IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

STARR INVESTMENTS CAYMAN II, INC.,	:	
Plaintiff,	:	
vs.	:	Civil Action No. 6484-VCP
CHINA MEDIAEXPRESS HOLDINGS, INC.,	:	
Defendant.	:	

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Chancery Courtroom No. 12B
New Castle County Courthouse
Wilmington, Delaware
Wednesday, August 3, 2011
2:00 p.m.

BEFORE: HON. DONALD F. PARSONS, JR., Vice Chancellor.

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DEFENDANT'S MOTION TO DISMISS

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APPEARANCES:

ANDRE G. BOUCHARD, ESQ.
Bouchard Margules & Friedlander, P.A.
-and-
MARILYN C. KUNSTLER, ESQ.
KEOLA R. WHITTAKER, ESQ.
of the New York Bar
Boies, Schiller & Flexner LLP
For Plaintiff

ALBERT H. MANWARING, IV, ESQ.
JAMES G. McMILLAN, III, ESQ.
Pepper Hamilton LLP
For Defendant

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MR. BOUCHARD: Good afternoon, Your Honor.

THE COURT: Good afternoon. Okay.

MR. MANWARING: Good afternoon, Your Honor. May it please the Court. Albert Manwaring from Pepper Hamilton. I'm here with my colleague Jay McMillan, and I represent China Media Express for the motion to dismiss Starr's 220 complaint to state a proper purpose.

By way of pertinent background, on March 15th plaintiff Starr filed a complaint, a federal securities complaint in the U.S. District Court for the District of Delaware. They named the company, China Media Express, the CFO and CEO and the company's auditor, Touche. They asserted federal securities claims and broad purposes here. In particular, they asserted state law claims for breach of fiduciary duties, fraud, negligent misrepresentation and aiding and abetting.

The company, as well as a number of other defendants, immediately tried to obtain an extension in light of the company being located in China and the CEO not speaking English. This was initially refused. Eventually the plaintiff Starr did

agree and then immediately moved for a 220 -- to make a 220 demand. I submit that the timing of the 220 demand, as well as the substance of the demand in the 220 complaint, indicate that the purpose of that demand was in fact to seek discovery in the event the motion to dismiss was granted, and in fact they needed to replead their claims in the federal action.

Substantively the demand repeats some of the core allegations in the federal complaint concerning the Muddy Waters report, the Deloitte Touche resignation, the CEO's response letter to that and a number of DNO resignations. The demand then goes on to request documents concerning all those issues. In turn, the 220 complaint repeats almost verbatim on pages one and two some of these core allegations in the federal complaint. It references the federal complaint and then incorporates by reference the entire demand into it.

On 6/13 defendants moved to dismiss the federal complaint. Instead of responding and filing an answering brief, Starr chose to exercise its right to amend the complaint on July 5th. That amended complaint adds a number of new parties, but for our purposes here it continues to assert federal

securities claims under the exchange act against the original parties, and it also continues to assert the state law claims for breach of fiduciary duties, fraud, aiding and abetting, and this time adds a conspiracy count which wasn't in the original complaint.

The law in this area is really governed by three leading cases. There's Cohen, there's Romero, which is Your Honor's case, and then there's Beiser. I think a couple of principles can be gleaned that are applicable here. The first is that there certainly is no preemption by the PSLRA of a 220 action here in Delaware. I think the federal courts and state courts are unanimous in reaching that conclusion.

I think another principle that could be gleaned is, when you don't assert state law claims in your federal securities action, and even if there's an overlap in facts between the two actions but you have a different plaintiff and you have a different counsel in the 220 action versus the federal securities action, that Cohen and Romero stand for the proposition that you can carve out and differentiate your 220 action and your request for records to bring

a derivative action and plead demand futility. You can carve that out, as they did in Cohen, to make out a waste mismanagement case, as they did in Romero, which Your Honor found to plead a breach of fiduciary action concerning the ethics codes.

I think a couple of the federal cases are pertinent here and need to be mentioned. The stay applies in a federal securities action not only to discovery on the federal securities claims but also as to any pendent state law claims that are asserted in that action. I recommend to the Court the Winer decision, which is referenced in our papers. There's an excellent treatment of that issue by Judge Padova in the Eastern District of Pennsylvania.

In addition, the Private Securities Litigation Reform Act applies not only when there's a motion to dismiss but when there's a contemplated or a mere indication of a motion to dismiss. I think the law is well settled in this area. And I reference the Court, there's an excellent treatment of that in the Carnegie decision, which is also referenced in our papers.

So here we filed a motion to dismiss, or China Media and the defendants Lam and the CEO

Cheng moved for a motion to dismiss. The plaintiff Starr amended their complaint and the parties have now reached a hard fought stipulation to extend the time to respond to the amended complaint, and that stipulation also includes a briefing schedule for an answering brief and a reply brief in the event that Lam, Cheng and the company move to dismiss, and the company -- Cheng and Lam -- will move to dismiss the amended complaint.

So accordingly, there is a stay in effect. It applies to this action and it applies to the federal action, and it applies to the pendant state law claims in that action, even though we haven't reached September 9th, the due date for our motion to dismiss, or the company's motion to dismiss the amended complaint.

I think another key case -- another principle is Beiser. In Beiser there was a pending action. The stay was in effect. We had the same plaintiffs, same counsel, same claims that were being pursued on the same facts. And in Beiser, Vice Chancellor -- former Vice Chancellor Lamb found that there wasn't a proper purpose in that particular case.

Beiser is distinguished from -- the

last principle here is the Meltzer-King principle, and that's the principle that it is quite okay to do a contemporaneous 220 action in order to do discovery, when there's no PSLRA in effect, when there's no action.

And I think Meltzer and King stand for the proposition -- and those cases, in contrast to Beiser, there was the same plaintiff, same counsel, same claims, same facts, but the difference between a Beiser, a Meltzer and a King is that the action in those cases had been dismissed. There was no stay in effect. So we were in an interim period. And then the Court gave leave to amend and said, "Go pursue your 220 action and then come back and amend your complaint."

I think the Supreme Court in King was very careful to carve out that that Beiser line of cases was still good law; that in fact that what distinguishes King and Meltzer from Beiser was in fact a pending action in which there's a stay in effect and then the Court then directing them to get leave to amend.

So where does that leave us here in our case? Our case, I respectfully submit, is the

Beiser case. The PSLRA stay is still in effect. We have the same plaintiff in the 220 action as in the federal securities action. We have the same counsel representing that same plaintiff. Plaintiff seeks discovery on the same claims on the same core facts.

In contrast to a Cohen-Romero, the plaintiffs here, I think -- and they had to do it, otherwise I think their state law claims would have been barred by res judicata, is that they had to assert their state law claims in the federal securities action. But by asserting those state law claims on the very same facts those claims became subject to the PSLRA stay. That's the case Winer that I directed your attention to.

So accordingly, unlike Cohen and Romero, in which there were no state law claims, the sum overlap in facts and no overlap of counsel and no overlap of the plaintiffs, here there's no room to assert any additional state law claims, whether they're direct or they're derivative. They're fiduciary duty claims and they're based on the same core set of facts. To suggest that they can bring on those same facts, another claim would amount to improper claim splitting, which is a subset of the

doctrine of res judicata.

Plaintiffs try and get around this issue by asserting, well, there's some additional facts that were now alleged that weren't in the original complaint concerning the NASDAQ listing and the suspension of trading on the NASDAQ and then the resignation of one of the directors from the audit committee, and then NASDAQ then, in turn, said we're not going to give you an opportunity to cure. Those additional facts are now asserted in the amended complaint. That amended complaint under Winer and Carnegie are subject to the PSLRA stay. So this is a red herring.

Having said that, merely adding a director's resignation, that may exchange the demand futility issue but that doesn't create an entire new cause of action. These are just collateral consequences. The NASDAQ issue and the subsequent director resignations are collateral consequences of the alleged malfeasance that is the subject of the breach of fiduciary duty actions and not a new cause of action in and of itself.

Having said that, it's now part of the amended complaint. They expressly put it in the

amended complaint and now it's subject to the stay. So it's really not an issue I think we need to address any further, which really brings us to the last issue in the case and which is plaintiff's primary argument here and that's their reliance on the King v. VeriFone and the Meltzer cases and the concept that, if there's an opportunity for leave to amend the complaint, an opportunity to take discovery in anticipation to amend the complaint, that there will be an opportunity to amend the complaint here if a motion to dismiss is granted, and they're given leave to amend, that they should be able to conduct discovery now in anticipation of being able to use that discovery to amend their complaint. They rely on King, they rely on Meltzer.

In both King and Meltzer, we were in that interim period where the federal action had been dismissed. There was no action pending. There was no PSLRA stay in effect to stay anything because there was no action pending. And the Court in both King and Meltzer expressly directed the plaintiff to conduct a 220 action in the Delaware Court of Chancery.

So accordingly we're not in that case. In contrast here, there's still a pending action.

There's still a PSLRA in effect. There's been no dismissal and there's been no grant of leave to amend. So accordingly I think the Court need not look any further than Sedona, cited in our papers and the 9th Circuit decisions they look at. And in Sedona, the 9th Circuit sounded lifting a stay to allow a plaintiff to do discovery so they can amend their complaint is a violation of the stay. That is an improper lifting of the stay. And so, if conducting that discovery now in Federal Court is improper, I respectfully suggest that it is certainly not a proper purpose here. And so accordingly I respectfully request the Court dismiss Starr's 220 complaint.

Any questions, Your Honor? That's all I have.

THE COURT: Thanks.

MR. BOUCHARD: Good afternoon, Your Honor. Andy Bouchard for the plaintiff, Starr Investments Cayman II, Inc. I want to first introduce my co-counsel Marilyn Kunstler, and Keola Whittaker from the Boies, Schiller & Flexner firm.

I want to make, I guess, two fundamental points in my argument today. One is, I want to put the demand that's been made here in a

factual context. I think it's been overlooked in the presentation so far. And then, second, I want to address head on this contention China Media has made that Starr's real purpose here -- and it's making this on a motion to dismiss, where all inferences are read in the plaintiff's favor -- the contention that our real purpose is a pretense to try to circumvent the PSLRA. And I want to make the point about why that assertion cannot be resolved on a motion to dismiss based on the record that exists in this case.

Let me first turn to the context of the demand. I'm not going to repeat everything in the briefs because I know Your Honor is familiar with the record. In a very brief summary, Starr made the demand on May 2nd of this year. And it stems from an extraordinary set of circumstances raising numerous red flags of mismanagement and wrongdoing at China Media. In late January and in early February of this year, multiple analysts -- there was reference made to Muddy Waters -- that was one of the two -- issued detailed reports challenging the veracity of the company's representations concerning its operations and financial performance. On March 3rd, the company's auditor, Deloitte, sent a letter to

China Media's board and to its audit committee raising serious issues about the validity of certain transactions.

On March 11th, Deloitte resigned as China Media's auditors saying in its authorization letter it could no longer rely on management's representations. That same day trading in China Media's stock halted. Within two weeks two members of the China Media board resigned. On April 7th the chair of the audit committee resigned and in his resignation letter saying he could not fulfill his fiduciary duties to the company, given the circumstances surrounding the company.

On April 29th, the company announced they couldn't comply with NASDAQ regulations requiring an independent audit committee.

On May 2nd, the company retained counsel and undertook to conduct an investigation concerning the concerns that had been raised by Deloitte.

Now, any one of those events, I submit, would provide a credible basis to infer mismanagement and wrongdoing. Together it's an avalanche of such evidence. And unsurprisingly

numerous investigations have been launched, including an investigation of this company by the SEC and numerous lawsuits have been filed, including two that are before Your Honor. Another case -- that is, another Section 220 demand case to investigate similar issues and a derivative in its own right. I don't know if Your Honor is aware of it or not but it's on your docket and pending before the Court.

I bring this up to put the demand in a factual context. But No. 2, there was a faint effort in the opening brief of China Media. I think it's an argument that has since been abandoned. It wasn't in the reply brief, and I didn't hear Mr. Manwaring make any reference to it, that there was a credible basis for inferring mismanagement. I take it that's by the boards and no more needs to be said about it.

THE COURT: I guess the way I'm looking at it is all these facts are in the amended complaint in the federal action. If anything, it just seems to support the view that all that's going on here is an attempt to get around the PSLRA.

MR. BOUCHARD: Well, I'm going to gild that head on. I'll give you the pray see of that issue right now. The key fundamental fact there is

the federal complaint does not allege any derivative claims. They are solely individual claims, and I'll explain exactly what the nature of those claims are in a moment. They do not allege any derivative claims. And we have a right to investigate potential derivative claims and we would have the ability to assert them in a separate lawsuit, not in the current federal action, either in this court or in another state court, or in another Federal Court for that matter.

THE COURT: Well, doesn't that -- I mean, is this case going to be the paradigm for every federal plaintiff to circumvent the PSLRA by never making your derivative claim in the federal case, keep it on the side, come around here, do all your discovery. Lo and behold, at the end of the day the light bulb will go on: we ought to consolidate this and make all our claims in one court. Or it's the same evidence that you're going to be using for the derivative claim as you're using for the other -- I mean, it's not very appealing to have this Court signing on to that kind of a proposition.

MR. BOUCHARD: I don't think the Court is signing on to that proposition. I think litigants

are entitled to assert direct individual claims. Here we are doing exactly what this Court and the Delaware Supreme Court has told plaintiffs to do time and time again before asserting derivative claims, and that is to conduct your 220 investigation. That is an independent right that we have as shareholders under Delaware law. It's one, as Mr. Manwaring acknowledges, as he has to because you so held in the Romero case and Chancellor Chandler held in the Cohen case, that we have independent of the PSLRA because the PSLRA did not pre-empt Section 220.

THE COURT: Right. You know, in those kind of cases, maybe we could have said that whatever you find out in this case you won't use in the federal case. Here, unlike those cases, we've got the same attorneys, the same parties, and they're supposed to do a lobotomy or something like that and forget what they know from the Delaware case and don't use that in the federal case. That's a little hard to imagine it working as a practical matter.

MR. BOUCHARD: I do take issue with that, Your Honor. No. 1, we've represented that we won't use anything that we learned, or we're prepared to represent we won't use anything we learned as a

result of our 220 inspection for purposes of our federal action that's currently pending so long as the same is a fact. That offered, to try to resolve this.

THE COURT: Even that, that I don't think the other cases where there was an agreement not to use the information included that last qualification. And they probably didn't need it because they had -- they didn't have the same counsel as are in the federal actions.

What is happening is, if the PSLRA was put in place to save the defendants in the federal action from the costs and the burden of going through their -- all this discovery and so on, and that's why they have got those stays, and what you're saying is you just kind of come around through the back door, take all the discovery here, put it on the shelf until you're finished with the proceedings in the federal case and then use it, you completely defeated the purpose.

MR. BOUCHARD: I think what we're saying is -- and I want to go through it because I think it's important to highlight the allegations.

THE COURT: All right. I'll stay quiet.

MR. BOUCHARD: No. I want to answer your question directly, and then I want to go through and explain what we pled and what's not pled that I think illustrates the difference.

The key point is this. We could file -- once we conduct our investigation and get the requisite information to make a determination whether we plead demand futility, which is one of the core purposes of the 220 demand we made, which is what the courts of this state tell us to do -- we could file tomorrow or after getting that information a derivative case in this Court, and we'd be perfectly entitled to do that and go along our way and never use anything we learned from this 220 demand in the federal case. It's a stand-alone separate proposition.

We only have in the Federal Court proceeding right now individual claims. And the PSLRA only protects the company and gives it this stay power with respect to the claims that are at issue in that case, not with respect to other litigations or potentially other litigations that could be initiated to assert derivative claims. If I could take a moment and just go through, I think, the complaint in the

federal case. I think it's important to highlight what we're really talking about. I think what you'd find -- I don't know if Your Honor had a chance to look at either the first version or the amended version of the federal complaint, but the gravamen of each of the claims in that complaint is that Starr -- not China Media -- that Starr was individually harmed when it purchased securities, both common preferred stock, and when it exercised certain warrants based on false representations that China Media had made. That premise underlies every single claim in the federal complaint: the securities law claims, the fraud claims and the fiduciary duty claims. Nothing is asserted seeking any form of recovery on behalf of China Media.

Now, Gaffin versus Teledyne makes clear, when you assert state fraud claims, you have to prove reliance individually. And it's exactly the kind of state fraud claim we have alleged in the federal action.

Now, let's focus on the fiduciary duty claim, the paradigm claim that can be potentially brought in a derivative context as well. There is a footnote -- I think it's telling, frankly that it's in a footnote -- argument that's made in the reply brief

by China Media that they say at one point, "Oh, our claims are really derivative in nature." I didn't hear Mr. Manwaring make that argument so maybe he's conceding the point. None of them are derivative. But it's very interesting because he sites Malone versus Brincat for the proposition that fiduciary duty claims, based on allegedly false and misleading disclosures in SEC filings, have to be derivative. Malone versus Brincat recognizes that they can be either derivative or individual. I think it's important just to take a moment to highlight those portions of the opinion for the Court.

I need the reading glasses for this, Your Honor. Sorry.

THE COURT: All right.

MR. BOUCHARD: So, for example, on page nine of Malone versus Brincat on the central holding of the Court it says, "We hold that directors who knowingly disseminate false information that results in corporate injury or damage to an individual stockholder" -- so it could be corporate injury or damage to an individual stockholder -- "violate their fiduciary duty, and may be held accountable in a manner appropriate to the circumstances."

Then later in the opinion the Court states, "When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty. That violation may result in a derivative claim on behalf of the corporation or a cause of action for damages."

It goes on to elaborate. "If the plaintiffs intend to assert a derivative claim, they should be permitted to replead to assert such a claim and any damage or equitable remedy sought on behalf of the corporation. Likewise, the plaintiffs should have the opportunity to replead to assert any individual cause of action and articulate a remedy that is appropriate. . . ." And it goes on.

The point is, a fiduciary duty claim can be either individual, which is all we've asserted in the federal case, or it can be derivative. And we deliberately, consciously refrained from asserting derivative claims because we wanted to do what this Court and the Supreme Court tells us to do, which is conduct your investigation using 220 before you do it.

If I could just highlight the

paragraphs to make clear what I'm talking about in the federal complaint. It's the entire guts of the fiduciary duty claim in the federal complaint which is in paragraphs 319 to 321. I won't read it all, Your Honor, but you'll get the point. It says, "Defendants Cheng and Lam breached their fiduciary duties to Starr by. . .employing devices, schemes, and artifices to defraud;. . .deliberately making untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and. . .engaging in acts, practices, and a course of business which operated as a fraud and deceit upon Starr."

And it continues. We relied on those representations, cite certain documents that were issued. Then the ultimate point, "The actions of Defendants Cheng and Lam are directly. . .responsible for Plaintiff's injuries, including inducing Starr's October 2010 purchase of CCME securities, its December 2010 exercise of warrants, and its continuing to hold CCME securities up to and including until the date when trading in CCME stock was halted."

What's not in the federal complaint -- this is very important -- what's not in the federal

complaint? Exactly all the kind of claims you typically would see when you assert a derivative claim in these circumstances. There's no claim of waste, no claim of unjust enrichment, no claim of loyalty violations or of oversight violations that cause harm to the company. And to be sure, such claims -- they have already been made in one case in front of Your Honor -- such claims would entail damage, such as damage to the reputation and good will of China Media not asserted in the current federal action, damage in the exposure to liability as a result of the investigations. And then numerous litigations have been initiated, not asserted in the federal action. Damage for the costs that the company's incurring to deal with this mess, which these fiduciaries caused. None of that is in the federal case. And that's precisely the kind of allegations and information.

Sure, there's some factual overlap. But the nature of the claim is fundamentally different, and that's precisely what this Court tells us to investigate through 220 before bringing derivative claims.

So now I want to focus, though, on the procedural posture of this motion because I think

that's really critical. Excuse me one moment, Your Honor.

THE COURT: Sure.

MR. BOUCHARD: And I think this really gets to the heart of all that we're really dealing with today. We're here on a motion to dismiss. As I mentioned a moment ago, the issue is -- as framed by the other side -- is our purpose -- our stated purpose -- a pretense? And I think, frankly, just when you articulate it that way, that is a fact-intensive inquiry that has to be resolved at trial, not on a motion to dismiss, and that's in the context where all the inferences go in our favor.

The only way -- and this is the true teaching of the Beiser case and I'll get to that in a little bit more detail in a minute -- but the only way as a legal matter that China Media has a right to prevail on this motion -- on a motion to dismiss -- is if the only -- I underscore that word five times -- the only reasonable inference from the record is that the Section 220 demand we made was made in bad faith or improper purpose to circumvent the PSLRA stay. I submit to you that contention is unfounded. We'll prove that at trial. That's not what we need to

discredit today.

The only thing we need to do today is demonstrate to the Court that our complaint, and in turn our demand, adequately pleads, or it's reasonably inferable from the complaint and the demand that we have an intended use for the documents that is a proper use under Delaware law. And I submit, Your Honor, there's no question that the complaint here and the demand make that out, and specifically they make out a demand to investigate corporate wrongdoing for the purpose of asserting derivative claims. That is the key point. That is clearly a proper purpose under Delaware law.

Now, they want to say that's a sham, that's improper. And they can test that at trial but you can't resolve that on the face of this demand.

What was different about the Beiser case?

THE COURT: You say Beiser. Were you involved or something? You know that's the way to say it?

MR. BOUCHARD: I just assumed. Is it Beiser?

THE COURT: So none of us know. You

can -- you're perfectly entitled.

MR. BOUCHARD: I'll go PMC-Sierra because that might be safer grounds for me in terms of pronunciation. I've been calling it the Beiser case, Your Honor.

I think the key point there, though, is that in that case -- and this pertains as well to the West Coast case that Mr. Manwaring didn't discuss, but it's really discussed in the briefs a bit -- derivative claims had already been filed and the plaintiffs had been foreclosed from repleading demand futility essentially as a matter of law.

What were the facts in Beiser? In very brief order, the plaintiff had already filed three complaints or variations of complaints and had his complaint dismissed -- I believe it was by a federal court -- for failure to plead demand futility. After that event, it made a demand. It went ahead and did a fourth pleading. It was after that it made a demand under 220. And Vice Chancellor Lamb held that the only end use for the requested documents that could have been inferred -- remember, derivative claims were the subject of the federal case -- was to circumvent the PSLRA. And the Vice Chancellor held --

and I think this is my key point for today -- if another intended use for the documents had been pled, or was reasonably inferable from the complaint, he would have to deny the motion to dismiss. But he didn't have the circumstance we have, where only individual claims were pending in the other action that had already been filed and was being pressed and derivative claims were the subject of an investigation. That scenario did not exist there.

I submit, Your Honor, we have stated that other intended purpose that clearly would defeat a motion to dismiss and entitle us to have a trial. If they want to claim our real purpose is a sham or a pretense, they can cross-examine our witness and try to demonstrate that. They can use all the facts Mr. Manwaring wants to use to that effect. But we should have our day in court to show, no, our real purpose here is exactly what we said it is, which is to try and investigate and see if we have derivative claims which we are totally required to bring in a separate case.

Briefly, on West Coast, the key there was demand futility had been denied or -- excuse me -- the complaint had been dismissed for failure to plead

demand futility, and the Court specifically said you don't have a right to replead. So they basically were out of the box.

Again, we don't have that situation here because we haven't brought any derivative claims in the first place precisely because we're doing what we're supposed to be doing. It would be an odd rule in the world of Mr. Manwaring's proposition that it's okay if you bring a derivative claim.

Let's assume the federal case didn't exist. You bring a federal claim, get dismissed, and bring 220s, which the Supreme Court said you can do. But if you can't get 220, when you never brought a derivative claim in the first place, that would be an odd view of the world.

Let me also deal with another point. There is this claims splitting assertion that's been made in the papers and by Mr. Manwaring here today, and I think his language was that, because we've filed a federal action, we left no room for these distinct claims that can be asserted in a Section 220 case. I think that really does misapprehend the differences between individual claims and individual state law claims of the nature which are essentially variations

of security fraud claims that we have asserted. It's not uncommon for plaintiffs to assert derivative claims in one case and individual claims in another case, even when there is factual overlap in those cases. I'm sure Your Honor has seen it. I know I personally have been involved in it. And I'll give you one specific example that there's some discussion by Chancellor Allen that that is perfectly permissible, and that's the Carlton case from 1995, at 1995 Del. Chanc. Lexis 140.

So it's incorrect, I think, to suggest that there's some improper claims splitting going on here. We'd be perfectly entitled to assert derivative claims in a separate case. And indeed it would make perfect sense to do so because the fundamental character of those claims, in seeking relief in a much broader way than the kind of claims that are in the federal action, seeking relief on behalf of the company would appropriately be isolated and a separate case.

The one claim splitting case, if you will, that was cited by the other side is the Kossol -- K-O-S-S-O-L -- forgive me if I mispronounce that case -- decision of the Delaware Supreme Court.

And critically that case didn't have anything to do with derivative claims. Nothing. And what it did, or what it dealt with was the simple application of the doctrine of res judicata where a party had prevailed on a basic claim for a collection and tried to bring a second lawsuit to collect his attorneys' fees from the first lawsuit. The Court said you can't do that. It has nothing to do with derivative claims which you clearly can bring separately.

I think the final point I want to make, Your Honor, subject to any questions you have, is there's no per se bar as being suggested here that just because you have a case in federal court asserting derivative claims that the same lawyer or the same plaintiff can't assert separately derivative claims elsewhere, that you're somehow per se barred.

Mr. Manwaring in his comments, and I think in a passage that's quoted in their brief reply on the Beiser case -- and they sort of ignore the independent rights that exists under 220 and argue that Section 220 can't be used -- they argue this is a black letter rule that Section 220 can't be used when a discovery stay is in effect under the PSLRA, unless three conditions are met, they say. One is that the

plaintiff wasn't currently involved in the federal case; two, plaintiffs' counsel is not currently involved in the federal case; and, three, the plaintiff agrees to not use the information in the federal case, if you will.

What they're saying there -- and all three need to be met -- they're saying, irrespective of the nature of the claims that are in that federal case, irrespective of what they are, whether they're totally individual or really whatever the nature of the claims can be, there's a per se bar on the same plaintiff using 220 to conduct an investigation for derivative claims. I submit that's not supported by the case that they're relying on, and it's not supported by the rationale of the case they're relying on, which is the Beiser or Beiser case, and it's totally inconsistent with the proposition that Section 220 gives a shareholder independent rights that are not preempted by the PSLRA.

THE COURT: Okay. So it's your understanding that that statement of a rule or principle is based on what the defendants have teased out of the cases?

MR. BOUCHARD: Yeah.

THE COURT: I mean, we don't have a case that lays it out quite like that.

MR. BOUCHARD: I think two points on this. I think they have that block quote from the case. I'm not going to quarrel that the case says what they quote it to say. I think the key point is that, when you fairly read Vice Chancellor Lamb's decision, what he was doing is essentially summarizing the facts of the two cases that he cited right after the quotation -- namely, the Cohen case and the Romero case -- but he was not providing an exhaustive list of all the circumstances, or the only circumstances, if you will, in which a plaintiff could use Section 220, when that same plaintiff happens to have another case pending that is subject to a stay in the PSLRA. I would support that by two points.

THE COURT: Your understanding of what Vice Chancellor Lamb was doing is concluding that the Cohen and Romero cases were distinguishable from the case he had in front of him?

MR. BOUCHARD: Exactly. On that ground. And I think that's supported by two basic points: one is China Media submitted to Your Honor in their compendium a PSLRA article that Vice Chancellor

Lamb wrote a few months after deciding the Beiser -- Beiser case -- in which it's interesting because, when he's talking about these same three factors, he says in this -- there's a quotation in there, "The courts have been more likely to grant relief pursuant to Section 220 when those assurances exist." Not that it has to, not that that's the only circumstance in which that exists. I think that reinforces the point. It was not intended to be the sole exception, or those were requirements for any case, No. 1.

No. 2, it's just the logic of the opinion. The logic of the opinion -- he was on a motion to dismiss as we are here. He had a factual record where somebody already pled derivative claims, had already had a complaint pleading those derivative claims dismissed for failure to plead demand futility, was subject to a PSLRA stay, and in that context said the only -- the only reasonable inference I can draw from the demand is that it's being used improperly to circumvent that stay.

And back to my fundamental point here. There is another -- I think it's more reasonable, and the only inference I think that we'll demonstrate at trial is the correct one that exists on this record,

which is we have a complaint and a demand that state facially valid purposes under Delaware law to pursue, or to investigate and potentially pursue and demonstrate demand futility to do it, derivative claims which we can do, which we haven't done to date, and which we can do in a separate action. And we are entitled to do that.

And I think, Your Honor -- let me just take a quick look at my notes -- but that may be all I have, subject to whatever questions you have.

I just make one final point, Your Honor. I'll answer any questions you have on any of this at this point. But we do have, as often occurs in sort of Section 220, sort of a level of frustration that we get bogged down in a motion to dismiss practice, which is, I think, unusual in Section 220 because trials are more the norm.

If Your Honor agrees with our position, what we request, frankly, is that we move on quickly and get a trial date scheduled and pin down -- and they can ask all the questions they want -- and try to probe whether our purpose is valid or not. But there would be an evidentiary record to let that issue be hashed out.

If Your Honor doesn't have any other questions, that's all I have.

THE COURT: This issue of whether you can use -- if you were able ultimately to get access to books and records through this proceeding, whether you get to use them in federal proceedings later on, there's no reason this Court has to decide that, as far as I know.

MR. BOUCHARD: Let's put it this way. If that's an issue this Court ever has to get into -- and I don't know that it does -- that's an issue that should be worked out at trial, like we'll work out the scope issues or whatever else they want to litigate about. It's not an issue for today. That would be an issue down the road, I think, Your Honor, at trial.

MR. MANWARING: Your Honor, I just have three brief points in rebuttal. What you didn't hear plaintiffs state is that they had not asserted state law claims for breach of fiduciary duties. What you didn't hear is that those --

THE COURT: State it again.

MR. MANWARING: They didn't say they had not asserted state law claims. That is their problem in this case is that --

THE COURT: No. I understand that they asserted state law claims.

MR. MANWARING: In the federal action. And that's the problem here.

THE COURT: No, it's not. Well, if you've got some case that says if they asserted state law claims in the federal action on a direct basis, that the only place in which they can assert state law claims on a derivative basis on the same underlying nucleus of operative facts -- that the only place that they can thereafter raise that kind of claim is in a federal action, I'd like to hear it. But I don't know of any case like that.

MR. MANWARING: I think there's an overwhelming amount of authority that when you assert a claim and it's based on facts -- the same facts -- that you have an obligation to plead all those claims arising from the same transaction and occurrence. I think it logically comes right out of Rule 12 under the Federal Rules of Civil Procedure that you have to -- when you assert the state law claims and you assert a group of facts and you have the very same facts, your obligation is to assert all the claims arising from that same transaction and occurrence.

THE COURT: You certainly haven't given me any authority for that proposition. And what we have here is one set of facts which are saying these things happened and there were individual injuries suffered as a result of it. That's set of facts one.

No. 2 is we have these wrongs were committed and a harm to the corporation occurred. I mean, I deal with these kind of cases all the time where they're split. Then they're all -- everybody is just off the reservation. But they seem to be operating in that way. So, I mean, if you think you have something like that --

MR. MANWARING: I respectfully submit, the case we cited for improper claims splitting is just a subset of the doctrine of res judicata.

THE COURT: Is it direct to plaintiff?

MR. MANWARING: It's basically just changing the substance or a new theory, but it's based on the same facts.

THE COURT: Look, I deal with that all the time in terms of is it a breach of contract or is it promissory estoppel, or is it unjust enrichment or some kind of other quasi contract. But those kinds of

things -- you've got the same person saying we've been harmed and by X wrongs. That's a different kettle of fish, in my view, from the situation of whether it's an individual asserting the claim or it's a company asserting the claim.

What you're saying is, if somebody has an individual -- if they have a claim for breach of fiduciary duty and they decide to make their individual claims in the federal court, that they must bring their derivative claims in that court. Maybe they must; maybe not. That's not something that's covered in the briefing at all.

MR. MANWARING: I think it is at least covered in the sense that we made an argument --

THE COURT: You stated it as though it's a foregoing conclusion. I'm telling you I don't think it is, and I don't think the case you cited demonstrates that it is.

MR. MANWARING: Whether they can fairly -- the Court, when they look at a claim, whether it's direct or derivative, they don't look at the way it's denominated. In fact, our motion to dismiss was based on 23.1 that, in fact, it was a derivative complaint. But whether it's direct or

derivative to be characterized, they have alleged the facts and state law claims that are now tied to the stay in the PSLRA. So if there is going to be repleading and it arises out of the same claim, that repleading would have to be in the federal action not in a separate state action.

THE COURT: That's what I'm telling you. Says who? Says you. But what's the authority that really backs that up?

MR. MANWARING: The case that we cited in our brief for the improper claim splitting being a subject of res judicata is directly on point.

THE COURT: Which case is that?

MR. MANWARING: Kossol versus Ashton Condo Association, Inc, It's 1994 Del. Lexis 16, and six through seven.

THE COURT: Let me go to where you talk about it in your brief.

MR. MANWARING: It's in our opening brief on pages eight and nine. It's on Starr pages six through seven.

THE COURT: All right. Hold on a second. All right. Is this the Delaware Supreme Court? I can't tell from your cite on page 12.

MR. MANWARING: It is the Supreme Court of Delaware, Your Honor.

THE COURT: What's the nature of the claim that they were talking about in that case?

MR. MANWARING: It looks like a contract related claim, Your Honor, relating to a condominium association fee. But I'm not quite sure. The principle is the rule against claims splitting and being a doctrine of res judicata, and they cite Maldonado on pages --

THE COURT: But wouldn't you --

MR. MANWARING: The theory is that there is a different substantive theory, even though it arises from the same facts as the claim is deferred. The claim is split. It must be dismissed. It's an issue of policy, if you will, and practicality to assert all your claims arising from the facts in one single action.

THE COURT: But res judicata, the first principle is it's got to be the same parties. So it would make sense that you would have -- you know, if I had a single party -- if I'm in there making a claim for breach of contract and I also have a promissory estoppel claim, or something like that, I

guess I got to make them all at that time if it's based on the same facts, or else I'm going to be barred by the judgment on any one of them. But that's quite a bit different from saying that that judgment against me individually, when I said I was individually harmed, is res judicata against the company. If I said these people breached their fiduciary duties, they put out false and misleading statements that I relied on, I bought my securities, I've been harmed and let's say I lose that claim, that's not going to be binding under principles of res judicata against the company saying that it relied on false -- not that it relied on false statements. That these people did wrongful things that ended up resulting in harms to the company.

MR. MANWARING: Aren't the same parties, whether it's direct and the injury is directly to the plaintiff, or through the company indirectly in a derivative. The same parties, the defendants -- the directors -- are going to be the same defendants, whether it's direct or derivative in the fiduciary duty action.

THE COURT: The defendants -- there might be a collateral estoppel issue or an issue

preclusion against those directors. But as far as a principle of res judicata, or claim preclusion, I don't think the individual shareholder and the company are the same person. So the company can come in through that shareholder or somebody else and make that different claim. I mean, that's just my top-of-the-head analysis of it. And what I'm telling you is that a contract case is not going to get me there. So I think we understand each other on that particular point.

If you want to submit something further, you can do it. If you find something that really addresses it -- is the issue of a shareholder suing directly and then derivatively and they can't do one in federal court and one in state court --

MR. MANWARING: I hear what you're saying, Your Honor. I'll take a look at the issue.

THE COURT: All right.

I don't know if you were finished with your remarks.

MR. MANWARING: I have two brief other points: one is, there was remarks made about whether it would be improper at this stage to decide a motion to dismiss for failure to state a purpose. I

respectfully submit that many cases in this arena -- Beiser being our leading case -- has decided ripeness in the same context. The three issues the Court needs to decide are presently before the Court: same parties, same counsel, fiduciary duty claims stated in the action and the same facts. These can be gleaned from the demand, which is incorporated in the 220 complaint. The Court can also take -- it's not only referenced in the 220 complaint, but I think the Court can take judicial notice of the federal action.

Accordingly, everything -- the key parts of what the Court needs to decide -- comparing the two actions, the stay is in effect, same counsel, same parties, those key facts that the Court needs are before the Court, and accordingly they can be decided in connection with the motion to dismiss.

I think the Beiser or Beiser decision, there was a remark made that this was in fact not a binding legal test. I would submit that Vice Chancellor Lamb described those as safeguards. He said that those safeguards were not present in the Beiser case.

Similarly, those same safeguards -- that three-part legal test he announced in Beiser --

are not present here. We have the same counsel, same plaintiff, and there's no way that we can agree that they wouldn't be able to use it. It just belies sense that they wouldn't be using this to amend their complaint in some way. It's just not possible.

Lastly, there was a reference to the West Coast case. The West Coast case didn't involve a stay. The case had been dismissed without prejudice. And then the Court said, "No leave to amend." So they were in a kind of difficult situation where they could have filed another action. But by dismissing the case without prejudice, the case wasn't there. There was no stay in effect. West Coast is not a stay case and is not pertinent to our analysis here. Instead I think the key cases, as I said initially, were Cohen, Romero and Beiser. And Beiser, I think we've decided -- basically, if our case isn't a Cohen and Romero -- and Your Honor has pointed out you think you can separate a direct and derivative claim based on these facts and make our case a Romero case or a Cohen case; and if that's possible, you know, that certainly kind of fits there. But I don't think that is possible here when you allege state law claims based on the facts and you have an obligation to state all

your claims arising out of the same transaction occurrence in one single action against the same defendants.

So accordingly, in my view, any amendment here or any additional -- if those state law claims don't give notice of the purported derivative claims, assuming they are not already derivative claims and the Federal Court will decide that here shortly, you know, that's an issue that they would have to plead in this case and not in a subsequent case, if you will. That makes them -- all those claims that are wrapped up there -- subject to the stay.

So accordingly, you know, in the cases where they have allowed this, there hadn't been any state law claims. In Meltzer and King they were all -- pardon me. Not Meltzer. In Cohen and Romero they were not state law claims. The cases they had a problem with were Meltzer and King and Beiser, where the plaintiff had served federal securities and state law claims arising out of stock option backdating. They were all asserted in one single action.

The Court didn't get into that analysis. Hey, the stay is in effect. We have a

problem here and how are we going to get around it. What the Supreme Court did in King is not try to make a distinction about whether it's direct or derivative. Instead what they said is the stay is not in effect because the case is dismissed. The Court --

THE COURT: So it left for another day that particular issue. One thing that I certainly take out of the King case is that the Supreme Court in the 220 context is not a big fan of per se rules that block the plaintiffs from proceeding with their cases. But what you're asking me to do is -- on a motion to dismiss -- insert exactly that kind of a pro se rule. Turn Beiser or Beiser -- whatever we're calling it -- into a complete block so, for the plaintiff going forward, it's not very appealing.

MR. MANWARING: I understand that. And the key thing is that you can't assert the state law claims if you want to get yourself into a Cohen-Romero situation. You need to kind of create and separate yourself from that. So even if there is a slight overlap in facts, here, though, the facts are exactly the same. They had an obligation to plead these things in the federal case under Rule 12. The fact that they think their claim doesn't give notice

of derivative or direct claims to me is a red herring. The Court doesn't rely on their characterizations. It looks at its own characterizations. I respectfully submit these are derivative claims under Malone and they will be dismissed for failure to plead demand futility. Exact thing they're trying to do here they already done in the state law. Because of this pleading obligation -- in my view, any repleading here, to the extent it doesn't give us notice of these derivative claims, since it's based on the same transaction and occurrence, has to be in the federal action and therefore subject to the stay.

No more comments, Your Honor. Thank you.

THE COURT: Thank you very much.

You can sit down. I think I share the views of some of the other Judges on this court that motions to dismiss in summary proceedings, like 220 actions, 225 actions and so on, are rarely a good idea. And that's certainly the way I'm approaching this. I think this situation presents interesting issues. I'm not exactly sure how those issues ought to be resolved. This is not the same set of facts that Vice Chancellor Lamb confronted in the Beiser

case. It certainly isn't the set of facts from Romero or Cohen. And it's closer to a situation where it certainly does give rise to one permissible inference is that the plaintiff is trying to circumvent the stay of the PSLRA. But the fact that the allegations in the complaint could support one reasonable inference that would lead to the dismissal of plaintiff's case is only sufficient to dismiss the case under Rule 12(b)(6) for failure to state a claim upon which relief can be granted, if it appears with reasonable certainty that the plaintiff cannot prevail on any set of facts that can be inferred from the pleadings.

It's hard to say that at this point. Some of it depends on this issue of: can you split the claims derivative and direct in the way that Mr. Bouchard has suggested, or whether that runs afoul of the claim splitting doctrine that's referred to by Mr. Manwaring. I'm going to take the motion under advisement. But I'm also going to set the case down for trial.

It's my expectation that more than an 80 percent chance is that I'm going to get to the pretrial conference and I'll deny with three sentences, or something like that, the motion to

dismiss and go forward with the trial. These actions are supposed to be summary in nature and proceed to a hearing somewhere in the range of 60 to 90, maybe even 120 days. I think this action already has been pending for a while. So I'm going to suggest that we have a trial November 17, 18, 21, 22, 23 -- one of those days. I would imagine just a single day of trial would be all that would be required. Does anybody think more than one day is going to be needed?

MR. BOUCHARD: No, Your Honor. I think it would be less than a day, half a day.

MR. MANWARING: I think one day is fine, Your Honor.

THE COURT: All right. Why don't you confer. I think, if it's the 17th, I'd have to start at either ten -- I could start at ten and then just run for the rest of the day, or start at 2:00 p.m. The other days -- 18, 21, 22, 23 -- at this point are clear. We could start in the morning, 9:30 or 10, and then just run for the rest of the day.

It's an interesting issue. And if counsel want to submit something further, or they think there is something that's going to be useful to the Court in sorting this matter out in terms of this

claim splitting issue, you can submit supplemental brief, if you want. It shouldn't be too long. Or letters. I'm not too concerned about the form that that takes. And I recognize that there will be some additional work in terms of taking the discovery -- possible discovery relating to the 220 action.

But the thing I want to emphasize is we're only talking about a 220 action. There's very limited discovery in a 220 action. It's going to be a very limited trial. At that point I can make a decision, without having to worry about drawing inferences as to whether something was pretense or not. It's an invitation to err in a way to get to be ruling out any other possibilities.

It did strike me, as I read the Beiser case, that the Vice Chancellor there -- Vice Chancellor Lamb -- was saying the only purpose that was stated, or the only inferences he could draw from that record were a particular end use. The plaintiffs are articulating different end uses, whether they really merge into a single thing because of legal doctrines like -- doctrines against claim splitting and so on. I just don't know at this point.

So it's taken under advisement.

You'll advise my assistant as to the date. And then, once you've agreed on a date and get from her a date for the pretrial conference, which will probably be like 4:30 within a week of that time, then you can agree on the rest of the schedule and submit that.

MR. BOUCHARD: Your Honor, the dates went by pretty quickly.

THE COURT: Seventeen -- but there we'd have to start at ten or later -- 18, 21, 22, 23.

MR. BOUCHARD: Thank you. I appreciate that.

THE COURT: Thank you very much.

(Court adjourned at 3:06 p.m.)

CERTIFICATE

I, DIANE G. McGRELLIS, Official Court Reporter of the Chancery Court, State of Delaware, do hereby certify that the foregoing pages numbered 3 through 52 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I have hereunto set my hand at Wilmington, this 10th day of August, 2011.

/s/ Diane G. McGrellis

Official Court Reporter
of the Chancery Court
State of Delaware

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