

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

WILLIAM M. NOE, and  
O. RUSSELL CRANDALL,

Plaintiffs,

v.

ROBERT KROPF, JAMES R. HERBERT,  
and TRACY GNAGY,

Defendants,

and

TURNAROUND ADVISORS, LLC.,

Intervening Defendant,

and

AMERISTAR NETWORK, INC.,

Nominal Defendant.

C.A. No. 4050-CC

**INTERVENOR TURNAROUND ADVISORS LLC'S (1)OPPOSITION TO PLAINTIFFS'  
MOTION FOR DEFAULT JUDGMENT, MOTION FOR JUDGMENT ON THE  
PLEADINGS AND MOTION FOR ATTORNEYS' FEES AND COSTS; AND  
(2) OPENING BRIEF IN SUPPORT OF ITS MOTION FOR ATTORNEYS' FEES AND  
COSTS**

Cathy L. Reese (#2838)  
Brian M. Rostocki (#4599)  
Charles B. Vincent (#5078)  
FISH & RICHARDSON P.C.  
222 Delaware Avenue, 17<sup>th</sup> Floor  
P.O. Box 1114  
Wilmington, Delaware 19899  
(302) 652-5070  
*Attorneys for Intervening Defendant  
Turnaround Advisors, LLC*

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**TABLE OF CONTENTS**

	<u>Page</u>
TABLE OF AUTHORITIES .....	ii
NATURE AND STAGE OF THE PROCEEDINGS .....	1
FACTUAL BACKGROUND.....	3
ARGUMENT .....	6
I. THE COURT SHOULD DENY PLAINTIFFS’ MOTION FOR DEFAULT JUDGMENT BECAUSE PLAINTIFFS CONSPICUOUSLY IGNORE THE FACT THAT THE COURT GRANTED TURNAROUND’S MOTION TO INTERVENE AND THE DIRECTIONS IMPOSED BY THE COURT IN DOING SO.....	6
II. THE COURT SHOULD DENY PLAINTIFFS’ MOTION FOR JUDGMENT ON THE PLEADINGS ON COUNT II OF THE COMPLAINT BECAUSE THIS MOTION IS CONTINGENT ON THE DEFAULT JUDGMENT MOTION AND EFFECTIVELY SEEKS RECONSIDERATION OF THE OCTOBER DECISION .....	11
A. If The Court Accepts Plaintiffs’ Invitation To Reverse The October Decision, The Protected Purchaser Issue Should Be Resolved As A Matter Of First Impression.....	13
III. TURNAROUND TAKES NO POSITION ON PLAINTIFFS’ MOTION FOR FEES AND COSTS .....	20
IV. THE COURT SHOULD AWARD FEES AND COSTS TURNAROUND HAS INCURRED IN RELATION TO THIS LATEST MOTION.....	21
CONCLUSION.....	23

**TABLE OF AUTHORITIES**

	<u>Page</u>
<b>Cases</b>	
<i>Bowen v. Imperial Theaters, Inc.</i> , 115 A. 918 (Del. Ch. 1922).....	15
<i>Carballal v. PMBC Corp.</i> , 1999 WL 342341 (Del. Ch. May 14, 1999) .....	11
<i>Carlton Invs. v. TLC Beatrice Int’l Holdings, Inc.</i> , 1996 WL 426501 (Del. Ch. July 24, 1996).....	6, 7, 9
<i>Clark v. Airavada Corp.</i> , 12 F. Supp. 2d 1114 (D. Nev. 1998).....	17
<i>Dean Witter &amp; Co. v. Educ. Computer Corp.</i> , 369 F. Supp. 757 (E.D. Pa. 1974) .....	19
<i>Encite LLC v. Soni</i> , 2008 WL 2973015 (Del. Ch. Aug. 1, 2008) .....	11
<i>Estate of Parker v. Assiniboia Corp.</i> , 1990 WL 18398 (Del. Ch. Feb. 15, 1990) .....	6, 7
<i>Fairthorne Maint. Corp. v. Ramunno</i> , 2007 WL 2214318 (Del. Ch. July. 20, 2007) .....	21
<i>Gebelein v. Four State Builders</i> , 1982 WL 17829 (Del. Ch. Oct. 8, 1982).....	6, 7
<i>Giammalvo v. Sunshine Mining Co.</i> , 644 A.2d 407 (Del. 1994) .....	7
<i>Hauspie v. Stonington Partners, Inc.</i> , 945 A.2d 584 (Del. 2008).....	6
<i>Hope E.H. v. Margaret R.</i> , 1994 WL 811750 (Del. Fam. Ct. Jan. 14, 1994) .....	7
<i>In re Coca-Cola Enters., Inc.</i> , 2007 WL 3122370 (Del. Ch. Oct. 17, 2007).....	11
<i>In re Seneca Invs. LLC</i> , 2008 WL 4329230 (Del. Ch. Sept. 23, 2008) .....	11
<i>In re SS &amp;C Techs., Inc. S’holders Litig.</i> , 948 A.2d 1140 (Del. Ch. 2008).....	21
<i>Kalageorgi v. Kamkin, Inc.</i> , 750 A.2d 531 (Del. Ch. 1999).....	14
<i>MBKS Co. Ltd. v. Reddy</i> , 924 A.2d 965, 972 (Del. Ch. 2007) .....	passim
<i>McMillan v. Intercargo Corp.</i> , 768 A.2d 492, 500 (Del. Ch. 2000).....	11
<i>Noe v. Kropf</i> , 2008 WL 4603577 (Del. Ch. Oct. 15, 2008).....	passim
<i>OSI Sys., Inc. v. Instrumentarium Corp.</i> , 892 A.2d 1086, 1090 (Del. Ch. 2006).....	11
<i>Schoon v. Troy Corp.</i> , 948 A.2d 1157 (Del. 2008).....	21
<i>Smokey, Inc. v. Pany Inv. Co.</i> , 276 A.2d 741 (Del. 1971) .....	13
<i>Smouha v. MTA and J.P. Morgan Chase</i> , 797 N.Y.S.2d 278 (N.Y. Sup. Ct. 2005) .....	19
<i>Speiser v. Baker</i> , 525 A.2d 1001 (Del. Ch. 1987) .....	11

<i>Staar Surgical Co. v. Waggoner</i> , 588 A.2d 1130 (Del. 1991).....	14
<i>Steinkraus v. GIH Corp.</i> , 1991 WL 3922 (Del. Ch. Jan. 16, 1991).....	11
<i>Stonington Partners, Inc. v. Lernout &amp; Hauspie Speech Prods., N.V.</i> , 2002 WL 31439767 (Del. Ch. Oct. 23, 2002) .....	6, 7
<i>Superwire.com, Inc. v. Hampton</i> , 805 A.2d 904 (Del. Ch. 2002).....	14
<i>Toll Bros., Inc. v. Gen. Accident Ins. Co.</i> , 1999 WL 1442016 (Del. Super. Ct. Dec. 27, 1999) .....	19
<i>Waggoner v. Laster</i> , 581 A.2d 1127 (Del. 1990).....	14
<i>Wilson v. State</i> , 305 A.2d 312, 317 (Del. 1973) .....	19
<b>State Statutes</b>	
6 <i>Del. C.</i> § 8-202.....	13
6 <i>Del. C.</i> § 8-202(b) .....	17
6 <i>Del. C.</i> § 8-202(d) .....	17
6 <i>Del. C.</i> § 8-303(a) .....	17
6 <i>Del. C.</i> § 8-303(b) .....	17
8 <i>Del. C.</i> § 124 .....	18
8 <i>Del. C.</i> § 201 .....	16, 18
<b>State Rules</b>	
DEL. CT. CH. R. 12(c).....	11
DEL. CT. CH. R. 24(a).....	7
DEL. CT. CH. R. 55(b) .....	6
DEL. CT. CH. R. 59(e).....	13
DEL. CT. CH. R. 59(f) .....	13
<b>Other Authorities</b>	
C. Stephen Bigler and Seth Barrett Tillman, <i>Void or Voidable?—Curing Defects in Stock Issuances Under Delaware Law</i> , 63 BUS. LAW. 1109 (2008).....	14, 16, 18, 19
8 LARY LAWRENCE, LAWRENCE’S ANDERSON ON THE UNIFORM COMMERCIAL CODE (3d ed.1996) .....	17, 18
Donald J. Wolfe, Jr. & Michael A. Pittenger, <i>Corporate &amp; Commercial Practice in the Delaware Court of Chancery</i> (2008) .....	12

## NATURE AND STAGE OF THE PROCEEDINGS

On September 17, 2008, Turnaround filed a Complaint for Declaratory Judgment (the “Utah Complaint”) against AmeriStar and its agent OTC Stock Transfer (“OTC”) in the Third Judicial District Court in Salt Lake County, State of Utah (the “Utah Court”). Turnaround Motions (as defined below), Ex. A. Turnaround served Ameristar with the Utah Complaint on September 18, 2008. The Utah Complaint seeks a judgment from the Utah Court declaring that: (a) Turnaround’s 70,000,000 shares of Ameristar voting common stock are valid under Delaware law; (b) Turnaround is a Protected Purchaser under Utah law because it paid consideration for those shares and did so without notice of any adverse claim; (c) Turnaround is entitled to access and inspection of Ameristar’s corporate records in OTC’s possession or control, including Ameristar’s stockholder list; and (d) OTC is obligated to register the transfer of the 70,000,000 Ameristar shares pursuant to the reasonable instructions of Turnaround. *Id.*

After Turnaround filed and served the Utah Complaint, on September 19, 2008, William M. Noe (“Noe”) and O. Russell Crandall (“Crandall,” together with Noe, “Plaintiffs”) filed in this Court a Verified Complaint Pursuant To Section 225 And Section 227 Of The Delaware General Corporation Law (the “Delaware Complaint”) against Robert Kropf (“Kropf”), James R. Herbert (“Herbert”) and Tracy Gnagy (“Gnagy,” together with Kropf and Herbert, “Defendants”). (Docket No. 1). The Delaware Complaint seeks a judgment: (a) declaring that Plaintiffs are the sole and valid directors of Ameristar; (b) declaring that Defendants are not directors of Ameristar; (c) declaring that Defendant Kropf is not the Chief Executive Officer of Ameristar; (d) declaring that the shares of voting common stock of Ameristar issued to Turnaround and CRI were not validly issued; (e) declaring that all actions authorized by Defendants as directors or officers of Ameristar are void as a matter of law; and

(f) awarding attorneys' fees and costs in favor of Plaintiffs and against Defendants, jointly and severally, in connection with the attorneys' fees and costs incurred by Plaintiffs in this action. Plaintiffs also filed with the Delaware Complaint a Motion To Expedite Proceedings to shorten the time for Defendants to respond to the Delaware Complaint, the parties to conduct discovery, and briefing and the presentation to this Court of any arguments in connection therewith.

Turnaround was not named as a party in the Delaware Complaint. Defendants also did not appear, answer, move, or otherwise respond to the Delaware Complaint. As a result, on September 24, 2008, the Court granted Plaintiffs' motion to expedite. (Docket No. 4.)

Turnaround was apprised of the Delaware Complaint on September 22, 2008 and promptly filed a Motion to Intervene and Motion to Vacate Order to Expedite Proceedings on September 25, 2008 (the "Turnaround Motions") (Docket No. 8). Plaintiffs opposed the Turnaround Motions and concurrently filed a Motion for Entry of Default Judgment against Defendants. (Docket Nos. 10, 11.) The Court granted the Turnaround Motions. (Docket No. 18.) Thereafter, the Court granted a scheduling order proposed by Plaintiffs and Turnaround, which anticipates discovery being completed by January 13, 2009 and a one-day trial on January 27, 2009. (Docket Nos. 21, 23.)<sup>1</sup>

On October 31, 2008, pursuant to the scheduling order, Turnaround answered the Complaint. (Docket No. 22.) Written discovery requests have been exchanged, but not yet answered. Defendants have still not appeared, answered, moved, or otherwise responded to the Complaint. On November 12, 2008, Plaintiffs filed a Motion for Default Judgment, Motion for Judgment on the Pleadings and Motion for Attorneys' Fees and Costs ("Pl. Second Default Mot."). (Docket No. 24.) This is Turnaround's response to that motion.

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<sup>1</sup> The Court notified the parties on December 3, 2008 that this trial date will have to be postponed.

## **FACTUAL BACKGROUND**

AmeriStar is a publicly-traded Delaware corporation located in Hurricane, Utah and is listed on the “Pink Sheets.” Compl. at ¶¶ 2, 7, 11, Ans. at ¶¶ 2, 7, 11. On April 18, 2008, Turnaround purchased from AmeriStar 35,000,000 newly issued shares of AmeriStar voting common stock. Ans. at ¶ 15. AmeriStar via its actual agent OTC Stock Transfer, Inc. delivered a newly issued 35,000,000 share stock certificate in the name of Turnaround on April 21, 2008. Ans. at ¶¶ 5, 16; Turnaround Motions, Ex. A to Ex. A. On that same day, AmeriStar delivered a second newly issued 35,000,000 share stock certificate in the name of Corporate Restructuring, Inc. (“CRI”). Compl. at ¶ 15, Ans. at ¶ 15, Turnaround Motions, Ex. B to Ex. A. Turnaround purchased those shares of AmeriStar voting common stock in a private transaction with CRI in May 2008. Ans. at ¶¶ 8, 15. At the time Turnaround acquired and obtained control of its AmeriStar voting common stock, neither Turnaround nor its member or manager were aware of any dispute as to the composition of AmeriStar’s board, any defect going to the validity of any of its shares, any adverse claims against the shares, nor after reasonable diligence was there any reason to suspect any alleged defect. Ans. at ¶¶ 4, 8, 15. The heart of this dispute lies in the validity of the 70,000,000 shares issued by AmeriStar and owned by Turnaround.

After Turnaround paid valuable consideration for its AmeriStar shares and obtained the stock certificates for the same, a dispute arose concerning Turnaround’s rights with respect to the shares. In August 2008, Turnaround received notice from AmeriStar’s attorney that the disputed board created a defect in Turnaround’s shares. Turnaround Motions, Ex. A at ¶¶ 12, 13. The parties were unable to resolve the dispute informally.

Turnaround filed an action in Utah District Court on September 17, 2008, styled as *Turnaround Advisors, LLC v. AmeriStar Networks, Inc., et al.*, Utah 3d Dist. Ct.,

C.A. No. 080920413 (the “Utah Action”). Turnaround Motions, Ex. A. In that action, Turnaround requested, among other things, a declaration that the stock was validly issued under Delaware law and that Turnaround was a protected purchaser, having paid value and lacking notice of any defect in the stock. *Id.* at ¶ 18.

Meanwhile, Plaintiffs filed an action in the Delaware Court of Chancery on September 19, 2008, styled as *Noe, et al. v. Kropf, et al.*, Del. Ch., C.A. No. 4050-CC (the “Delaware Action”). Even though Plaintiffs sought a declaration that the 70,000,000 shares owned by Turnaround are void in the Delaware Action, Plaintiffs did not serve Turnaround or name it as a party. The Court granted Plaintiffs’ motion to expedite the proceedings. Turnaround was apprised of the Delaware Action on September 22, and on September 25, filed the Turnaround Motions. Plaintiffs filed an opposition to the Turnaround Motions and concurrently filed a Motion for Entry of Default Judgment based on Defendants’ failure to appear or to file an answer in the Delaware Action.

The Court found that “in the unusual circumstances of this case,” Turnaround had standing to intervene and granted Turnaround’s motions as a matter of right under Court of Chancery Rule 24(a) (the “October Decision”).<sup>2</sup> In supporting this conclusion, the Court relied on a premise that the “[f]ailure to allow Turnaround to intervene would likely result in a default judgment against the defendants, who have (so far) failed to appear, which would then lead to a declaration that Turnaround’s shares of AmeriStar are void.”<sup>3</sup> The Court also noted that because “it is unlikely Turnaround possesses facts relating to the [AmeriStar] board composition,” it would afford Turnaround “reasonable time to file its answer and conduct discovery.”<sup>4</sup> The

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<sup>2</sup> *Noe v. Kropf*, 2008 WL 4603577, C.A. No. 4050-CC, at 7 (Del. Ch. Oct. 15, 2008) (“*Noe Slip Op.*”).

<sup>3</sup> *Id.* at 8.

<sup>4</sup> *Id.*

parties agreed to an appropriate form of scheduling order which would have Turnaround answer the complaint by October 31, followed by a discovery period extending until January 13, 2009 and a one-day trial to follow.

Notwithstanding this procedural posture and the fact that no discovery has yet taken place, Plaintiffs filed a second motion for default judgment against the non-appearing Defendants on November 12, 2008. In this motion, Plaintiffs also filed a motion for judgment on the pleadings regarding Count II of its Complaint, and moved for fees and costs against the non-appearing Defendants.

This Court has already found that Turnaround has an interest in the litigation<sup>5</sup> and is required to conduct discovery<sup>6</sup> to defend the threshold question of whether the issuing board was validly constituted.<sup>7</sup> Although the Court has made its decision, Turnaround has not yet been able to defend the validity of the contested AmeriStar board, in part because discovery on the underlying factual and legal issues has not yet begun. Plaintiffs know this, yet bring this second motion anyway. Not only is this second motion duplicative of Plaintiffs' earlier filed motion for default judgment, it purports to obtain the very relief and contravene the clear direction of the Court given in its October Decision. The actions taken in filing this unnecessary motion and Plaintiffs' arguments in support of it are clear evidence that Plaintiffs have unilaterally made the procession of this case unduly complicated and expensive. Accordingly, Turnaround seeks its fees and costs incurred in connection with this response.

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<sup>5</sup> *Id.* at 7.

<sup>6</sup> *Id.* at 8.

<sup>7</sup> This determination must be made before the other arguments are considered. *Id.* at 6 nn.18-19.

## ARGUMENT

### **I. THE COURT SHOULD DENY PLAINTIFFS' MOTION FOR DEFAULT JUDGMENT BECAUSE PLAINTIFFS CONSPICUOUSLY IGNORE THE FACT THAT THE COURT GRANTED TURNAROUND'S MOTION TO INTERVENE AND THE DIRECTIONS IMPOSED BY THE COURT IN DOING SO**

Under Court of Chancery Rule 55(b), the Court may grant judgment by default “[w]hen a party against whom a judgment for affirmative relief is sought, has failed to appear, plead or otherwise defend as provided by [the Court of Chancery Rules].”<sup>8</sup> Rule 55(b) also provides, in relevant part: “If, in order to enable the Court to enter judgment or to carry it into effect, it is necessary to take into account or to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the Court may conduct such hearings or order such references as it deems necessary and proper.”<sup>9</sup> The cases cited by Plaintiffs<sup>10</sup> generally provide correct propositions of the aspects the Court may consider when faced with a motion for default judgment.<sup>11</sup>

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<sup>8</sup> DEL. CT. CH. R. 55(b).

<sup>9</sup> *Id.*

<sup>10</sup> See *Stonington Partners, Inc. v. Lernout & Hauspie Speech Prods., N.V.*, 2002 WL 31439767, at \*4 (Del. Ch. Oct. 23, 2002); *Carlton Invs. v. TLC Beatrice Int’l Holdings, Inc.*, 1996 WL 426501, at \*1 (Del. Ch. July 24, 1996); *Estate of Parker v. Assiniboia Corp.*, 1990 WL 18398, at \*1 (Del. Ch. Feb. 15, 1990); *Gebelein v. Four State Builders*, 1982 WL 17829, at \*2 (Del. Ch. Oct. 8, 1982). See also *Hauspie v. Stonington Partners, Inc.*, 945 A.2d 584, 586-87 (Del. 2008) (analyzing the heightened pleading standards of Court of Chancery Rule 9(b) in the context of a default judgment).

<sup>11</sup> Plaintiffs also cite *Gebelein* for its language that “[t]he default judgment, then, is final and conclusive and has the same effect as a trial on the merits.” 1982 WL 17829, at \*2; Pl. Second Default Mot. at ¶ 5. Although *Gebelein* acknowledges generally that “[a] default judgment, however, does not in and of itself settle the matter of relief available to a moving party,” 1982 WL 17829, at \*2, the quote cited by Plaintiffs may be overbroad in light of subsequent caselaw. See, e.g., *Hauspie*, 945 A.2d at 586 (“The effect of a default in answering, however, is to deem admitted all the well-pleaded facts in the complaint. A plaintiff is only entitled to a default judgment if those facts, taken together, state a claim upon which relief can be granted.”) (citations omitted); *Carlton Invs.*, 1996 WL 426501, at \*1 (“[I]n most instances, the fact of a default provides the predicate for a further legal and factual inquiry by the court. The first aspect of that inquiry (which, of course, may be quite simple in many cases) is whether the well pleaded allegations of the complaint state a claim; the second aspect is an inquest into damages.”).

Notwithstanding these generalities, Plaintiffs in making this second motion for a default judgment ignore the entirety of the Court’s reasoning in the October Decision. By virtue of the order authorizing it to intervene, an intervenor such as Turnaround “becomes a party to the litigation and is bound by the judgment.”<sup>12</sup> The order granting leave to intervene determines implicitly that the intervenor has both standing to intervene<sup>13</sup> and an interest in the matter in litigation.<sup>14</sup> None of the cases cited by Plaintiffs involve an intervenor or the effect an intervening party may have on the underlying litigation.<sup>15</sup> Nor do they address how the Court should address a motion for default judgment when it has already given clear, specific, and unambiguous instructions regarding discovery and how the case is to proceed.

The Court’s direction in the October Decision is unequivocal: As intervenor, “Turnaround (even though it hopes to limit its arguments to the validity of the issuance of stock) *will be required to defend* the validity of the contested AmeriStar board as a means of protecting its after-issued stock in AmeriStar.”<sup>16</sup> Further presupposing that “it is unlikely Turnaround possesses facts relating to the board composition” (that is, the issue Turnaround is now required

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<sup>12</sup> *Giammalvo v. Sunshine Mining Co.*, 644 A.2d 407, 408 (Del. 1994). *See also generally Hope E.H. v. Margaret R.*, 1994 WL 811750, at \*2 (Del. Fam. Ct. Jan. 14, 1994) (noting that “an intervenor is generally treated as if she was an original party in the action and has equal standing with the original parties” but “is bound by all prior orders and adjudications of fact and law as though she had been a party from the commencement of the suit”) (citations omitted).

<sup>13</sup> *Noe Slip Op.* at 5 (“Consideration of an [intervenor’s] standing is implicit in the court’s analysis of the elements of [Court of Chancery] Rule 24, and if the intervenor lacks standing to assert the claim, *ipso facto*, the [intervenor’s] interest cannot be recognized.”) (quotations and citation omitted).

<sup>14</sup> DEL. CT. CH. R. 24(a) (“Upon timely application anyone shall be permitted to intervene in an action: . . . (2) *when the applicant claims an interest relating to the property or transaction which is the subject of the action* and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant’s ability to protect that interest, unless the applicant’s interest is adequately represented by existing parties.”) (emphasis added).

<sup>15</sup> *See Stonington Partners, Inc.*, 2002 WL 31439767, at \*1 (co-defendants); *Carlton Invs.*, 1996 WL 426501, at \*1 (multiple defendants); *Estate of Parker*, 1990 WL 18398, at \*1 (same); *Gebelein*, 1982 WL 17829, at \*2 (same).

<sup>16</sup> *Noe Slip Op.*, at 6 (first emphasis added).

to defend), the Court also directed Turnaround to file an answer and conduct discovery.<sup>17</sup> Despite these explicit instructions, Plaintiffs have decided to spin the wheels of motion practice and rehash their argument regarding entitlement to a default judgment based on the non-appearing defendants and Turnaround's answer to the Complaint. The Court has already touched on these issues once when it issued the October Decision.

There the Court recognized, almost explicitly, that it was premature to reach the issue of default judgment. The Court acknowledged that one of the "unusual circumstances" of this case included the logical fallacy of "exclud[ing] from a § 227 action an individual or entity claiming to own stock in a company simply because the directors issuing the stock *might* not have been properly elected."<sup>18</sup> Another was that "the § 227 question hinges on the outcome of the § 225 claim."<sup>19</sup> Intervention was necessary because, as made clear by the Court, if Turnaround was not permitted to intervene, it would likely result in default judgment against the defendants.<sup>20</sup> The contrapositive to this statement is that if Turnaround was permitted to intervene, it would not result in default judgment. Given the Court's unambiguous reasoning in support of granting Turnaround's motion to intervene, it seems clear that the granting of the motion to intervene necessarily disposed of (or at least stayed) Plaintiffs' first motion for default judgment.

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<sup>17</sup> *Id.* at 8. Curiously, in support of its argument, Plaintiffs rely on Turnaround's previous position that it has no information relevant to the Section 225 aspect of this action. The Court has already considered this argument and has directed Turnaround to defend the validity of the contested board in order to reach the subsequent arguments. *Id.* at 6; *id.* at 6 nn.18-19; *id.* at 8. To the extent that Plaintiffs raise a factual dispute regarding Turnaround's protected purchaser argument, Pl. Second Default Mot. at 6 n.1, the Court has already notified the parties that the threshold issue is whether the issuing board was not validly constituted. *Noe Slip Op.* at 6 n.18. Discovery into this new factual dispute may resolve it at the appropriate time.

<sup>18</sup> *Id.* at 7.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 8.

Even assuming that it did not, the circumstances of this case approach those raised in cases involving multiple defendants where fewer than all defendants default, and one must reach the same conclusion. For example, in *Carlton Investments v. TLC Beatrice International Holdings, Inc.*, the Court was faced with a motion brought by plaintiffs under Rule 55(b) for a “conditional default” against a non-appearing co-defendant.<sup>21</sup> The Court first recognized that the question of proceeding against the non-appearing party was “within the discretion of the trial court in its general management and superintendence of the case and its docket.”<sup>22</sup> Presumably because the case was proceeding to trial against some of the defendants and plaintiffs had “sought broad discovery against an extremely wide cast of defendants,” the Court noted that “the costs and delays that would be occasioned by proceeding to determine if plaintiff is entitled to the entry now of a ‘conditional’ judgment in a liquidated amount, appears to me unproductive, when viewed from a perspective concerned with fairly and promptly adjudicating the whole case.”<sup>23</sup> The Court also noted that “the process entailed in adjudicating a ‘contingent’ default judgment is too cumbersome to be administratively sensible here . . . .”<sup>24</sup> Plaintiffs seek the identical piecemeal relief as in *Carlton Investments* and ignore the fact that the Court has already directed Turnaround to conduct discovery to defend the validity of the contested AmeriStar board. It seems clear from the Court’s decision that it has already exercised its discretion regarding the default judgment issue. Plaintiffs’ actions in seeking a second default judgment,

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<sup>21</sup> 1996 WL 426501, at \*2.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* See also *id.* (“I recognize that this court, and the plaintiffs, must depend upon the processes of the judicial system in the jurisdiction in which [the non-appearing defendant] resides to force his participation at the risk of contempt.”).

therefore, are just as repetitive and unproductive as the motion for a “conditional default” in *Carlton Investments*.

Likewise, Turnaround’s Answer does not provide any additional support for Plaintiffs’ argument that default judgment should be granted.<sup>25</sup> Answering that Turnaround is “without knowledge or information sufficient to form a belief as to the truth of the averments of the paragraph, which therefore are denied” is entirely consistent with its previous positions.<sup>26</sup> While these answers may provide Plaintiffs’ some comfort in their belief that Turnaround has no information relating to the Section 225 aspect of its Complaint, they simultaneously reinforce the Court’s discretion exercised under the last sentence of Rule 55(b) to order Turnaround to conduct discovery into the issue. As the October Decision clearly explains, discovery is necessary for Turnaround to comply with the Court’s requirement that it must “defend the validity of the contested AmeriStar board as a means of protecting its after-issued stock in AmeriStar.”<sup>27</sup> The scheduling order, to which Plaintiffs agreed, contemplates these directions as well as the summary nature of a Section 225 proceeding. Plaintiffs’ motion here, by contrast, unnecessarily complicates this case and requires the Court to restate the October Decision even more forcefully. The Court should deny Plaintiffs’ motion for default judgment.

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<sup>25</sup> To the extent that Plaintiffs rely on statements made in the Utah Action to manufacture support for its motion for a default judgment in a footnote, Pl. Second Default Mot. at 8 n.2, and that somehow Turnaround is connected with Defendants’ actions here, Turnaround submits that this suggestion is both misleading and inappropriate. Moreover, any factual dispute over the validity of the shares may be capable of being resolved under the discovery ordered by the Court.

<sup>26</sup> See, e.g., Ex. D to Pl. Second Default Mot. at ¶¶ 2, 3, 7. The Answer also confirms the Court’s assumption that “it is unlikely Turnaround possesses facts relating to the board composition.” *Noe Slip Op.* at 8.

<sup>27</sup> *Id.* at 6 (emphasis omitted).

## II. THE COURT SHOULD DENY PLAINTIFFS' MOTION FOR JUDGMENT ON THE PLEADINGS ON COUNT II OF THE COMPLAINT BECAUSE THIS MOTION IS CONTINGENT ON THE DEFAULT JUDGMENT MOTION AND EFFECTIVELY SEEKS RECONSIDERATION OF THE OCTOBER DECISION

“After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings.”<sup>28</sup> In determining a motion for judgment on the pleadings, the Court will confer the nonmoving party with “the same benefits as a plaintiff defending a motion under [Court of Chancery] Rule 12(b)(6).”<sup>29</sup> The Court will “evaluate the legal sufficiency of the facts alleged while ignoring wholly conclusory statements.”<sup>30</sup> A motion for judgment on the pleadings will be granted when, “accepting as true the nonmoving party’s well pleaded facts,” and drawing “all reasonable inferences in favor of the nonmoving party,” “there is no material fact in dispute and the moving party is entitled to judgment under the law.”<sup>31</sup>

It is not entirely clear what Plaintiffs are relying on as the basis for their motion for judgment on the pleadings on Count II of their Complaint.<sup>32</sup> One seems to hinge on the outcome

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<sup>28</sup> DEL. CT. CH. R. 12(c).

<sup>29</sup> *McMillan v. Intercargo Corp.*, 768 A.2d 492, 500 (Del. Ch. 2000).

<sup>30</sup> *Speiser v. Baker*, 525 A.2d 1001, 1006 (Del. Ch. 1987). “An allegation is conclusory when it merely states a generalized conclusion with no supporting facts.” *In re Coca-Cola Enters., Inc.*, 2007 WL 3122370, at \*2 (Del. Ch. Oct. 17, 2007), *aff’d sub nom. Int’l Bhd. Teamsters v. Coca-Cola Co.*, 954 A.2d 910 (Del. 2008) (Table). *See also Encite LLC v. Soni*, 2008 WL 2973015, at \*5 (Del. Ch. Aug. 1, 2008) (“Though vague allegations may be well-pleaded so long as they give the opposing party notice of the claim, the Court need not accept as true conclusory statements unsupported by fact.”) (citations omitted).

<sup>31</sup> *In re Seneca Invs. LLC*, 2008 WL 4329230, at \*2 (Del. Ch. Sept. 23, 2008) (internal quotation marks and citations omitted). “The court may also consider the unambiguous terms of exhibits attached to the pleadings, including those incorporated by reference.” *OSI Sys., Inc. v. Instrumentarium Corp.*, 892 A.2d 1086, 1090 (Del. Ch. 2006).

<sup>32</sup> Plaintiffs also overlook the fact that Section 227 does not give rise to an independent cause of action. *See Carballal v. PMBC Corp.*, 1999 WL 342341, at \*2 (Del. Ch. May 14, 1999) (“Section 227(a), however, does not create an independent cause of action; it simply confirms what is implicit in § 225, namely that the Court may determine the right and power of persons claiming to own stock to vote at any meeting of the stockholders.”) (quotations, ellipses, and citations omitted); *Steinkraus v. GIH Corp.*, 1991

of the Court's decision with regard to Plaintiffs' motion for default judgment. That is, if the Court grants that motion, then it must also grant the motion for judgment on the pleadings on Count II.<sup>33</sup>

The problem with this argument is two-fold. First, it ignores the fact that the Court has already held that it will not reach the question regarding the validity of the shares until it has determined whether the issuing board was validly constituted.<sup>34</sup> Turnaround, as intervenor, will have to conduct discovery in order to defend the validity of the contested AmeriStar board.<sup>35</sup> Given the plain and unambiguous direction of the Court and the stipulation of the parties regarding scheduling for this issue, Plaintiffs' motion for judgment on the pleadings seems unnecessarily redundant. Second, Plaintiffs' argument ignores the fact that Turnaround's motion to intervene has been granted and the Court has ordered that Turnaround conduct discovery to defend the very issue as to which Plaintiffs now seek default judgment. For the same reasons already explained as to why default judgment is inappropriate, so too is this motion.

To the extent that this interpretation is incorrect, Plaintiffs' motion should also be rejected because it implicitly seeks reconsideration of the Court's decision ordering discovery and granting Turnaround's motion to intervene given Turnaround's answer to the Complaint.

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WL 3922, at \*3 (Del. Ch. Jan. 16, 1991) ("Section 227 does not create a cause of action. It helps to delineate the contours of the Court's power in actions under Sections 211, 215 or 225."); Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate & Commercial Practice in the Delaware Court of Chancery*, § 8.08[e], at 8-172 (2008) ("It has been stated that [Section 227] gives rise to no independent cause of action, but merely further defines the court's remedial power in actions elsewhere authorized."). This fact notwithstanding, Plaintiffs can easily amend their complaint to plead this Count under Section 225, which would not change the analysis required to resolve the underlying issues.

<sup>33</sup> See Pl. Second Default Mot. at ¶ 11.

<sup>34</sup> *Noe Slip Op.* at 6 n.18. Plaintiffs acknowledge this point, Pl. Second Default Mot. at ¶ 11, but seem to ignore it.

<sup>35</sup> *Noe Slip Op.* at 6, 8. See also *id.* at 7 n.20 (noting that part of Plaintiffs' standing argument "fails to acknowledge that the Court must first determine the § 225 action").

Plaintiffs' motion for reconsideration, filed almost a month after the October Decision and almost two weeks after Turnaround filed its answer is untimely.<sup>36</sup>

**A. If The Court Accepts Plaintiffs' Invitation To Reverse The October Decision, The Protected Purchaser Issue Should Be Resolved As A Matter Of First Impression**

If the Court is persuaded by Plaintiffs' invitation to reverse course and address the protected purchaser issue now, Turnaround will restate its argument to preserve its rights.<sup>37</sup> Notably, Plaintiffs' motion mirrors the previous argument they raised when opposing Turnaround's motion to intervene<sup>38</sup> and Turnaround has already responded to this argument once.<sup>39</sup> Further, the Court has already explained that it will not reach this argument unless and until it determines the threshold issue of whether the issuing board was not validly constituted. Turnaround agrees that the questions of whether the shares are void or voidable and whether and to what extent the Delaware Uniform Commercial Code ("DUCC") and, in particular, 6 *Del. C.* § 8-202 applies are legal ones appropriate for summary disposition.<sup>40</sup>

Plaintiffs continue to argue that the shares of stock issued to CRI and to Turnaround are void and thus legal nullities and that 6 *Del. C.* § 8-202 consequently has no applicability.<sup>41</sup> As Turnaround has previously responded, a number of Delaware cases discuss the distinction

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<sup>36</sup> See DEL. CT. CH. R. 59(f). Even if the Court was to consider this to be a motion to alter the Court's judgment under Rule 59(e), the ten-day jurisdictional period has also passed. See DEL. CT. CH. R. 59(e).

<sup>37</sup> See *Smokey, Inc. v. Pany Inv. Co.*, 276 A.2d 741, 742-43 (Del. 1971) (affirming the Superior Court's grant of default judgment and order of sale and holding that the intervening party had passed on the opportunity to defend against the order of sale when the intervening party briefed only the default judgment issue).

<sup>38</sup> Compare Pl. Opposition To Turnaround Advisors, LLC's Combined Motion To Intervene And To Vacate Order To Expedite Proceedings ¶¶ 12-19 with Pl. Second Default Mot. at ¶¶ 11-13, 15-18.

<sup>39</sup> See Ex. D to Pl. Second Default Mot. at ¶¶ 8-18. Plaintiffs incorporate the entirety of the protected purchaser argument by reference into this motion.

<sup>40</sup> Of course, if the Court determines that the protected purchaser provision applies, it would still need to make the factual determination of whether Turnaround is, in fact, a protected purchaser.

<sup>41</sup> Pl. Second Default Mot. at ¶ 11.

between void stock and voidable stock in the context of a stock issuance defective under the DGCL.<sup>42</sup> The Court of Chancery recently acknowledged that the law as to when and whether a defective stock issuance is curable “is not as clear as it could be.”<sup>43</sup> In other cases, save one,<sup>44</sup> the provisions of the DUCC have not been discussed in the context of stock issuances that are technically deficient under the DGCL.<sup>45</sup>

Plaintiffs dispute that Delaware law is moving away from the rigid rule they articulate<sup>46</sup> and toward a position that “where stock is held by an innocent third-party purchaser, technical defects relating to statutory formalities should not lead to a finding of void stock, but at worst to a finding of voidable stock.”<sup>47</sup> Delaware courts have “demonstrated a willingness to look beyond statutory violations to the equitable result caused by voiding the stock.”<sup>48</sup> For example, *Kalageorgi v. Kamkin, Inc.* was a Section 225 action, affirmed by the Delaware Supreme Court, where the plaintiffs held thirty-nine shares, sixty-one shares were issued to the defendants, and

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<sup>42</sup> See C. Stephen Bigler and Seth Barrett Tillman, *Void or Voidable?—Curing Defects in Stock Issuances Under Delaware Law*, 63 BUS. LAW. 1109 (2008) (citing cases).

<sup>43</sup> See *MBKS Co. Ltd. v. Reddy*, 924 A.2d 965, 972 (Del. Ch. 2007), *aff’d*, 945 A.2d 1080 (Del. 2008).

<sup>44</sup> See *id.*

<sup>45</sup> See Bigler and Tillman, *supra* at 1111. Plaintiffs continue to rely on the same cases for the proposition that if a corporation issues stock in violation of Section 151 of the DGCL, then the shares of such stock are legal nullities and void as a matter of law. Pl. Second Default Mot. at ¶ 12-13. For example, in *Staar Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991), although there the Delaware Supreme Court held that stock issued in violation of Section 151 of the DGCL is invalid and void, that case did not involve a “protected purchaser.” *Id.* at 1134, 1136-37. In fact, in *Staar*, the Supreme Court simply rejected the defendants’ argument that even though the stock was technically defective the defendants were equitably entitled to an order, akin to specific performance, treating the stock as if it were validly issued, as consideration for the defendants’ personal guarantee of the company’s debt. *Id.* The other cases cited by Plaintiffs also did not involve a “protected purchaser.” See, e.g., *Waggoner v. Laster*, 581 A.2d 1127 (Del. 1990) (not involving a “protected purchaser”); *Superwire.com, Inc. v. Hampton*, 805 A.2d 904, 909 (Del. Ch. 2002) (same); *Kalageorgi v. Kamkin, Inc.*, 750 A.2d 531 (Del. Ch. 1999), *aff’d*, 748 A.2d 913 (Del. 2000) (same).

<sup>46</sup> See Pl. Second Default Mot. at ¶¶ 19-21.

<sup>47</sup> See Bigler and Tillman, *supra* at 1148-49.

<sup>48</sup> *Id.* at 1149.

the plaintiff claimed to be the sole *de jure* stockholder because the sixty-one shares purportedly issued to defendants had not been validly authorized by the corporation's board of directors.<sup>49</sup> If the shares were validly issued, then the slate of directors elected by the defendants properly constituted the corporation's board of directors; otherwise, the plaintiff was the sole stockholder and director.<sup>50</sup> The Court of Chancery never reached the question of whether the shares were validly issued *ab initio*. Rather, the Court of Chancery in *Kalageorgi* held that the defective shares were capable of being cured by retroactive ratification by the director defendants.<sup>51</sup> Thus, *Kalageorgi* stands for the proposition that stock issuances defective under the DGCL are not necessarily null and void.

Similarly, in *Bowen v. Imperial Theaters, Inc.*, the Court of Chancery recognized the importance of an "innocent purchaser" in a situation where it was alleged that a stock issuance was void.<sup>52</sup> Although the Court of Chancery found that the complainant was not an innocent purchaser, it stated that if the complainant "did purchase for value without notice of the infirmity in [the complainant's transferor's] title to the stock, or without knowledge sufficient in law to impute notice to him, he would be entitled to the relief prayed, for in such case the corporation would be estopped from denying the recital in its certificate to the effect that the stock was full-paid and nonassessable."<sup>53</sup>

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<sup>49</sup> 750 A.2d at 532, 536.

<sup>50</sup> *Id.* at 536-37.

<sup>51</sup> *Id.* at 538-40.

<sup>52</sup> 115 A. 918, 922 (Del. Ch. 1922) ("It is, therefore, pertinent to now examine the question of whether the complainant, Bowen, was an innocent purchaser from Stover.").

<sup>53</sup> *Id.*

Most recently in *MBKS Co. Ltd. v. Reddy*,<sup>54</sup> the Court of Chancery demonstrated its willingness to look to the “protected purchaser” provisions of the DUCC to validate a stock issuance that may be technically defective under the DGCL.<sup>55</sup> In *MBKS*, the plaintiff challenged under Section 225 the election of directors by the vote of shares that were alleged to have been defectively issued under the DGCL for invalid consideration.<sup>56</sup> The Court of Chancery, albeit in *dicta*, stated that when the defective “stock has been transferred to a protected purchaser,” such “[t]hird parties without knowledge of the defect in the stock should be permitted to rely on what appears to be validly issued stock.”<sup>57</sup> This statement is significant because it is the first (and only) Delaware case applying the “protected purchaser” provisions of the DUCC in the context of stock issued in violation of the DGCL, and provides that although a stock issuance is technically deficient under the DGCL, the stock is valid in the hands of the “protected purchaser.”

The provisions of the DUCC are incorporated into the DGCL by Section 201 of the DGCL, which provides, *inter alia*, that except as otherwise provided in the DGCL, Article 8 of the DUCC governs the transfer of stock and stock certificates that represent stock or uncertificated stock.<sup>58</sup> The DUCC provides the following rule in situations where the security is claimed to be invalid:

A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that

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<sup>54</sup> 924 A.2d 965 (Del. Ch. 2007), *aff'd*, 945 A.2d 1080 (Del. 2008).

<sup>55</sup> *See* Bigler and Tillman, *supra* at 1149.

<sup>56</sup> 924 A.2d at 967.

<sup>57</sup> *Id.* at 974 and 974 n.30.

<sup>58</sup> 8 *Del. C.* § 201.

case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.<sup>59</sup>

The DUCCL further provides that “[a]ll other defenses of the issuer of a security . . . are ineffective against a purchaser for value who has taken the certificated security without notice of a particular defense.”<sup>60</sup> In addition, a “protected purchaser” acquires the rights of a purchaser, as well as “its interest in the security free of any adverse claim.”<sup>61</sup> A “protected purchaser” is defined under the DUCCL as “a purchaser of a certificated or uncertificated security, or of an interest therein, who: (1) gives value; (2) does not have notice of any adverse claim to the security; and (3) obtains control of the certificated or uncertificated security.”<sup>62</sup> “The[se] Code provision[s] [are] operative without regard to whether the security is declared void by the law which creates the requirements which has been violated.”<sup>63</sup>

A determination that Turnaround is a “protected purchaser” is significant to the outcome of this case. If Turnaround is a “protected purchaser,” then Plaintiffs cannot invalidate Turnaround’s stock. As explained in *MBKS*, stock issued in violation of the DGCL is valid in the hands of a “protected purchaser.”<sup>64</sup> Thus, the “protected purchaser” provisions of the DUCCL

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<sup>59</sup> 6 *Del. C.* § 8-202(b).

<sup>60</sup> 6 *Del. C.* § 8-202(d).

<sup>61</sup> 6 *Del. C.* § 8-303(b).

<sup>62</sup> 6 *Del. C.* § 8-303(a).

<sup>63</sup> See 8 LARY LAWRENCE, LAWRENCE’S ANDERSON ON THE UNIFORM COMMERCIAL CODE § 8-202:11, at 106 n.20 (3d ed. 1996) (citing Official Comment 4 to Uniform Commercial Code Section 8-202, as read at the time).

<sup>64</sup> 924 A.2d at 974 and n.30 (citing *Clark v. Airavada Corp.*, 12 F. Supp. 2d 1114, 1117 (D. Nev. 1998) (“A protected purchaser takes stock free of any adverse claim.”)); see also LAWRENCE, *supra* § 8-202:11, at 106 (“As to defects not involving a violation of constitutional provisions, a non-governmental security is valid in favor of an immediate purchaser for value who is without notice of the defect; such a purchaser takes free of *statutory* invalidation . . . as to subsequent purchasers for value who are without notice of the defect, neither *statutory* nor constitutional invalidities may be raised.”) (emphasis added).

“protect[] a purchaser for value without notice of the defect, irrespective of whether the purchaser took by original issue or subsequently.”<sup>65</sup>

Plaintiffs make three new arguments in light of these positions: (i) “there is no evidence that Delaware Courts are ‘moving away from this rigid rule’ as Turnaround suggests”; (ii) “Turnaround’s argument would ‘gut’ Section 151 of the DGCL and would result in this Court improperly amending Section 151 and Section 201 of the DGCL”; and (iii) a separate ratification “is necessary to make voidable stock validly issued stock” and that has not taken place.<sup>66</sup> Plaintiffs’ arguments ignore the above discussed cases and that the issue of whether the shares are void or voidable needs to be addressed after the protected purchaser argument is resolved. Shares acquired by Turnaround are valid if it is ultimately determined that Turnaround is a “protected purchaser.” No further action is required to validate those shares.<sup>67</sup>

Plaintiffs’ arguments also continue to ignore the plain language of Section 201.<sup>68</sup> Nowhere in Section 151 of the DGCL does it state that stock issuances in violation of that statute are null and void. Accordingly, there is no inconsistency in the statutory provisions relating to “protected purchasers” under the DUCC and Section 151 of the DGCL. The only inconsistency

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<sup>65</sup> See Bigler and Tillman, *supra* at 1146. The DUCC does not clearly apply where one stockholder asserts the invalidity of another stockholder’s purported stock. However, where a corporation is estopped from asserting the invalidity of purported stock, the holder of the stock should be similarly estopped, and so should other holders of corporate securities (whether of that class or of another class or series). *Cf.* 8 *Del. C.* § 124 (limiting those with standing to claim that a corporate act is *ultra vires*). This is a logical conclusion in this case because Plaintiffs seek a declaration from this Court that they are the valid directors of Ameristar and, as a result, they seek to invalidate Turnaround’s shares on behalf of Ameristar.

<sup>66</sup> Pl. Second Default Mot. at ¶ 19.

<sup>67</sup> See LAWRENCE, *supra* § 8-202:10, at 105-06 (“It is to be noted that there is no formal act which ‘validates’ or makes the security valid; the defect or invalidity is merely ignored and the security regarded as valid when the question is raised in the courts.”); Bigler and Tillman, *supra* at 1146 (explaining that no formal action is required “because the stock is deemed valid and this action would accomplish nothing.”).

<sup>68</sup> 8 *Del. C.* § 201 (“Except as otherwise provided in this chapter, the transfer of stock and the certificates of stock which represent the stock or uncertificated stock shall be governed by Article 8 of subtitle I of Title 6. ***To the extent that any provision of this chapter is inconsistent with any provision of subtitle I of Title 6, this chapter shall be controlling.***”) (emphasis added)

is between the “protected purchaser” provisions of the DUCC and the gloss on the case law cited by Plaintiffs.<sup>69</sup> This hurts Plaintiffs’ position, because the cases cited by Plaintiffs interpreting the DGCL can be superseded or trumped in future cases “by amendment to the DGCL or by *other* on-point statutes” such as the DUCC.<sup>70</sup>

Based on the foregoing analysis, “the policy underlying Article 8 of the DUCC to validate stock in the hands of innocent purchasers for value, notwithstanding technical defects in its issuance, should be recognized as a principle of law” and “should be applied by Delaware courts as such.”<sup>71</sup> “As a result, where stock is held by an innocent third-party purchaser, technical defects relating to statutory formalities should not lead to a finding of void stock.”<sup>72</sup> A pall could be cast over the purchase of shares in a Delaware corporation were the Court to conclude that a “protected purchaser” who took shares in a Delaware corporation without notice of any defect in the issuance of the stock had no rights in those shares. In the present case, if it is determined that Turnaround is a “protected purchaser,” the stock at issue is valid in the hands of Turnaround, regardless of the defects claimed by Plaintiffs, provided Turnaround is found not have had notice of any defect in the stock.<sup>73</sup>

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<sup>69</sup> See Bigler and Tillman, *supra* at 1143 n. 203 (explaining that the Delaware case law that stock is “void (for statutory nonconformity) was not expressly controlled by statute rather, it was a judicial gloss on the DGCL . . .”).

<sup>70</sup> *Id.* (emphasis added); see also *Wilson v. State*, 305 A.2d 312, 317 (Del. 1973) (“Delaware follows the common law except when changed by statute.”); *Toll Bros., Inc. v. Gen. Accident Ins. Co.*, 1999 WL 1442016, at \*6 n.4 (Del. Super. Ct. Dec. 27, 1999) (recognizing that case law may be superseded by statute).

<sup>71</sup> See Bigler and Tillman, *supra* at 1111.

<sup>72</sup> *Id.*; see also *MBKS*, 924 A.2d at 974 (“Third parties without knowledge of the defect in the stock should be permitted to rely on what appears to be validly issued stock.”).

<sup>73</sup> See, e.g., *Smouha v. MTA and J.P. Morgan Chase*, 797 N.Y.S.2d 278, 286 (N.Y. Sup. Ct. 2005) (making “protected purchaser” determination on summary judgment motions after discovery); *Dean Witter & Co. v. Educ. Computer Corp.*, 369 F. Supp. 757, 762-64 (E.D. Pa. 1974) (same).

### **III. TURNAROUND TAKES NO POSITION ON PLAINTIFFS' MOTION FOR FEES AND COSTS**

Plaintiffs also seeks fees and costs based on Defendants' failure to appear, answer, move or otherwise respond to the Complaint. Pl. Second Default Mot. at ¶¶ 23, 24. This motion does not implicate Turnaround nor subject Turnaround to any fees. Except for how Plaintiffs' couch this motion as dependent on the resolution of their motion for default judgment and for the above-mentioned reasons regarding why the motion for default judgment and judgment on the pleadings is inappropriate, Turnaround takes no position on how the Court should extend relief to Plaintiffs with regard to the actions taken (or lack thereof) by Defendants.<sup>74</sup>

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<sup>74</sup> If the Court were to enter any default judgment against Defendants in this case, Turnaround respectfully requests that the Court make clear that it made no determination relating to Turnaround's rights as a "protected purchaser" under Article 8 of the DUCC.

#### **IV. THE COURT SHOULD AWARD FEES AND COSTS TURNAROUND HAS INCURRED IN RELATION TO THIS LATEST MOTION**

“This court has broad discretion to award attorneys’ fees where litigation was brought in bad faith or where bad faith conduct by one of the parties increases the costs of the litigation.”<sup>75</sup> “Delaware courts have shifted fees and costs when defendants unnecessarily required the institution of litigation, delayed the litigation, and asserted frivolous motions, or, put another way, when defendants’ bad faith has made the procession of the case unduly complicated and expensive.”<sup>76</sup> “To award fees under the bad faith exception, the party against whom the fee award is sought must be found to have acted in subjective bad faith. A finding of bad faith involves a higher or more stringent standard of proof, *i.e.*, clear evidence.”<sup>77</sup>

Turnaround does not argue that the entire litigation was brought in bad faith. Rather, Turnaround limits its argument to this motion, which was brought after Turnaround’s right to intervene was granted. Plaintiffs’ motion has unduly complicated the prosecution of this case in light of both its timing and the relief sought therein and therefore justifies an award of fees. Less than six weeks before Plaintiffs filed this motion, the Court explained (in a written decision) how it was proceeding with the issues Plaintiffs again bring to the Court’s attention. In the October Decision, the Court recognized that Plaintiffs had filed a motion for default judgment (based largely on the same reasons presented here) concurrently with its motion in opposition of Turnaround’s motion to intervene.<sup>78</sup> When it granted the motion to intervene, the only logical conclusion, based on the plain language of the Court’s reasoning, was that the default would

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<sup>75</sup> *In re SS &C Techs., Inc. S’holders Litig.*, 948 A.2d 1140, 1149 (Del. Ch. 2008).

<sup>76</sup> *Fairthorne Maint. Corp. v. Ramunno*, 2007 WL 2214318, at \*9 (Del. Ch. July. 20, 2007) (quotations, brackets, and citations omitted).

<sup>77</sup> *Schoon v. Troy Corp.*, 948 A.2d 1157, 1177 (Del. 2008) (citation and quotations omitted).

<sup>78</sup> *Noe Slip Op.* at 4.

have been granted only had it denied Turnaround's motion. Moreover, the Court (in that same decision) explained exactly why any determination into whether Turnaround is a "protected purchaser" will have to be made with Turnaround's participation in this action, after adequate discovery has taken place, and not before the Court resolves the threshold issue of whether the issuing board was validly constituted.

That Plaintiffs have decided to test the Court's resolve and patience by bringing this second motion for default judgment (even though Turnaround is now a party to this action as intervenor and a discovery schedule has been implemented) is clear evidence that they are attempting to delay the litigation and complicate this case even further than it already is. If this is not clear evidence, Plaintiffs' motion for judgment on the pleadings on the very issue that the Court stated explicitly that it would not reach until it determined the threshold question regarding the validity of the issuing board (which Turnaround is to conduct discovery into) certainly is. Plaintiffs have either missed, misread, or have simply chosen to ignore the part of the Court's October Decision that addresses these very issues, which, coincidentally, forms the entire basis for its decision finding that Turnaround had both standing and an interest in the litigation.

Consequently, Turnaround has been forced to expend additional resources in defending its position (again), without the benefit of being able to add to its substantive argument, in large part because the only subsequent action in the litigation has been to file an Answer to the Complaint. The motions brought by Plaintiffs have certainly made the "procession of the case unduly complicated and expensive" and justify this Court awarding fees to Turnaround. Accordingly, the Court should not only dispose of Plaintiffs' latest motion in such a way that Plaintiffs understand it this time, it should also exercise its discretion and award fees and costs to

Turnaround in connection with its defense of Plaintiffs' latest tactic to avoid actually litigating this case.

**CONCLUSION**

For the reasons discussed above, Turnaround respectfully requests that the Court (i) deny Plaintiffs' motion for default judgment; (ii) deny Plaintiffs' motion for judgment on the pleadings; (iii) award Turnaround its fees and costs in connection with the defense of this motion; and (iv) award any relief it determines is necessary and just.

Dated: December 4, 2008

FISH & RICHARDSON P.C.

*/s/ Cathy L. Reese*

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Cathy L. Reese (#2838)

Brian M. Rostocki (#4599)

Charles B. Vincent (#5078)

222 Delaware Avenue, 17<sup>th</sup> Floor

P.O. Box 1114

Wilmington, Delaware 19899

(302) 652-5070 – Telephone

*Attorneys for Intervening Defendant*

*Turnaround Advisors, LLC*

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of **Intervenor Turnaround Advisors LLC's (1)Opposition To Plaintiffs' Motion For Default Judgment, Motion For Judgment On The Pleadings And Motion For Attorneys' Fees And Costs; And (2) Opening Brief In Support Of Its Motion For Attorneys' Fees And Costs** was caused to be served via e-Service on December 4, 2008 on the following counsel:

Michael J. Maimone, Esquire  
Titania Mack Parker, Esquire  
Greenberg Traurig LLP  
The Nemours Building  
1007 N. Orange Street, Ste. 1200  
Wilmington, Delaware 19801

/s/ Charles B. Vincent  
Charles B. Vincent (DE #5078)