

1 UNITED STATES DISTRICT COURT  
2 FOR THE NORTHERN DISTRICT OF CALIFORNIA  
3 OAKLAND DIVISION

4 FRANK MCBRIDE, III,

5 Plaintiff,

6 vs.

7 PENTAGON TECHNOLOGIES GROUP,  
8 INC., et al.,

9 Defendants.

Case No: C 15-2696 SBA

**ORDER DENYING DEFENDANTS'  
MOTIONS TO DISMISS**

Dkt. 4, 9.

10  
11 Plaintiff Frank A. McBride (“McBride” or “Plaintiff”) brings this diversity  
12 jurisdiction action against his former employer, Pentagon Technologies Group, Inc.  
13 (“Pentagon”), claiming that he is owed deferred compensation under the terms of his Equity  
14 Deferred Compensation Agreement (“EDC Agreement”). Also named as party-defendants  
15 are Baird Capital Partners III Limited Partnership, BCP III Special Affiliates Limited  
16 Partnership, BCP III Affiliates Fund Limited Partnership (collectively “BCP Partnerships”)  
17 and Baird Capital Partners Management Company III, L.L.C. (“Baird Capital Partners”),  
18 which purchased a majority interest in Pentagon in July 2000.<sup>1</sup>

19 The parties are presently before the Court on Pentagon and Baird’s respective  
20 motions to dismiss for failure to state a claim upon which relief can be granted, pursuant to  
21 Federal Rule of Civil Procedure 12(b)(6). Dkt. 4, 9. Having read and considered the  
22 papers filed in connection with this matter and being fully informed, the Court hereby  
23 DENIES the motions for the reasons set forth below. The Court, in its discretion, finds this  
24 matter suitable for resolution without oral argument. See Fed. R. Civ. P. 78(b); N.D. Cal.  
25 Civ. L.R. 7-1(b).

26  
27 <sup>1</sup> Baird Capital Partners is the general partner of each of the BCP Partnerships, and  
28 utilized each of those partnerships to invest in Pentagon. See First Am. Complaint-  
Corrected (“FAC”) ¶¶ 4, 5. Baird Capital Partners and the BCP Partnerships collectively  
are referred to as “Baird.”

1 **I. BACKGROUND**

2 **A. FACTUAL SUMMARY**

3 This case arises out of McBride’s employment with Pentagon, where he served as its  
4 Chief Executive Officer from 1998 to 2008. Order at 2, Dkt. 20. Pentagon, which “sells  
5 products and services that improve the front-end process tools used in the manufacturing of  
6 semiconductors,” was incorporated in Ohio in 1998 and established its headquarters in  
7 Northern California. Id. at 5; FAC ¶¶ 11, 12. At the time Pentagon was formed, Plaintiff  
8 was awarded a 9% equity stake in the company. Id. ¶ 12.

9 In 2000, Baird purchased majority interest in Pentagon for approximately \$22  
10 million. Id. ¶ 13. In connection with Baird’s investment, Plaintiff entered into the EDC  
11 Agreement, under which he was given the economic value of his equity stake in Pentagon  
12 through a combination of common stock and deferred compensation. Id. ¶¶ 15-16. The  
13 amount of Plaintiff’s initial deferred compensation was \$1,936,398.60, which was credited  
14 to a Deferral Contributions Account. Id. ¶ 17. The EDC Agreement states that the Deferral  
15 Contributions Account is “a bookkeeping account maintained by the Company and shall  
16 reflect the Deferred Compensation.” Id. ¶ 17; Obselik Decl. Ex. 1 (EDC Agt.) ¶ 2.2, Dkt.  
17 4-1. The Deferral Contributions Account is characterized as an unsecured liability of  
18 Pentagon, wherein “[Plaintiff] is solely an unsecured creditor of the Company with respect  
19 to any amount payable to him under this Agreement.” FAC ¶ 17; EDC Agt. 3.1.

20 The Deferral Contributions Account was to be invested in “one or more Permitted  
21 Investments as of the date of [the EDC] Agreement.” Id. ¶ 18. A “Permitted Investment”  
22 is defined as “shares of Series A Preferred Stock, par value \$.01 per share, of the Company,  
23 and thereafter such funds, investments or other assets of equal fair market value as may be  
24 approved by the Committee from time to time for purposes of this Agreement.” Id.; EDC  
25 Agt. § 1.14. The term “Committee” refers to “the Compensation Committee of the Board  
26 of Directors or, if none exists, the entire Board of Directors.” FAC ¶ 18; EDC Agt. ¶ 1.7.<sup>2</sup>

27 \_\_\_\_\_  
28 <sup>2</sup> According to Plaintiff, the Pentagon Compensation Committee was controlled by  
Baird, through its agents. FAC ¶ 19.

1 The balance in the Deferral Contributions Account was payable to Plaintiff, inter alia, as of  
2 July 17, 2010, or upon the occurrence of specified events, including a “BCP Liquidity  
3 Event.” FAC ¶ 22; EDC Agt. § 4.2. A BCP Liquidity Event refers to a transaction in  
4 which Baird received at least 80% of the value of its investment in the Company’s Series A  
5 preferred stock (or replacement securities). FAC ¶ 22; EDC Agt. § 1.4.

6 In August 2002, Pentagon’s Board amended the Company’s articles of incorporation  
7 to provide for the issuance of a new Series B stock, which carried a dividend rate of 25%.  
8 FAC ¶ 23. The following year in October 2003, the Board authorized the issuance of new  
9 Series C stock, which carried a 10% dividend and a 7-to-1 return on redemption. Id. ¶ 25.  
10 Both the new Series B and Series C stock were senior to Series A stock. Id. ¶ 26. In 2006,  
11 Pentagon declared a \$10 million dividend on its Series B and Series C stock. Id. ¶ 27.  
12 Pentagon borrowed most of the funds from its bank lending group to pay the dividend, most  
13 of which went to Baird. Id.

14 In 2008, Irv Pfister, a partner in Baird Capital Partners and the Chairman of the  
15 Board, “forced” Plaintiff to resign his position. Id. ¶ 28. As part of his separation, Plaintiff  
16 was required to surrender his common stock, options and management appreciation rights.  
17 Id. Plaintiff retained his Series B preferred stock and deferred compensation. Id.

18 In May 2010, Plaintiff contacted Pentagon in anticipation of the July 17, 2010  
19 deadline for the payment of his deferred compensation. Id. ¶ 29. In response, Rob Ospalik  
20 (“Ospalik”), a partner with of Baird Capital Partners told Plaintiff that Pentagon lacked the  
21 money to pay his deferred compensation and that all excess cash was being paid to the  
22 banks. Id. ¶ 30. Ospalik further stated that Plaintiff would not receive any payout until  
23 there was a liquidity event and that all “participants” would be paid equally after the banks  
24 were paid. Id.

25 On July 15, 2010, two days prior to the due date for deferred compensation payout,  
26 Ospalik sent Plaintiff a Subordination Agreement. Id. ¶ 31. Ospalik told Plaintiff that the  
27 Pentagon Board of Directors was requiring him to subordinate his rights, pursuant to § 6.6  
28 of the EDC Agreement. Id. In particular, the draft Subordination Agreement specified that

1 Plaintiff's right to the payment under the EDC Agreement is deemed subordinate to  
2 Pentagon's obligations to its senior lending group. Id. ¶ 32.

3 Plaintiff proposed modifications to the Subordination Agreement to confirm his right  
4 to receive deferred compensation and limit the subordination period. Id. ¶ 33. By letter  
5 dated August 11, 2010, Opsalik rejected the requested changes. Id. ¶ 36. He added that  
6 Plaintiff's Deferral Compensation Account was worthless because it was deemed invested  
7 in Pentagon Series A Preferred Stock, which had "no value." Id. Opsalik warned Plaintiff  
8 that if he did not sign the Subordination Agreement, Pentagon would declare him to be in  
9 breach of the EDC Agreement. Id. ¶ 34. Plaintiff signed the Subordination Agreement,  
10 without modification. Id. ¶ 35. Plaintiff asserts that Opsalik's claim that his Deferral  
11 Compensation Account had no value is contradicted by Pentagon's financial statements.  
12 Id. ¶ 37.

13 In May 2011, Baird, as Pentagon's majority shareholder, sponsored a proposal to  
14 eliminate all outstanding shares of Pentagon stock. Id. ¶ 80. In its stead, the holders of  
15 Series C preferred shares, which was principally or entirely Baird, would be issued voting  
16 common stock. Id. The effect of this arrangement was to maintain Baird's interest in  
17 Pentagon while extinguishing the interests of all other shareholders. Id. Plaintiff alleges  
18 that Baird's action was "the final step in its plan to deny [him] his rights as a  
19 shareholder . . . in Pentagon. Id.

## 20 **B. PROCEDURAL HISTORY**

21 On December 1, 2014, Plaintiff filed the instant action in the Northern District of  
22 Ohio, alleging six claims for relief against Pentagon and Baird. The first through third  
23 claims of the original Complaint alleged violations of the Employee Retirement Income  
24 Security Act ("ERISA"), 29 U.S.C. §§ 1001 et seq. The remaining claims were for  
25 declaratory relief to declare that the Subordination Agreement is unconscionable (fourth  
26 claim); breach of contract based on Pentagon's refusal to pay the value of his Series B  
27 shares as required by the Pentagon Subscription Agreement ("Subscription Agreement"),  
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1 dated August 14, 2002 (fifth claim); and breach of fiduciary duty against Baird, based on  
2 his position as a majority shareholder of Pentagon (sixth claim).

3 In response to the Complaint, Pentagon filed a motion to dismiss under Rule  
4 12(b)(6) for failure to state a claim, and Rule 12(b)(3) and 28 U.S.C. § 1406(a) for  
5 improper venue. Dkt. 9. Alternatively, Pentagon moved to transfer venue to the Northern  
6 District of California for the convenience of the parties and witnesses, pursuant to 28  
7 U.S.C. § 1404(a). Baird separately moved under Rule 12(b)(6) to dismiss claims three and  
8 four and the “majority” of claim six. Dkt. 4 at 1.

9 Before briefing on Defendants’ motions was completed, Plaintiff filed a First  
10 Amended Complaint (“FAC”), which eliminated the ERISA claims and added claims for  
11 breach of contract and breach of the covenant of good faith and fair dealing based on the  
12 EDC Agreement. Dkt. 11, 12, 18. Though acknowledging that Plaintiff had filed an  
13 amended pleading, Defendants filed their respective reply briefs, noting that the parties had  
14 agreed to adjudicate the motions in relation to the original complaint. Dkt. 16 at 1 n.1. On  
15 June 11, 2015, the Ohio District Court granted Pentagon’s alternative § 1404(a) motion,  
16 resulting in the transfer of the action to this District. The parties have now requested that  
17 the Court address the arguments for dismissal presented in their previously filed motions  
18 that were not addressed by the Ohio District Court. Dkt. 44, 45.<sup>3</sup>

## 19 **II. DISCUSSION**

### 20 **A. BREACH OF CONTRACT AND BREACH OF THE COVENANT OF GOOD FAITH** 21 **AND FAIR DEALING (EDC AGREEMENT)**

22 In his first claim, Plaintiff alleges that Pentagon breached the EDC Agreement by  
23 failing to disburse the balance in his Deferral Contributions Account, which, as of July 17,  
24 2010, was valued at \$6,297,939.30. FAC ¶¶ 42-44. Plaintiff’s second claim for breach of  
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26 <sup>3</sup> The Court notes that upon its filing, the FAC became the operative pleading.  
27 *Ferdik v. Bonzelet*, 963 F.2d 1258, 1262 (9th Cir. 1992) (stating that it is a “well-  
28 established doctrine that an amended pleading supersedes the original pleading.”). As such,  
the Court construes the arguments presented in the instant motions as being directed to the  
claims alleged in the FAC, not the original complaint.

1 the covenant of good faith and fair dealing alleges that Pentagon acted in bad faith in  
2 relation to the EDC Agreement through various acts, such as threatening the loss of his  
3 deferred compensation if he refused to sign the Subordination Agreement. Id. ¶ 52.

4 A breach of contract claim under Ohio law has four elements: (1) the existence of a  
5 contract; (2) the plaintiff's performance; (3) the defendant's breach; and (4) damages.

6 Pavlovick v. Nat'l City Bank, 435 F.3d 560, 565 (6th Cir. 2006) (interpreting Ohio law).<sup>4</sup>

7 The implied covenant of good faith and fair dealing is violated "when a party acts in a  
8 manner which would deprive the other party of the right to receive the benefits of their  
9 agreement." PepsiCo, Inc. v. Cent. Inv. Corp., Inc., 268 F.Supp.2d 962, 967 (S.D. Ohio  
10 2001) (citations omitted).

11 The original complaint alleged a breach of contract claim based on the Subscription  
12 Agreement only. The FAC added a second contract claim based on the EDC Agreement,  
13 which is set forth as the First Claim for Relief. Because Pentagon's motion to dismiss was  
14 directed to the original complaint, it contains no argument regarding the EDC Agreement.  
15 Although Pentagon now argues in its reply that Plaintiff's claim based on the EDC  
16 Agreement should be dismissed, Pentagon's Reply at 12-13, Dkt. 17, the Court does not  
17 consider arguments that were not first presented in the moving papers, see Zamani v.  
18 Carnes, 491 F.3d 990, 997 (9th Cir. 2007) ("[A court] need not consider arguments raised  
19 for the first time in a reply brief."). Pentagon's motion to dismiss Plaintiff's first claim for  
20 breach of contract is therefore DENIED. However, because a claim for breach of the  
21 covenant of good faith and fair dealing is not an independent claim, the Court sua sponte  
22 dismisses such claim. See McCubbins v. BAC Home Loans Servicing, L.P., No. 2:11-cv-  
23 547, 2012 WL 140218, at \*46-47 (S.D. Ohio Jan. 18, 2012) (noting that a claim for breach  
24 of the covenant of good faith and fair dealing is subsumed in a claim for breach of contract,  
25 and cannot be asserted as a stand-alone claim). The Court grants Plaintiff leave to amend

26 \_\_\_\_\_  
27 <sup>4</sup> The EDC Agreement contains a choice of law clause, which specifies that it "shall  
28 be construed in accordance with the law of the state of Ohio, to the extent not preempted by  
any applicable federal law." EDC Agt. § 6.9. None of the parties dispute the applicability  
or enforceability of this clause.

1 his breach of contract claim to incorporate allegations that Pentagon breached the covenant  
2 of good faith and fair dealing.

3 **B. DECLARATORY JUDGMENT (RESCISSION)**

4 In his third claim for declaratory judgment, Plaintiff seeks rescission of the  
5 Subordination Agreement on the ground that it is unconscionable. FAC ¶¶ 56, 61.  
6 Defendants contend that Plaintiff’s claim is barred by the doctrine of laches. “Laches is an  
7 equitable time limitation on a party’s right to bring suit, resting on the maxim that one who  
8 seeks the help of a court of equity must not sleep on his rights.” Jarrow Formulas, Inc. v.  
9 Nutrition Now, Inc., 304 F.3d 829, 835 (9th Cir. 2002) (internal citations and quotation  
10 marks omitted).

11 “To successfully invoke the doctrine the party invoking it must establish by a  
12 preponderance of the evidence the following four elements: (1) unreasonable delay or lapse  
13 of time in asserting a right; (2) absence of an excuse for the delay; (3) knowledge, actual or  
14 constructive, of the injury or wrong; and (4) prejudice to the other party.” Sims v.  
15 Anderson, 38 N.E.3d 1123, 1130 (Ohio Ct. App. 2015). At the motion to dismiss stage, a  
16 defendant seeking dismissal based on a laches defense “must rely exclusively upon the  
17 factual allegations set forth in the complaint.” Kourtis v. Cameron, 419 F.3d 989, 1000  
18 (9th Cir. 2005), abrogated on other grounds in Taylor v. Sturgell, 553 U.S. 880 (2008).

19 Defendants contend that Plaintiff was contractually obligated to sign the  
20 Subordination Agreement under § 6.6 of the EDC Agreement, and therefore, his request to  
21 rescind the Subordination Agreement is tantamount to seeking to rescind the EDC  
22 Agreement. In that regard, Defendants assert that it is too late for Plaintiff to challenge the  
23 EDC Agreement because they have “undergone a number of refinancing and restructuring  
24 transactions” in the fifteen years since its execution. See Baird Mot. at 12 (citing Compl.  
25 ¶ 39). The Court is unpersuaded that Defendants’ laches defense can be adjudicated based  
26 on pleadings. Even if Defendants are correct that Plaintiff is, in effect, challenging part of  
27 the EDC Agreement, the mere passage of time is insufficient to establish the requisite  
28 prejudice for a laches defense. See State ex rel. Meyers v. Columbus, 71 Ohio St.3d 603,

1 605 (1995) (“Prejudice will not be inferred from a mere lapse of time.”). Moreover, the  
2 allegation that Pentagon entered into financial transactions subsequent to the execution of  
3 the EDC Agreement, standing alone, fails to establish that Defendants suffered prejudice as  
4 a result. See Kinney v. Mathias, 10 Ohio St.3d 72, 75 (1984) (holding that the father’s  
5 change of financial position was, “as a matter of law, insufficient to rise to the level of  
6 prejudice necessary to invoke the doctrine of laches.”); State ex rel. Doran v. Preble Cty.  
7 Bd. of Commrs., 995 N.E.2d 239, 246 (Ohio Ct. App. 2013) (citation and internal  
8 quotations omitted) (“What constitutes material prejudice is primarily a question of fact to  
9 be resolved through a consideration of the special circumstances of each case.”).  
10 Defendants’ motion to dismiss Plaintiff’s claim for declaratory judgment is therefore  
11 DENIED.<sup>5</sup>

12 **C. BREACH OF CONTRACT (SUBSCRIPTION AGREEMENT)**

13 In his fourth claim, Plaintiff alleges that Pentagon breached the Subscription  
14 Agreement by refusing “to redeem the shares for their value, including accrued dividends”  
15 after he tendered his Series B shares for redemption. FAC ¶ 79. He further alleges that  
16 “Pentagon’s purported elimination of Series B preferred shares in May 2011 was manifestly  
17 unfair and a breach of the company’s duty of good faith and fair dealing to the Series B  
18 shareholders.” Id. ¶ 67. The pertinent sections of the Series B Subscription Agreement  
19 state:

20 3. Redemption

21 (a) Mandatory Redemption. Except and to the extent  
22 prohibited by applicable law, the Corporation shall redeem all  
23 shares of Series B Preferred Stock outstanding on December 31,  
24 2006 by paying each such sum of the Series B Liquidation  
25 Value plan an amount equal to the dividends accrued but unpaid  
26 thereon (the “Redemption Price”).

27 (b) . . . .

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28 <sup>5</sup> Pentagon also argues that “[it], its lenders and its investors have substantially  
changed positions in reliance on the Subordination Agreement.” Pentagon Mot. at 18. As  
noted, simply changing positions does not necessarily establish prejudice.



1 (c) Default. If the Corporation fails to redeem the  
2 Series B Preferred Stock by December 31, 2006, dividends shall  
3 accrue on the Series B Preferred Shares at the Dividend  
4 Payment Amount plus 2%, and such dividends shall accrue up  
and until such time as the Redemption Price of all of the  
5 outstanding Series B Preferred Shares is paid in full. Dividends  
6 accruing after December 31, 2006 may be paid only in cash.

7 Christeson Decl. Ex. C (Subscription Agreement) at A-6, ¶ 3(c) (emphasis added), Dkt. 9-2.

8 Pentagon argues that its refusal to redeem Plaintiff's stock is not a breach, but  
9 merely a "default" that entitles him to nothing more than a 2% increased dividend. The  
10 Court disagrees. As set forth above, the Subscription Agreement provides that Pentagon  
11 "shall" redeem the stock by December 31, 2006. Under the "default" provision, the  
12 consequence of failing to timely redeem the stock is that Pentagon becomes obligated to  
13 pay an increased dividend. Nothing in the agreement, however, states that the payment of  
14 such dividend obviates Pentagon's contractual obligation to redeem the stock. Indeed, the  
15 provision that the enhanced dividend shall continue to accrue "until such time as the  
16 Redemption Price of all of the outstanding Series B preferred shares is paid in full"  
17 underscores that Plaintiff's right to redeem continues to exist in tandem with the accrual of  
18 additional dividends.

19 With regard to Plaintiff's related bad faith claim regarding the elimination of Series  
20 B preferred shares in May 2011, see FAC ¶ 67, Pentagon asserts, in effect, that Plaintiff  
21 assumed the risk that his stock would lose value, see Pentagon Mot. at 20. This  
22 mischaracterizes Plaintiff's claim. The pleadings specifically allege that Pentagon used its  
23 position as the majority shareholder of Pentagon to eliminate the interests of other  
24 shareholders, including those of Plaintiff. FAC ¶¶ 38, 39, 80, 81. In Plaintiff's view, the  
25 loss of stock value was not attributable to natural market forces, but rather was a deliberate  
26 course of conduct by Baird to undermine his interests as a minority shareholder. As such,  
27 for purposes of the instant motion, Plaintiff has sufficiently alleged a claim for breach of  
28 duty of good faith and fair dealing. Baird's motion to dismiss Plaintiff's Fourth Claim for  
Breach of Contract is therefore DENIED.

1           **D.       BREACH OF FIDUCIARY DUTY**

2           Plaintiff’s fifth claim for breach of fiduciary duty is directed against Baird. He  
3 alleges that Baird, as a majority shareholder, owed a fiduciary duty to minority  
4 shareholders, such as himself. FAC ¶ 73. According to the FAC, since 2006, Baird has  
5 pursued a “scheme to control Pentagon” for its own benefit, to Plaintiff’s detriment. Id.  
6 ¶ 74. Baird allegedly “took the final step in its plan to deny McBride his rights as a  
7 shareholder” in May 2011 when it effectively eliminated the value of his Deferral  
8 Contributions Account. Id. ¶ 80.

9           “The elements for a breach of fiduciary duty claim are: (1) the existence of a duty  
10 arising from a fiduciary relationship; (2) a failure to observe the duty; and (3) an injury  
11 resulting proximately therefrom.” Camp St. Mary’s Ass’n of W. Ohio Conference of the  
12 United Methodist Church, Inc. v. Otterbein Homes 176 Ohio App.3d 54, 68 (Ohio Ct. App.  
13 2008) (internal quotation marks omitted). “A claim of breach of a fiduciary duty is  
14 basically a claim of negligence, albeit involving a higher standard of care.” Strock v.  
15 Pressnell, 38 Ohio St.3d 207, 216 (1988). Under Ohio law, claims for breach of fiduciary  
16 duty are governed by the four-year statute of limitations set forth in Ohio Revised Code  
17 § 2305.09(D).

18           Baird contends Plaintiff’s breach of fiduciary claim should be dismissed insofar as it  
19 is premised on any conduct occurring outside the four-year limitations period, i.e., prior to  
20 December 31, 2010. See Baird Mot. at 14-15. Plaintiff responds that he is not seeking  
21 damages based on specific conduct occurring prior to that date, but that those actions are  
22 alleged because they culminated in Baird’s efforts in May 2011 to eliminate the preferred  
23 stock upon which his deferred compensation was based. Since Plaintiff is not predicating  
24 his breach of fiduciary claim on pre-December 31, 2010 conduct, Baird’s motion to dismiss  
25 is unnecessary. Baird’s motion to dismiss Plaintiff’s Fifth Claim for Relief is therefore  
26 DENIED.

1 **III. CONCLUSION**

2 For the reasons set forth above,

3 IT IS HEREBY ORDERED THAT Baird and Pentagon's respective motions to  
4 dismiss are DENIED. The Court sua sponte dismisses Plaintiff's Second Claim for Relief,  
5 and grants Plaintiff leave to amend to incorporate the allegations set forth therein into his  
6 First Claim for Relief for breach of contract. Plaintiff shall file a Second Amended  
7 Complaint within twenty-one (21) days of the date this Order is filed. Defendants shall file  
8 a responsive pleading within fourteen (14) days of the date Plaintiff files his Second  
9 Amended Complaint.

10 IT IS SO ORDERED.

11 Dated: 12/22/15

  
SAUNDRA BROWN ARMSTRONG  
Senior United States District Judge

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