COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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MASTER IN CHANCERY

NEW CASTLE COUNTY COURTHOUSE
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WILMINGTON, DE 19801-3734

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Re: *Aequitas Solutions, Inc. v. Larry Anderson, et al.*
C.A. No. 7249-ML

Dear Counsel:

This statutory proceeding pursuant to 8 *Del. C.* § 225 comes before me, most recently, on defendant Gary P. Loyd's motion for judgment on the pleadings. The plaintiff's complaint seeks a judicial declaration that the individuals the plaintiff elected to the board of C Innovation, Inc. were validly elected and constitute the entirety of C Innovation's board of directors. Section 225 actions are intended to be summary proceedings, the purpose of which is to provide an expeditious review of the corporate election process to prevent a Delaware corporation from being immobilized by controversies about whether a given officer or director properly is holding office. Unfortunately, and for a variety of reasons, this action has dragged on far longer than the Court would expect or the parties would desire. In a nutshell, resolution to this action has

been impeded by delays in the discovery process, as well as by unexpected and serious health problems that defendant Larry Anderson has confronted.

After willingly participating in these proceedings for several months, Mr. Loyd moved for judgment on the pleadings, arguing that the plaintiff's complaint fails to state a claim against him because he does not purport to be a director, officer, or shareholder of C Innovation. The procedural posture of this motion is puzzling, to say the least. In any event, for the reasons set forth below, I conclude that, drawing all reasonable inferences in favor of the plaintiff, the complaint states a claim against Mr. Loyd. This letter is my final report denying Mr. Loyd's motion for judgment on the pleadings.

FACTUAL AND PROCEDURAL BACKGROUND

The plaintiff, Aequitas Solutions, Inc. ("Aequitas"), filed this Section 225 action on February 25, 2012. On January 23, 2012, Aequitas acquired 100 shares of C Innovation stock from the United States Trustee for the bankruptcy estate of James Charlton, who had a security interest in the C Innovation stock.[1] Aequitas contends that these shares constituted all of the duly authorized, issued, and outstanding shares of C Innovation.[2]

Immediately after acquiring the stock, Aequitas removed the existing board of directors and filled the resulting vacancies by electing three new board members: John Uhler, William Naughtin, and Louis Casselle (collectively, the "Aequitas Directors"). The Aequitas Directors then appointed new officers to manage C Innovation. Aequitas contends that Messrs. Uhler, Naughtin, and Casselle constitute the sole duly elected directors of C Innovation.

Defendant Larry Anderson, who previously owned stock in C Innovation and holds himself out as C Innovation's secretary, contends that what Aequitas purchased from the trustee in bankruptcy was only a small minority position in C Innovation. Mr. Anderson contends that, just before Aequitas completed its purchase, C Innovation's board authorized the issuance of an additional 50,000 shares of C Innovation stock.[3] The complaint alleges that Mr. Anderson and Mr. Loyd have refused to recognize the Aequitas Directors, have interfered with efforts of Aequitas's directors and officers to

[1] Compl. ¶¶ 2, 11-20. The facts recited herein are drawn from the complaint, the documents it incorporates by reference, and documents of which I may take judicial notice. *See TravelCenters of America, LLC v. Brog*, 2008 WL 5272861, at *1, n.1 (Del. Ch. Dec. 5, 2008).
[2] Compl. ¶ 2.
[3] Compl. ¶¶ 3, 28, 29.

manage the company, and continue to assert that they control Aequitas and its assets.[4] Specifically, Aequitas alleges that Mr. Anderson and Mr. Loyd demanded that C Innovation customers pay Loyd for software the customers license from C Innovation, represented to C Innovation's customers that Aequitas owns less than one percent of the outstanding shares of C Innovation, and retained their own attorneys to represent C Innovation in various lawsuits.[5] Aequitas therefore filed this action under Section 225.

Trial initially was scheduled for mid-April, but was postponed due to discovery issues and rescheduled for mid-May. The week before trial was scheduled to begin, Mr. Anderson fired his counsel (who he shared with Mr. Loyd), and sought a continuance so he could obtain new representation. The Court denied that motion. The Saturday before trial, Mr. Anderson notified the parties that he would not attend trial because he was experiencing symptoms of another heart attack (having had two such attacks in the past). The morning that trial was scheduled to begin, the Court granted a continuance due to Mr. Anderson's emergent health problems. Two weeks later, the Court stayed the proceedings to allow Mr. Anderson time to recover from a heart procedure. Mr. Anderson consented to the Court resolving Mr. Loyd's motion for judgment on the pleadings during the pendency of the stay.

Mr. Loyd's initial eve-of-trial motion was a motion to dismiss that relied on deposition testimony and other evidence outside the complaint to support his argument that he does not claim to own or control C Innovation or its stock. In that motion, Mr. Loyd argued that he had purchased certain trademarks, copyrights, and software from C Innovation, as well as C Innovation's interest in certain lawsuits, but that he does not own stock in C Innovation. I have made it clear that I will not be resolving in this Section 225 action who owns the trademarks, copyrights, or software at issue, because those matters are beyond the scope of these proceedings. Because Mr. Loyd's initial motion relied on matters outside the pleadings, Aequitas rightfully argued that it was entitled to discovery into the contract or contracts through which Mr. Loyd claimed to acquire these rights. I agreed, and therefore instructed Mr. Loyd to make a choice and either (1) file a motion for judgment on the pleadings that omitted any reference to matters outside the pleadings, or (2) provide Aequitas the requested discovery, and file a motion for summary judgment. Mr. Loyd elected to pursue the former option.

[4] Compl. ¶¶ 26, 27, 30, 31.
[5] Compl. ¶¶27, 28, 30, 31.

LEGAL ANALYSIS

Any party may move for judgment on the pleadings after the pleadings are closed, provided such motion is made within such time as not to delay the trial.[6] "In considering a motion for judgment on the pleadings, the Court must be satisfied that there are no genuine issues of fact in dispute, and it must draw all reasonable inferences from those facts in the light most favorable to the nonmoving party."[7] The standard for a motion for judgment on the pleadings is "almost identical" to the Rule 12(b)(6) standard, and favors the plaintiff.[8] The governing pleading standard for a motion to dismiss under Rule 12(b)(6) is "reasonable 'conceivability.'"[9] This reasonable "conceivability" standard asks whether there is a "possibility" of recovery.[10] If the well-pleaded factual allegations of the complaint would entitle the plaintiff to relief under a reasonably conceivable set of circumstances, the court must deny the motion to dismiss.[11] The court, however, need not "accept conclusory allegations unsupported by specific facts or … draw unreasonable inferences in favor of the non-moving party."[12]

Mr. Loyd argues that Aequitas's complaint does not state a cause of action against him, because Aequitas does not allege that Mr. Loyd is a director, officer, or shareholder of C Innovation, and does not seek any substantive relief against Mr. Loyd in his individual capacity. Mr. Loyd argues that any claims Aequitas may have against Mr. Loyd are collateral to the proceedings before this Court, which are confined to determining the validity of the election of the Aequitas Directors. Aequitas, on the other hand, contends that it has alleged that Mr. Loyd has asserted "direct or indirect control" over C Innovation, and that it therefore properly has named Mr. Loyd as a defendant in this action.

Section 225 provides a means for this Court to conduct summary proceedings to determine "the validity of any election, appointment, removal or resignation of any director or officer of any corporation."[13] In *Genger v. TR Investors, LLC*, the Delaware

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[6] Ct. Ch. R. 12(c).
[7] *CorVel Enter. Comp., Inc. v. Schaffer*, 2010 WL 2091212, at *1 (Del. Ch. May 19, 2010).
[8] *Acierno v. Goldstein*, 2004 Wl 1488673, at *2 (Del. Ch. Jun. 25, 2004).
[9] *Central Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs., LLC*, 27 A.3d 531, 537 (Del. 2011).
[10] *Id.* at *5 & n.13.
[11] *Id.* at *6.
[12] *Price v. E.I. duPont de Nemours & Co., Inc.*, 26 A.3d 162, 166 (Del. 2011) (citing *Clinton v. Enterprise Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009)).
[13] 8 *Del. C.* § 225(a).

Supreme Court explained that a Section 225 proceeding "is not an *in personam* action. Rather, it is 'in the nature of an *in rem*' proceeding, where the 'defendants' are before the court, not individually, but rather as respondents being invited to litigate their claims to the *res* (here, the disputed corporate office) or forever be barred from doing so. The one exception is the corporation itself, which is the entity that embodies the '*res*,' and is [the] only party before the Court in its 'individual' capacity."[14]

The explanation of the scope and nature of a Section 225 proceeding provided in *Genger* is important. Although Mr. Loyd argues that he should be dismissed from the proceeding because Aequitas is not seeking any relief against him in his individual capacity, that argument misses the mark. Aequitas cannot seek relief against Mr. Loyd in his individual capacity, because a Section 225 proceeding is not an *in personam* action. That does not mean, however, that Mr. Loyd is not properly a defendant to this action. Aequitas has invited Mr. Loyd to litigate any claim he may have to the corporate office. Aequitas issued that "invitation," so to speak, because Mr. Loyd had asserted "direct or indirect control" over C Innovation.[15]

In support of its allegation that Mr. Loyd has asserted "direct or indirect control" over C Innovation, Aequitas relies upon the declaration that Mr. Loyd filed in December 2011 in the Bankruptcy Court for the Northern District of California (the "Declaration").[16] Mr. Loyd made that Declaration in support of the bankruptcy trustee's "Motion for Sale of Assets Free and Clear of Liens and Encumbrances." At the time, Mr. Loyd sought to purchase, among other things, the trustee's interest in the assets of C Innovation, Inc., including the C Innovation stock. Ultimately, Aequitas outbid Mr. Loyd for those assets. In the Declaration, Mr. Loyd alleged that he "own[ed] or control[led] superior rights to the Assigned Rights and Claims and the Encumbrances at issue."[17] The

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[14] *Genger v. TR Investors, LLC*, 26 A.3d 180, 200 (Del. 2011) (footnotes omitted).
[15] The use of the word "invitation" in this context is more than a little ironic. To say that this is not an invitation to the party of the season would be an understatement.
[16] I may take judicial notice of the Declaration because it is a pleading filed in the California bankruptcy proceeding. *See, e.g. Baca*, 2010 WL 2219715, at *1 (Del. Ch. June 3, 2010) (taking judicial notice, in the context of a motion to dismiss, of filings in pending derivative and securities actions); *Nelson v. Emerson*, 2008 WL 1961150, at *2 (Del. Ch. May 6. 2008) (taking judicial notice of "documents filed in the related federal court proceedings" in addressing a motion to dismiss); *Orloff v. Shulman*, 2005 WL 3272355, at *12 (Del. Ch. Nov. 23, 2005) (taking judicial notice of pleadings in bankruptcy proceeding).
[17] Declaration ¶ 17.

"Assigned Rights and Claims" were defined to include "all of the Trustee's claims to … the [C Innovation] Stock … ."[18]

Mr. Loyd has gone to some length to argue that Aequitas has misconstrued the statements in his Declaration, and that all the Declaration was intended to convey is that he had purchased trademarks, copyrights, and software rights from C Innovation, and that Mr. Loyd's claims to those assets were superior to any claims the trustee was making in those same items. I agree with Mr. Loyd that the Declaration fairly may be read in that way. But Aequitas's reading of the Declaration, coupled with Mr. Loyd's actions in refusing to recognize the Aequitas Directors, in inserting himself in C Innovation's relationships with its customers, and in hiring counsel to represent C Innovation, as alleged in the complaint, fairly supports Aequitas's allegation that Mr. Loyd has asserted control over the corporation. In short, the well-pleaded factual allegations in Aequitas's complaint would entitle it to relief "against" Mr. Loyd (or, in this context, against his claim of control over C Innovation) under a reasonably conceivable set of circumstances.

It is here that Mr. Loyd's strategic decision to file a motion for judgment on the pleadings, rather than a motion for summary judgment, is significant. If, as Mr. Loyd argues, he has no claim to C Innovation or its stock, and merely purchased some of the Company's trademarks, copyrights, and software, Mr. Loyd could have produced the contract(s) at issue and moved for summary judgment. But the nature of the rights Mr. Loyd owns introduce matters outside the pleadings. In order to consider those matters, I would need to treat Mr. Loyd's motion as one for summary judgment, after giving Aequitas "reasonable opportunity to present all material made pertinent to such a motion by Rule 56."[19]

In his exceptions to my draft report denying the motion for judgment on the pleadings, Mr. Loyd argued that Aequitas's allegations that Mr. Loyd has refused to recognize the Aequitas directors, inserted himself into C Innovation's relationships with its customers, and hired counsel to represent C Innovation relate to Mr. Loyd's contractual rights, rather than an exercise of control over the corporate office, and therefore are beyond the scope of this proceeding. That argument is a non-sequitur. More importantly, the argument misstates the Court's conclusion. In denying Mr. Loyd's motion, I concluded that those alleged actions, considered in conjunction with Aequitas's plausible reading of the Declaration, constituted well-pleaded allegations that supported

[18] *Id.* at ¶ 12.
[19] Ct. Ch. R. 12(c).

Aequitas's more general allegation that Mr. Loyd has asserted direct or indirect control over the corporation. I already have explained that I cannot consider Mr. Loyd's alternative explanation for those actions, because the explanation relies on matters outside the pleadings. That the factual explanation may depend on disputed contractual rights that are beyond the scope of this Section 225 proceeding does not change my conclusion regarding the well-pleaded allegations in the complaint.

Therefore, I deny Mr. Loyd's motion for judgment on the pleadings. Discovery should proceed accordingly. This Court will resolve Mr. Loyd's arguments after trial in this action. The period for taking exceptions to this final report is stayed until this Court issues a final post-trial report in this matter.

Respectfully submitted,

/s/ *Abigail M. LeGrow*

Master in Chancery