Thus, Plaintiffs have failed to plead a cognizable claim for inadequate disclosure as to the impetus for the Reclassification.

d. Failure to discuss Gantler's dissenting vote

The Reclassification Proxy described the December 5, 2005, vote to authorize Powell Goldstein to pursue the Reclassification as "a 3-to-1 vote," without mentioning it was Gantler in particular who dissented.[166] Plaintiffs contend the omissions of that fact and the reasons for Gantler's dissenting vote were material. Plaintiffs cite federal securities law mandating that where a director dissents from a Rule 13e-3 transaction, the Company must "identify the director, and indicate, if known, after making reasonable inquiry, the reasons for the dissent or abstention."[167]

While Delaware courts have looked to federal securities law to determine materiality,[168] and there may be circumstances in which a director's lone dissenting vote on a 13e-3 transaction would be material, Plaintiffs have not adequately pled materiality in this case. On one hand, Plaintiffs argue the relevant board for purposes of analyzing

---

165 PAB at 47.

166 Reclassification Proxy at 15.

167 17 C.F.R. § 229.1014 (a).

168 *See Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (adopting federal securities laws' definition of materiality); *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 948 n.167 (Del. Ch. 2004) (citing federal courts' determination of the materiality of intra-quarter earnings estimates for federal securities laws violation).

interestedness in order to overcome the presumption of the business judgment rule as to the Reclassification is the one that met on June 19, 2006 and approved the implementation of the Reclassification. That Board did not include Gantler, and voted unanimously to implement the Reclassification. On the other hand, for its disclosure claims, Plaintiffs urge the Court to focus on the Board that decided on December 5, 2005 to authorize exploration of a possible reclassification. Because the vote on December 5, 2005 was a preliminary decision to have Powell Goldstein go forward with a stock reclassification program in order to deregister from the SEC, and its requirements, Gantler's dissention from that decision is immaterial.

In summary, Plaintiffs have failed to demonstrate any material omission or misstatement in the Reclassification Proxy. Thus, Defendants' motion to dismiss is granted with respect to Count II. Furthermore, because there was adequate disclosure, the unaffiliated shareholders' ratification of the Reclassification is valid, bringing the Board's decision to effect the Reclassification back within the business judgment presumption. When evaluated under the business judgment standard of review, the Board's decision to effect the Reclassification stands. Accordingly, I also grant Defendants' motion to dismiss as to Count III.

III. CONCLUSION

For the reasons stated, Defendants' motion to dismiss is granted with respect to all Defendants on all Counts.

IT IS SO ORDERED.