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COURT OF CHANCERY
OF THE
STATE OF DELAWARE

COURT OF CHANCERY COURTHOUSE
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Date Submitted: June 10, 2013
Date Decided: July 2, 2013

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Re: *Rich v. Chong*,
Civil Action No. 7616-VCG

Dear Counsel:

The Defendants, Fuqi International, Inc. ("Fuqi") and its directors (the "Individual Defendants"), moved for reargument following my denial of their motion to dismiss or stay this Action on April 25, 2013. The Defendants' chief objection is that I agree with the Plaintiff's characterization of the facts instead of Fuqi's characterization. At the motion to dismiss stage, particularly under Rule 12(b)(6), I must accept the Plaintiff's well-pled allegations as true and draw all reasonable inferences in the Plaintiff's favor. Because the Defendants have not met their burden of proving that I ignored or overlooked some material fact or principle of law that would be outcome determinative regarding the motion to dismiss or stay, the Motion for Reargument is denied.

A. Background Facts

What follows is an adumbration of the facts stated fully in my Opinion of April 25, 2013 (the "Opinion").[1] Plaintiff George Rich, Jr. filed this action in June 2012, two years after making a demand to the Fuqi Board of directors to remedy material weaknesses in Fuqi's internal controls (the "Demand"). In the two-year interim between the time of the Demand and the time of the Complaint, Fuqi did not respond to the Demand. In the Complaint, the Plaintiff alleged that this delay, together with actions of management and the Board that frustrated meaningful investigation of the Demand, rendered the Demand wrongfully refused and therefore permitted the Plaintiff to sue derivatively. I agreed with the Plaintiff, finding that the Plaintiff had alleged particularized facts raising a reasonable doubt that the Individual Defendants acted in good faith in responding to the Demand.[2] I then denied the Defendants' motion to dismiss under Rule 12(b)(6) because the Plaintiff had pled adequate facts to raise a reasonable inference that (1) the Individual Defendants knew that Fuqi's internal controls had material deficiencies and (2) the Individual Defendants failed to correct such deficiencies.[3] Finally, I denied Fuqi's motion to stay this case in favor of actions pending in New York and an investigation being conducted by the SEC because I found that the

[1] *See Rich v.* Chong, 2013 WL 1914520, at *1-7 (Del. Ch. Apr. 25, 2013)
[2] *Id.* at *11.
[3] *Id.* at *13-15.

circumstances of those parallel actions did not justify the exercise of my discretion to stay the case. Therefore, pursuant to my decision of April 25, 2013, Plaintiff Rich's derivative suit may proceed. The Defendants moved for reargument on May 2, 2013. I heard oral argument on the Motion on June 10, 2013.

B. Standard

A motion for reargument is appropriate where the Court has "overlooked a controlling decision or principle of law that would have a controlling effect, or the Court misapprehended the facts or the law so the outcome of the decision would be different."[4] This Court has discretion to determine whether reargument is appropriate, and the moving party has the burden to show that the Court's misunderstanding is both "material and would have changed the outcome of its earlier decision."[5] Therefore, if a party simply restates its prior arguments, the motion will be denied.[6] In deciding whether to grant a motion for reargument, the Court does not consider new evidence, unless such evidence was learned after the disposition of the original motion and could not have been learned prior to that time.[7]

[4] *In re Mobilactive Media, LLC*, 2013 WL 1900997, at *1 (Del. Ch. May 8, 2013).
[5] *Id.* (quoting *Medek v. Medek,* 2009 WL 2225994, at *1 (Del. Ch. July 27, 2009)).
[6] *Id.*
[7] *See id.*

C. Analysis

1. Whether I overlooked some legal principle or fact in declining to stay this matter.

Fuqi argues that I erred in declining to stay this manner for the following reasons: (1) I erred in noting that "very little has been done so far in the Federal Action"; (2) I based my decision to deny Fuqi's request for a stay, in part, on my doubts that New York has personal jurisdiction over the Individual Defendants; (3) the derivative claims here are just "repackaged" securities claims; and (4) a temporary stay in favor of the SEC action is appropriate.

My decision to deny a stay in this case under *McWane* is discretionary.[8] Therefore, contrary to the Defendants' arguments, no fact or legal precedent may "compel" a different result, absent a showing of abuse of discretion. Instead, the Defendants' burden here is to demonstrate such an abuse of discretion. The Defendants have not met this burden. The consolidated securities and derivative actions pending in New York have been stayed, and staying this case in favor of such stayed actions would not fulfill the purposes and policies driving *McWane*. Namely, there is no likelihood of inconsistent judgments, since the actions pending in New York are not moving forward.[9] The fact that some "informal discovery"

[8] *See McWane Cast Iron Pipe Corp. v. McDowell–Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del.1970).

[9] *Id.* (noting that the policies driving the *McWane* doctrine are the likelihood of inconsistent judgment and the desire to avoid an unseemly race to the courthouse).

has been done in New York does not change that fact.[10] Likewise, my doubts regarding personal jurisdiction in the Federal Action persist. The cases the Defendants cite as countervailing these doubts—in which this Court stayed cases despite challenges in the related action based on personal jurisdiction—are not persuasive to me; in neither of those cases was the prior-filed case, itself, stayed.[11] Moreover, Fuqi's argument that I should stay this action in favor of the SEC's investigation is now moot, since the SEC settled its claims against Fuqi on July 1, 2013.[12]

Finally, Fuqi's arguments are undercut by its own representations to this Court in the past. I note that Fuqi's attorney told me, during a teleconference following oral argument, that it would be unhelpful to Fuqi's settlement efforts for me to stay this case. In effect, the parties (including Fuqi's counsel) asked me *not*

[10] *See* Defs.' Mot. Reargument 3 ("Fuqi has produced a significant number of documents to Lead Counsel in the Federal Action through informal discovery . . . .").

[11] In both *Citrin* and *Welbilt*, a Delaware action had been filed in response to a Texas action, and contained claims which were very similar to claims in the Texas Action. *See Citrin Hldgs. LLC v. Cullen 130 LLC*, 2008 WL 241615, at *1-2 (Del. Ch. Jan. 17, 2008); *Welbilt Corp. v. Trane Co.*, 2000 WL 1742053, at *1 (Del. Ch. Nov. 17, 2000). Neither of the Texas cases was stayed at the time the Court ruled on the motions to stay in Delaware.

[12] Fuqi Int'l, Inc., Litigation Release No. 22739, *Securities and Exchange Commission v. Fuqi Int'l, Inc. and Yu Kwai Chong*, C.A. No. 1:13-cv-995 (D. D.C. July 1, 2013), *available at* http://www. sec.gov/litigation/litreleases/2013/lr22739.htm. Under the settlement, Fuqi was deregistered and agreed to pay a $1 million fine. *Id.* Fuqi's largest stockholder and director, Yu Kwai Chong, likewise agreed to pay $150,000 personally and is barred from serving as an officer or director for five years. *Id.*

to stay this case.[13] Therefore, I see no reason prevent this derivative action, which has stated a claim under Delaware law, from moving forward.[14]

2. Whether my Opinion Improperly States the Standard for a Caremark Claim under Rule 12(b)(6) AND Rule 23.1

In my Opinion, I found that the Plaintiff satisfied Rule 23.1 by making a Demand on the Fuqi Board; Fuqi's wrongful refusal of the Demand allowed the suit to proceed under Rule 23.1.[15] Fuqi also moved to dismiss under Rule 12(b)(6), and I found that the Plaintiff had adequately stated a *Caremark* claim, without requiring the Plaintiff to plead the *Caremark* allegations with particularity.[16]

[13] *See* Teleconference Tr. 5:9-24 (Feb. 11, 2013).

> THE COURT: So I guess what I am hearing is: To the extent I am considering a stay in favor of New York, I withhold that decision pending a reasonable amount of time to see if the parties are going to move forward to mediation with the New York plaintiffs on all issues, and to the extent I am ready to issue a decision, either dismissing the action or letting it go forward, that won't interfere with your mediation efforts, and I can go ahead, in your view, and do that without jeopardizing the possibility of the settlement efforts and the mediation efforts. Is that correct from both of you?
> MR. FIORAVANTI: Yes, that's correct from plaintiffs' perspective, Your Honor.
> MR. REED: Yes, Your Honor.

[14] Furthermore, the cases cited by the Defendants as compelling the opposite result are limited rulings that are not controlling over this case. *See Brudno v. Wise*, 2003 WL 1874750, at *1 (Del. Ch. Apr. 1, 2003) ("In this opinion, I conclude that the Delaware Action should be stayed for now in favor of the prior pending Federal Securities Action. I do so not based on any rigid application of the *McWane* framework, which is pressed upon me by the defendants. Rather, the reasoning of this opinion recognizes the inherently discretionary nature of a decision on a stay motion and the importance of striking a sensible balance of the relevant competing interests."). In *Brudno*, then-Vice Chancellor Strine noted that the relevant Delaware action was just a "placeholder indemnity action." That is not the case here.

[15] *Rich*, 2013 WL 1914520, at *11.

[16] *Id.* at *11-12.

Citing to *Guttman v. Huang*, Fuqi argues that pleading with particularity is a requirement to adequately state a *Caremark* claim.[17]

The Defendants misunderstand the origins of the requirement, applied in *Guttman*, that plaintiffs must plead with particularity. That requirement arises under Rule 23.1, which requires a plaintiff to "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[18] In a case in which demand has been made, the requirement to plead with particularity concerns solely the plaintiff's efforts "to obtain the action the plaintiff desires from the directors . . . ." (i.e., the demand, itself, and the directors' response to the demand).[19] I found that the Plaintiff here did so by making a Demand and pleading particularized facts showing that Fuqi acted in bad faith in responding to the Demand.[20] Therefore, Rule 23.1 was satisfied, and the particularity requirement was extinguished.

Having found Rule 23.1 was satisfied, I then turned to the adequacy of the substantive pleadings under *Caremark*. Fuqi argues that I ignored Fuqi's public disclosures, external to the Complaint, which suggest that Fuqi's controls were, in fact, meaningful (even if they were materially inadequate). At the motion to

[17] Defs.' Mot. Rearg. 7.
[18] Ct. Ch. R. 23.1.
[19] *Id.*
[20] *Rich*, 2013 WL 1914520, at *11.

dismiss stage, I must assume all well-pleaded facts are true and draw all inferences in favor of the non-moving party, Plaintiff Rich.[21] Therefore, based on the facts pled, I determined that the Plaintiff raised a reasonable doubt that Fuqi had a meaningful set of internal controls in place. Nonetheless, there are two ways to adequately plead a *Caremark* claim. Even if the Defendants were correct that Fuqi had some meaningful controls in place, the Plaintiff's pleading burden under *Caremark* was satisfied by the "red flags" prong of the test. I remain satisfied that the Plaintiff pled adequate red flags showing that the individual defendants knew that Fuqi's internal controls were inadequate. The Defendants argue that this finding, too, was erroneous because I considered facts occurring after the Plaintiff made his Demand. The Plaintiff made a Demand in July 2010, two years before he filed the Complaint. After the Demand, additional negative information came to light, which was incorporated in the 2012 Complaint. My analysis of the sufficiency of the Complaint is not limited to those allegations raised in the (wrongfully refused) Demand. The facts alleged in the Complaint adequately plead red flags showing that the Fuqi Board knew that Fuqi had material weaknesses in its controls and failed to stop the cash transfers. That is sufficient for a *Caremark* claim on a motion to dismiss under 12(b)(6).

[21] Contrary to the Defendants' assertions, I need not comb through Fuqi's SEC statements looking for facts which rebut the Plaintiff's allegations. On a motion to dismiss under Rule 12(b)(6), the Court's sole concern is whether the Plaintiff has adequately stated a claim upon which relief can be granted. The time for rebutting the allegations in the Complaint, and for offering competing evidence, is at trial or on a motion for summary judgment.

Next, Fuqi argues that I misinterpreted the facts in finding that the directors acted in bad faith in failing to pay the fees of the lawyers, accountants, and auditors of the company. As I explained in my Opinion, I carefully considered the facts regarding this point, including the fact that multiple advisors had not been paid.[22] I further considered that two of the directors resigned in *protest* of the nonpayment.[23] These facts supported a reasonable inference that the directors acted in bad faith. Therefore, I remain convinced that my previous rulings were correct: namely, that the Plaintiff pled particularized facts showing that the Demand was wrongfully refused and that the Plaintiff adequately stated a *Caremark* claim under Rule 12(b)(6).

3. Whether I Misapplied the Facts or Law Concerning Wrongful Refusal to Respond to a Demand

Finally, the Defendant argues that I misapplied the standard under Rule 23.1 for determining whether the Plaintiff adequately alleged particularized facts showing the Board's response to the Demand was wrongful. In particular, the Defendants argue that I required the "Defendants to prove the Board's good faith in investigating and acting on the demand, rather than requiring Plaintiff to allege the Board's bad faith."[24] I disagree with this characterization. The Plaintiff pled facts showing that (1) he made a Demand, (2) Fuqi has now taken at least three

[22] *Rich*, 2013 WL 1914520, at *11 n.135.
[23] *Id.*
[24] Defs.' Mot. Rearg. 11.

years to consider the Demand, (3) Fuqi defunded the audit committee, (4) the audit committee resigned in protest, and (5) there is no foreseeable end to the investigation. These facts—stated more completely in my Opinion—are sufficient for me to determine that the Plaintiff met his burden of pleading particularized facts describing the efforts he undertook to allow the Board to move the case forward and that the Board responded to those efforts in bad faith.[25]

D. Conclusion

For the reasons above, I find that the Defendants have not met their burden of proving that I failed to consider or misinterpreted any point of law or fact. Most of the Defendants' arguments are factual in nature and more appropriate for summary judgment, toward which this matter may now proceed. To the extent that the Plaintiff is simply restating arguments rejected in the Opinion, such a restatement cannot support a Motion for Reargument. For these reasons, the Defendants' Motion for Reargument is denied.

Sincerely,

/s/ Sam Glasscock III

Sam Glasscock III

[25] *See* Rule 23.1 (requiring a plaintiff to "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action . . . .").