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Case No. 2018-0394-TMR

THE COURT OF CHANCERY OF THE STATE OF DELAWARE

STONE & PAPER INVESTORS, LLC, individually and derivatively on behalf of CLOVIS HOLDINGS LLC,	)	
Plaintiffs,	)	
v.	)	C.A. No. 2018-0394-TMR
RICHARD BLANCH, VIVIANNA BLANCH, RED BRIDGE & STONE, LLC, BRIAN SKINNER, and SKINNER CAPITAL, LLC,	)	
Defendants,	)	
and	)	
CLOVIS HOLDINGS LLC,	)	
Nominal Defendant.	)	

MEMORANDUM OPINION

Date Submitted: February 15, 2019
Date Decided: May 31, 2019

Blake Rohrbacher, Brian F. Morris, and John M. O'Toole, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; David Lackowitz and Zaid Shukri, MOSES & SINGER LLP, New York, New York; *Attorneys for Plaintiff*.

Catherine Damavandi, NURICK LAW GROUP, Wilmington, Delaware; *Attorney for Defendants Richard Blanch, Vivianna Blanch, Red Bridge & Stone, LLC and Nominal Defendant Clovis Holdings LLC.*

MONTGOMERY-REEVES, Vice Chancellor.

The dispute in this action centers on the management of a small limited liability company created to produce and sell stone-based paper products. The company's business did not take off the way that the founders hoped it would. The plaintiff alleges that the defendants, who were supposed to manage the company, breached fiduciary and contractual duties by spending the company's capital on personal expenses while doing nothing to advance the company. The defendants disagree, arguing that they worked tirelessly for years on the company's behalf and that the company has not prospered because of one of the manager's serious health issues. The defendants move to dismiss on multiple grounds. For the reasons that follow, I deny the Motion to Dismiss.

I. BACKGROUND

I draw all facts from the Verified Complaint (the "Complaint"), the documents attached to it, and the documents incorporated by reference into it.[1] At this stage of the proceedings, I must take all of Plaintiff's well-pled facts as true and draw all reasonable inferences in its favor.

[1] *In re Morton's Rest. Gp., Inc. S'holders Litig.*, 74 A.3d 656, 659 n.3 (Del. Ch. 2013) ("To be incorporated by reference, the complaint must make a clear, definite and substantial reference to the documents." (quoting *DeLuca v. AccessIT Gp., Inc.*, 695 F. Supp. 2d 54, 60 (S.D.N.Y. 2010))).

A. The Operating Agreement

Nominal Defendant Clovis LLC ("Clovis" or the "Company") is a Delaware limited liability company.[2] Clovis has three members: Plaintiff Stone & Paper Investors, LLC ("Stone"), a preferred member; Defendant Skinner Capital, LLC ("Capital"), a common member; and Defendant Red Bridge & Stone, LLC ("Red Bridge"), a common member.[3] Defendant Brian Skinner is and at all relevant times was a manager of Clovis and the sole member of Capital.[4] Defendant Richard Blanch is and at all relevant times was a manager of Clovis.[5] Defendant Vivianna Blanch, who is married to Richard Blanch, is and at all relevant times was the sole member of Red Bridge.[6]

The Limited Liability Company Operating Agreement of January 1, 2014 (the "Operating Agreement"), governs Clovis.[7]

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2 Compl. ¶ 6.

3 *Id.* ¶¶ 5-9.

4 *Id.* ¶ 8.

5 *Id.* ¶ 10.

6 *Id.* ¶ 11.

7 *Id.* ¶ 13.

Section 4.3 of the Operating Agreement, regarding the duties of managers, provides that "[a] Manager shall perform his duties hereunder in good faith and in a manner consistent with the requirements of the Act."[8]

Section 4.9 of the Operating Agreement, discussing reimbursement of expenses, mandates that "[t]he Managers will receive from the Company reimbursement for all reasonable out-of-pocket expenses incurred upon submission of receipts for such expenses; provided that the reimbursement of any expense item in excess of $5,000 shall require board approval."[9]

Section 4.10 of the Operating Agreement, laying out rules for financial reporting to members, provides that

> [t]he Company shall use commercially reasonable efforts to provide to each of the Members as soon as practicable after the end of any Fiscal Year (i) a statement of cash flows for such fiscal year, (ii) as to each Member, a report setting forth the closing Capital Accounts of each such Member and a description of the manner of their calculation, and (iii) to each Member of the Company and to each Person (or such Member's or Person's legal representative) who was a Member during any part of the Fiscal Year in question, a copy of the Member's Schedule K-1 thereto.[10]

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8 *Id.* Ex. A § 4.3.

9 *Id.* Ex. A § 4.9.

10 *Id.* Ex. A § 4.10.

Section 5.2 of the Operating Agreement, discussing interested-party transactions, mandates that

> [t]he Company shall not enter into an Interested Transaction (as defined below) unless it has first fully disclosed the terms and conditions of such Interested Transaction to the Board and the Members and the Board determines that the Interested Transaction is fair and reasonable to the Company and the terms and conditions are at least as favorable to the Company as those that are generally available from persons capable of similarly performing them and in similar transactions between parties operating at arm's length. An "interested transaction" means any transaction between a Member, a Manager or a member of the Board, or any Affiliate thereof, on the one hand, and the Company, on the other hand . . . .[11]

B. The Complaint's Factual Allegations

The Complaint sets out a detailed account of misconduct. Stone, Capital, and Red Bridge formed Clovis in 2013 to pursue a business based on making paper out of stone.[12] Stone contributed $3.5 million to the Company; the other members did not contribute capital.[13] Clovis had no revenue, so the $3.5 million represented all

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11 *Id.* Ex. A § 5.2 (emphasis omitted).

12 *Id.* ¶ 12.

13 *Id.* ¶ 15.

of the money available to the Company.[14] Richard[15] and Skinner served as the board of managers for Stone.[16]

The Complaint alleges that soon after formation Richard and Skinner began stealing money from the Company. They charged approximately $1 million to the Company's American Express card.[17] They caused the Company to loan $240,000 each to Red Bridge and Capital in December 2015, with no supporting documentation.[18] Richard and Skinner also caused the Company to loan them $600,000 in July 2016.[19] The Company loaned a total of $1.02 million in 2016.[20] In or around October 2016, Skinner and Richard asked the Company's accountant to reclassify additional previous payments as loans.[21] Defendants took a total of

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14 *Id.*

15 After I initially identify individuals, I reference them herein by their first names because many of the individuals share last names. I intend no disrespect or familiarity.

16 Compl. ¶ 16; *id.* Ex. A § 1.1(v).

17 *Id.* ¶ 20.

18 *Id.* ¶ 23.

19 *Id.* ¶ 24.

20 *Id.*

21 *Id.* ¶ 25.

$2,481,500.[22] Plaintiff alleges that Richard and Skinner did no work for the Company in exchange for those payments, loans, and American Express charges.[23]

The Complaint also alleges that Vivianna and Red Bridge participated in the theft. From some point in 2014 through September 2015, the Company paid Red Bridge $20,000 per month, but neither Red Bridge nor Vivianna, its sole member, provided any services to the Company.[24]

Skinner and Richard also repeatedly reclassified loans as guaranteed payments and vice versa.[25] Skinner and Richard initially classified some $891,500 of the money that went to Red Bridge as "guaranteed payments," but later reclassified that $891,500 as loans.[26] In January 2018, Skinner forgave $310,000 in loans to Capital by instructing the new accountant to recharacterize the loans from 2016 as payments.[27] In February 2018, Skinner instructed the Company's accountant to recharacterize another $295,000 in loans to Capital as payments.[28]

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22 *Id.* ¶ 18.

23 *Id.* ¶¶ 17, 22.

24 *Id.* ¶ 29.

25 *Id.* ¶ 21.

26 *Id.* ¶ 30.

27 *Id.* ¶ 42.

28 *Id.* ¶ 43.

In addition to stealing from the Company, Defendants attempted to conceal their actions from other members. For instance, Skinner and Richard withheld information from Stone in contravention of the terms of Section 4.10 of the Operating Agreement.[29] They also carried out interested-party transactions without disclosing that to the members, including Stone, in contravention of the terms of Section 5.2 of the Operating Agreement.[30] They provided Stone with misleading tax documents.[31] These documents reflected loans as assets but failed to disclose that the assets were largely comprised of loans to Richard and Skinner.[32] To further hide the theft, Richard and Skinner fired the Company's accountant for refusing to reclassify some guaranteed payments as loans.[33]

On May 18, 2018, Stone sought additional financial documents from Clovis, which Clovis declined to provide.[34] This litigation soon followed.

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29 *Id.* ¶ 33.

30 *Id.* ¶ 34.

31 *Id.* ¶¶ 35-39.

32 *Id.* ¶ 37.

33 *Id.* ¶¶ 40-41.

34 *Id.* ¶ 45.

C. Procedural History

On May 31, 2018, Stone filed its Complaint. The Complaint asserts multiple claims: a direct claim against Richard and Skinner for breaches of contract based on Sections 4.9 and 5.2 of the Operating Agreement (Count One); a derivative claim against Richard and Skinner for breaches of contract based on Sections 4.3, 4.9, and 5.2 of the Operating Agreement (Count Two); a derivative claim against Richard and Skinner for breaches of fiduciary duty (Count Three); and a derivative claim against Capital, Red Bridge, and Vivianna for aiding and abetting breaches of fiduciary duties (Count Four).

On July 3, 2018, Richard, Vivianna, Red Bridge, and Clovis (collectively, "Movants") moved to dismiss the Complaint (the "Motion to Dismiss").[35] On February 15, 2019, I held oral argument on the Motion to Dismiss.

II. ANALYSIS

Movants move to dismiss for failure to make demand or plead demand futility, for failure to state a claim under Court of Chancery Rule 12(b)(6), for false and misleading allegations under Court of Chancery Rules 3(aa) and 41(b), and for unclean hands.

[35] Movants amended their Motion to Dismiss on July 11, 2018.

A. Demand Is Excused as Futile

1. Count One states both direct and derivative claims

In Count One, Plaintiff alleges that Richard and Skinner breached Sections 4.9 and 5.2 of the Operating Agreement. Plaintiff alleges that Richard and Skinner failed to fully disclose interested transactions as Section 5.2 requires and failed to obtain board approval for out-of-pocket expenses as Section 4.9 requires. Movants argue that Count One states a derivative claim, although it is pled as a direct claim, and that the Complaint fails to meet the pleading standards for asserting a derivative claim.

When analyzing whether a claim is direct or derivative, "[t]he Court will independently examine the nature of the wrong alleged and any potential relief to make its own determination of the suit's classification. This determination is for the Court to make based upon the body of the complaint; plaintiffs' designation of the suit is not binding."[36]

In order to determine the nature of the claim, the Court must first assess whether a claim belongs to the plaintiff personally or to the entity. As the Delaware Supreme Court has recently stated,

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[36] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 2003 WL 203060, at *3 (Del. Ch. Jan. 21, 2003), *aff'd in part, rev'd in part*, 845 A.2d 1031 (Del. 2004); *see also Bakerman v. Sidney Frank Imp. Co., Inc.*, 2006 WL 3927242, at *19 (Del. Ch. Oct. 16, 2006).

> *Tooley* and its progeny deal with the narrow issue of whether a claim for breach of fiduciary duty or otherwise to enforce the corporation's own rights must be asserted derivatively or directly. Before evaluating a claim under *Tooley*, "a more important initial question has to be answered: does the plaintiff seek to bring a claim belonging to her personally or one belonging to the corporation itself?" Because the . . . claims at issue here belong to the holding stockholders under the state laws that govern the claims, . . . *Tooley* does not affect our [decision].[37]

If the claim belongs to the entity, the *Tooley* test applies. In order to determine whether a claim is direct or derivative, the Delaware Supreme Court held in *Tooley* that the Court must apply a two-part test: "(1) who suffered the alleged harm (the company or the suing stockholder, individually); and (2) who would receive the benefit of any recovery or other remedy (the company or the stockholder, individually)."[38] The same principles apply in the context of an alternative entity such as a limited liability company.[39]

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37 *Citigroup Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1127 (Del. 2016).

38 *Tooley*, 845 A.2d at 1033; *see also Bakerman*, 2006 WL 3927242, at *19 (applying *Tooley* in a limited liability company context). "The derivative suit is a corporate concept grafted onto the limited liability company form." *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 293 (Del. 1999). Thus, "case law governing corporate derivative suits is equally applicable to suits on behalf of an LLC," and I may "look to corporate case law to determine the proper method for distinguishing" between derivative and direct actions. *Kelly v. Blum*, 2010 WL 629850, at *9 (Del. Ch. Feb. 24, 2010).

39 *See Allen v. El Paso Pipeline GP Co., L.L.C.*, 90 A.3d 1097 (Del. Ch. 2014) (applying the *Tooley* test to claims against a limited partnership).

Stone attempts to assert direct claims for purported breaches of Sections 5.2 and 4.9 of the Operating Agreement. Section 5.2 requires the Company to disclose terms and conditions of any interested transaction to its members, including Stone, before carrying it out. This is a personal right belonging to the members, and Stone may bring its claim directly.

Section 4.9 provides for reimbursement for reasonable expenses, with board approval required for expenses above $5,000. The Company holds this right; therefore, the *Tooley* test applies. Under *Tooley*, the Court must first determine who suffered the alleged harm. Here, the Company suffered harm by reimbursing expenses without assessing whether they were reasonable and without board approval for large expenses. Second, the Court must determine who would receive the benefit of a recovery. Any recovery related to improperly paid expenses would flow to the Company. Thus, the claim for breach of Section 4.9 of the Operating Agreement is derivative.

2. Demand is futile

Plaintiff asserts Counts Two, Three, and Four, for breach of contract, breaches of fiduciary duties, and aiding and abetting breaches of fiduciary duties, derivatively on behalf of the Company. In addition, I held above that the portion of Count One claiming breach of Section 4.9 of the Operating Agreement is derivative.

The Delaware Limited Liability Company Act requires that a member may

only pursue claims derivatively on behalf of the company if the member can demonstrate that "managers or members with authority to do so have refused to bring the action or if an effort to cause those managers or members to bring the action is not likely to succeed."[40] Delaware Court of Chancery Rule 23.1(a) provides that a derivative complaint must "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."[41] Case law applying Rule 23.1 in the corporate context has been deemed instructive in interpreting the LLC Act's demand requirements.[42]

The demand requirement serves to "insure that a stockholder exhausts his intracorporate remedies,"[43] "provide a safeguard against strike suits,"[44] and "assure that the stockholder affords the corporation the opportunity to address an alleged

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40 6 *Del. C.* § 18-1001.

41 Ct. Ch. R. 23.1(a). Court of Chancery Rule 23.1(a) applies to limited liability companies through Court of Chancery Rule 23.1(d).

42 *VGS, Inc. v. Castiel*, 2003 WL 723285, at *11 (Del. Ch. Feb. 28, 2003) ("The right of a member of a Delaware LLC to bring a derivative claim is governed by *6 Del. C. §18-1000* . . . . This provision originates from the well-developed body of Delaware law governing derivative suits by stockholders of a corporation. Accordingly, case law governing corporate derivative suits is equally applicable to suits on behalf of an LLC." (citation omitted)).

43 *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984).

44 *Id.* at 812.

wrong without litigation and to control any litigation which does occur."[45] Where, as here, the plaintiff has failed to make a pre-suit demand on the board,[46] the Court must dismiss the complaint "unless it alleges particularized facts showing that demand would have been futile."[47]

Two Delaware Supreme Court cases articulate the tests for demand futility. *Rales v. Blasband*[48] applies when the plaintiff challenges an action not taken by the board that would consider the demand; *Aronson v. Lewis*[49] applies when the plaintiff challenges an action taken by the board that would consider the demand. Here, because the claims relate to purported board actions, *Aronson* applies. Under *Aronson*, to successfully plead demand futility a plaintiff must allege particularized facts sufficient to raise a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[50]

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45 *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del. 1988) (citing *Aronson*, 473 A.2d at 811-12).

46 Compl. ¶ 47.

47 *Ryan v. Gursahaney*, 2015 1915911, at *5 (Del. Ch. Apr. 28, 2015), *aff'd*, 128 A.3d 991 (Del. 2015).

48 634 A.2d 927, 934 (Del. 1993).

49 473 A.2d 805 (Del. 1984).

50 473 A.2d at 814.

A board member is considered "interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders. Directorial interest also exists where a corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders."[51] The Court will deem a board member "'interested' for purposes of this analysis when he stood on both sides of the transaction at issue or stood to receive a material benefit that was not to be received by others."[52]

Here, Richard and Skinner comprise the board. Stone pleads that Richard and Skinner breached their obligations under the Operating Agreement and their fiduciary duties by stealing millions of dollars from the Company for their own financial benefit and to the detriment of the Company. The Complaint alleges with specificity that Richard and Skinner stood on both sides of the challenged transactions. Stated differently, the complaint alleges that the entire board took money from the Company for their own benefit to the detriment of the Company and the other members. The Complaint's facts regarding theft fall into four categories: (1) Richard and Skinner stole money for themselves; (2) Richard and Skinner stole

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51 *Rales*, 634 A.2d at 936 (citing *Aronson*, 473 A.2d at 812; *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984)).

52 *Cumming v. Edens*, 2018 WL 992877, at *12 (Del. Ch. Feb. 20, 2018) (citations omitted).

money for their companies; (3) Richard and Skinner stole money for Richard's spouse; and (4) Richard and Skinner stole money for Richard's spouse's company. Thus, the board is interested for all four categories. Demand, therefore, is futile as to all of the derivative claims.

B. All Counts in the Complaint State Claims Under Rule 12(b)(6)

Movants also move to dismiss all counts under Rule 12(b)(6), arguing that dismissal is appropriate because "the Complaint does not state any claims upon which relief may be granted. None of the claims contain specific allegations of a date or time when the wrongful actions occurred."[53] When considering a motion to dismiss under Rule 12(b)(6), this Court must "accept as true all of the well-pleaded allegations of fact and draw reasonable inferences in the plaintiff's favor."[54] While the Court must draw all reasonable inferences in the plaintiff's favor, it is not "required to accept as true conclusory allegations 'without specific supporting factual allegations.'"[55] "[D]ismissal is inappropriate unless the 'plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances

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53 Movants' Am. Mot. to Dismiss 27. Movants introduce facts and documents outside of the pleadings to their Motion to Dismiss. Because at this stage my analysis is limited to the pleadings, I do not consider those facts.

54 *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (citing *Malpiede v. Townson*, 780 A.2d 1075, 1082 (Del. 2001)).

55 *Id.* (quoting *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 65-66 (Del. 1995)).

susceptible of proof."[56]

Because I found above that demand is futile due to well-pled allegations that the entire board stole millions of dollars for its benefit and to the detriment of the Company and other members, Movants' Motion to Dismiss fails as to the derivative claims against the board members.[57] This is consistent with general guidance, which directs that "[t]he standard for pleading demand futility under Rule 23.1 is more stringent than the standard under Rule 12(b)(6)."[58] Further, "[b]ecause the standard under Rule 12(b)(6) is less stringent than that under Rule 23.1, a complaint that

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56 *Id.* (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002)).

57 Movants also seek dismissal of the breaches of fiduciary duties claim on the grounds that this claim is duplicative of the breach of contract claim. *See* Defs.' Am. Opening Br. 28-29. The Delaware courts allow parallel breach of contract and breach of fiduciary duty claims when the fiduciary duty claims are "grounded on an additional and distinct fact." *Nemec v. Shrader*, 991 A.2d 1120, 1129 (Del. 2010) (citing *Schuss v. Penfield P'rs, L.P.*, 2008 WL 2433842, at *10 (Del. Ch. June 13, 2008)). Here, the fiduciary duty claim relates to allegations that the board members stood on both sides of transactions in which they stole money from the Company to the detriment of the Company. The breach of contract claims relate to alleged violations of specific provisions of the Operating Agreement: Section 5.2, which requires the Company to disclose terms and conditions of any interested transaction to its members, including Stone, before carrying out the transaction; and Section 4.9, which provides for reimbursement for reasonable expenses, with board approval required for expenses above $5,000; and Section 4.3, which requires that Managers perform their duties in good faith and consistent with the requirements of the LLC Act. The fiduciary duty claims are grounded in additional distinct facts and depend on allegations that Richard and Skinner "engaged in self-interested transactions that were unfair to the Company and/or committed waste of the Company's assets." Compl. ¶ 67. Thus, the claims are not duplicative.

58 *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009).

survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss, assuming that it otherwise contains sufficient facts to state a cognizable claim."[59]

The Complaint also adequately alleges a direct claim for breach of Section 5.2 of the Operating Agreement. Section 5.2 provides that "[t]he Company shall not enter into an Interested Transaction (as defined below) unless it has first fully disclosed the terms and conditions of such Interested Transaction to the Board and the Members and the Board determines that the Interested Transaction is fair and reasonable to the Company."[60] "An 'interested transaction' means any transaction between a Member, a Manager or a member of the Board, or any Affiliate thereof, on the one hand, and the Company, on the other hand . . . ."[61] The Complaint alleges a series of interested transactions[62] and a failure to disclose them to the members.[63] This is sufficient to state a reasonably conceivable claim and survive the Motion to Dismiss.

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59 *McPadden v. Sidhu*, 964 A.2d 1262, 1270 (Del. Ch. 2008).

60 Compl. Ex. A § 5.2.

61 *Id.* (emphasis omitted).

62 *See id.* ¶¶ 17-26.

63 *Id.* ¶ 54.

Finally, the Complaint also alleges that Capital, Red Bridge, and Vivianna aided and abetted Richard and Skinner's breaches of fiduciary duties. To survive a motion to dismiss for failure to state a claim,

> the complaint must allege facts that satisfy the four elements of an aiding and abetting claim: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, . . . (3) knowing participation in that breach by the defendants," and (4) damages proximately caused by the breach.[64]

Having already ruled that Stone's breaches of fiduciary duties claim survives, the only remaining disputed element of the aiding and abetting claim is "knowing participation." "Knowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach."[65] In the case of an entity, an individual defendant's "knowledge must be attributed to the entities that he controlled and used to effectuate his breaches of duty."[66] "An inference of knowing participation can be made

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64 *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001) (alterations in original) (citation omitted).

65 *Id.* at 1097 (citation omitted).

66 *In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *38 n.176 (Del. Ch. May 3, 2004).

where . . . the facts surrounding a transaction are 'so egregious . . . as to be inherently wrongful.'"[67]

The Complaint alleges that Red Bridge accepted large monetary payments directly from the Company for an extended period of time while neither it nor its sole member Vivianna provided any work or other benefit to the Company. It is reasonable to infer Vivianna's knowing behavior at the pleading stage, and her knowledge can be imputed to Red Bridge for the purpose of aiding and abetting liability. Likewise, the Complaint alleges that Capital accepted large monetary payments directly from the Company for an extended period of time while neither it nor its sole member and Skinner provided any work or other benefit to the Company in exchange for those payments. It is reasonable to infer Skinner's knowing behavior at the pleading stage, and his knowledge can be imputed to Capital for the purpose of aiding and abetting liability. Thus, the Complaint adequately pleads knowing participation by all of the aiding and abetting defendants.[68]

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67 *Houseman v. Sagerman*, 2014 WL 1600724, at *24 (Del. Ch. Apr. 16, 2014) (quoting *In re BJ's Wholesale Club, Inc. S'holders Litig.*, 2013 WL 396202, at *14 (Del. Ch. Jan. 31, 2013)).

68 Movants add that aiding and abetting claims are only available against third parties, and Stone has "failed to demonstrate how members of Clovis Holdings can be considered third parties." *See* Defs.' Am. Opening Br. 30. Third parties refers to non-fiduciaries, and the Complaint does not name the aiding and abetting defendants as fiduciaries. Thus, they are third parties.

C. Neither Rule 3(aa) nor Rule 41(b) Provides a Basis for Dismissal

Movants cite Court of Chancery Rules 3(aa) and 41(b) in support of their Motion to Dismiss.[69] Rule 3(aa), entitled "Verification," provides that

> [a]ll complaints . . . shall be verified by each of the parties filing such pleading. Every pleading, . . . which is required to be verified by a statute or by these Rules shall be under oath or affirmation by the party filing such pleading that the matter contained therein insofar as it concerns the party's act and deed is true, and so far as it relates to the act and deed of any other person, is believed by the party to be true.[70]

Rule 41(b), entitled "Involuntary dismissal; effect thereof," provides that

> [f]or failure of the plaintiff to prosecute or to comply with these Rules or any order of court, a defendant may move for dismissal of an action or of any claim against the defendant. After the plaintiff has completed the presentation of plaintiff's evidence, the defendant, without waiving the right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence.[71]

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69 Defs.' Am. Opening Br. 14-19.

70 Ct. Ch. R. 3(aa).

71 Ct. Ch. R. 41(b).

Movants cite three cases in favor of dismissal under Rules 3(aa) and 41(b): *Parfi Holding AB v. Mirror Image Internet, Inc.*,[72] *Bessenyei v. Vermillion, Inc.*,[73] and *OptimisCorp v. Waite.*[74]

In *Parfi*, then-Vice Chancellor Strine considered a motion to dismiss under Rule 41(b) for failure to prosecute or follow court rules.[75] The Court considered the motion on a second remand, and thus had access to a significant factual record developed through the action and in a related arbitration.[76] Analyzing the voluminous record before it, the Court dismissed the minority stockholders' action, holding that the plaintiffs had repeatedly and purposely misled the court about who the parties in interest were and why they had not filed an arbitration that the Court had mandated.[77] Then-Vice Chancellor Strine held that "the most compelling evidence . . . clearly support[s] a finding that [one minority stockholder] conjured up a misleading story to give to this court for tactical advantage."[78] The then-Vice

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72 954 A.2d 911 (Del. Ch. 2008).

73 2012 WL 5830214 (Del. Ch. Nov. 16, 2012).

74 2015 WL 5147038 (Del. Ch. Aug. 26, 2015).

75 954 A.2d at 917-18.

76 *Id.* at 914-15.

77 *Id.* at 931-32.

78 *Id.* at 932. He added that "this wrongful course of conduct implicates this court's authority under Rule 41(b), to dismiss a case when the plaintiffs fail 'to prosecute' or 'comply with' the court's rules or orders," and that "it implicates this court's

Chancellor wrote, "I do not reach these factual conclusions lightly. I have reviewed the factual record carefully and come to the conclusion that there is clear and convincing evidence supporting my findings."[79]

In this case, unlike in *Parfi*, there is no record before the Court, and nothing at this stage suggests that any party has attempted to mislead the court.

In *Bessenyei*, Vice Chancellor Noble considered a motion to dismiss based on Court of Chancery Rules 3(aa) and 41(b). The defendants argued that the notarizations in the complaint's verification were not valid because the plaintiff was not physically present in the United States at the time of the verification.[80] The Vice Chancellor wrote that the plaintiff's "signature was notarized in Pennsylvania even though he was not in the United States. Under Pennsylvania law," which governed because the purported notarizations occurred in Pennsylvania, "[the plaintiff's] failure to appear before [the notary] at the time the notarizations took place renders the notarizations invalid. [The plaintiff's] verifications are therefore also invalid for

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inherent authority to police the litigation process, to ensure that acts that undermine the integrity of that process are sanctioned." *Id.* (citations omitted). He further held that "[w]hen a party knowingly misleads a court of equity in order to secure an unfair tactical advantage, it should forfeit its right to equity's aid. Otherwise, sharp practice will be rewarded, and the tradition of civility and candor that has characterized litigation in this court will be threatened." *Id.* at 915.

79 *Id.* at 932.

80 2012 WL 5830214, at *1-2.

the purposes of Court of Chancery Rule 3(aa)."[81] Movants imply that *Bessenyei* requires that I should assess the merits of Stone's claim at the pleading stage. The Vice Chancellor, however, made his determination based on undisputed deposition testimony concerning the location of the plaintiff;[82] he did not address the merits of the underlying action.

In this case, unlike in *Bessenyei*, there is no evidence of patent untruthfulness and no issue with the verification.

In *OptimisCorp*, Vice Chancellor Parsons applied the Rule 41(b) standard post-trial to find that the plaintiffs had engaged in witness tampering. He wrote that "Plaintiffs fundamentally have impaired the Court's ability to find facts by offering improper material inducements and employing overbearing threats of criminal and civil litigation, a combination of carrots and sticks that has corrupted the witnesses."[83]

Thus, *Parfi*, *Bessenyei* and *OptimisCorp* were all on procedurally different postures. They involved careful review of record evidence, which revealed fraud on the court, facial problems with the verification to the complaint, or witness tampering. Neither they nor any other authority cited by Movants supports the use

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81 *Id.* at *4.

82 *See, e.g.*, *id.* at *4 n.24.

83 2015 WL 5147038, at *7.

of Rules 3(aa) and 41(b) to dismiss the claims on the merits at this stage. I, therefore, deny the Motion to Dismiss on the basis of these rules.

D. All Other Arguments for Dismissal Fail

Movants argue that this Court should dismiss the Complaint because of Stone's unclean hands[84] and for laches.[85] Dismissing a complaint for unclean hands at the pleading stage is only appropriate in extreme circumstances.[86] Furthermore,

> [b]ecause the Court generally is limited to the facts appearing on the face of the pleadings in ruling on a motion to dismiss, affirmative defenses, such as laches, are not ordinarily well-suited for disposition on such a motion. Thus, unless it is clear from the face of the complaint that an affirmative defense exists and that the plaintiff can prove no set of facts to avoid it, dismissal of the complaint based upon an affirmative defense is inappropriate.[87]

It is not clear from the face of the Complaint that the affirmative defenses asserted apply and plaintiff can prove no set of facts to avoid the defenses. Thus, I deny Movants' Motion to Dismiss on the basis of unclean hands and laches.

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84 Defs.' Am. Opening Br. 20-21.

85 *Id.* at 30-31.

86 *See, e.g.*, *Solak v. Sarowitz*, 2016 WL 7468070, at *12 (Del. Ch. Dec. 27, 2016) (holding that "it is inappropriate to dismiss a complaint based on an affirmative defense," such as unclean hands, "unless 'plaintiff can prove no set of facts to avoid it.'" (quoting *Stephen G. Perlman, Rearden LLC v. Vox Media, Inc.*, 2015 WL 5724838, at *12 (Del. Ch. Sept. 30, 2015))).

87 *Vox Media*, 2015 WL 5724838, at *12 (citations omitted).

III. CONCLUSION

For the foregoing reasons, Movants' Motion to Dismiss is DENIED.

IT IS SO ORDERED.