SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

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JOHN SHIELDS, derivatively on behalf of MEDALLION FINANCIAL CORP.,

Plaintiff,

-against-

ALVIN MURSTEIN, ANDREW W. MURSTEIN, DAVID L. RUDNICK, LOWELL P. WEICKER, JR., FREDERICK A. MENOWITZ, HENRY L. AARON, HENRY D. JACKSON, and SARAH FRIGO,

Defendants,

-and-

MEDALLION FINANCIAL CORP., a Delaware Corporation,

Nominal Defendant.

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Index No. 657482/2017

Mot. Seq. No. 001

Hon. C.E. Ramos, J.S.C.:

In motion sequence no. 001, defendants Alvin Murstein, Andrew W. Murstein, David L. Rudnick, Lowell P. Weicker, Jr., Frederick A. Menowitz, Henry L. Aaron, and Henry D. Jackson (collectively, Director Defendants), and nominal defendant Medallion Financial Corp. (Medallion, and together with Director Defendants, Defendants) move, pursuant to CPLR 3211[a][1] and [7], and Delaware Court of Chancery Rule 23.1, to dismiss the Stockholder Derivative Complaint (Complaint), with prejudice. For the reasons set forth below, the motion is granted.

Factual Background

The underlying dispute stems from alleged losses incurred in connection with defendant Sarah Frigo's publication of articles and blog posts relating to Medallion in 2016 (the Publications).

Medallion is a specialty finance company incorporated in Delaware with its principal place of business in New York, New York (Compl. ¶ 17). Its subsidiaries are in the business of originating, acquiring, and servicing loans for commercial businesses, including loans for taxi medallions (*Id.*, ¶¶ 17, 41). Medallion's common stock is publicly traded on NASDAQ as MFIN (2016 SEC Annual Report, Wu Aff. Ex. 2 at 33).

Medallion's Board of Directors (Board) has eight members (Compl. ¶ 67). Defendants Rudnick, Weicker, Menowitz, Aaron, and Alvin and Andrew Murstein are current directors, and defendant Jackson is a former director (*Id.*). Alvin Murstein is Medallion's CEO and Andrew Murstein is Medallion's President, while the remaining directors are not officers or employees of Medallion (*Id.*, at ¶¶ 18-24). John W. Everets and Allan Tanenbaum are current directors who joined the Board in 2017 and are not named as defendants (*Id.*, at ¶ 67).

In March 2017, plaintiff John Shields owned 119 shares of Medallion common stock, out of 24,127,785 shares outstanding (April 4, 2017 Stockholder Inspections Demand Letter, Wu Aff. Ex. 4 at Ex. A; 2016 SEC Annual Report, Wu Aff. Ex. 2 at 1). Shields

continues to own Medallion stock (Compl. ¶ 66).

On July 21, 2016, Frigo signed a contract with Medallion's subsidiary, Medallion Consulting Services LLC (Medallion Consulting) to provide public relations, marketing, and communication services from February 1, 2016 until September 30, 2016 (Independent Contractor Services Agreement (Agreement), Compl. Ex. A). Andrew Murstein signed the contract on behalf of Medallion Consulting (*Id.*, at 7).

On May 3 and 5, 2016, *The Huffington Post* published two articles allegedly written by Frigo that praised Medallion's financial prospects (Compl. ¶¶ 48-49). The articles included Frigo's picture but were published under her pen name, Jayme Stanley (*Id.*, ¶¶ 47-49). Frigo also wrote promotional statements about Medallion in blog posts and comment boards under some form of the pen name (*Id.*, ¶¶ 6, 50).

On January 17, 2017, *Debtwire* published an article revealing that Medallion had paid Frigo for favorable publications (*Id.*, ¶¶ 8, 54). Between January 27, 2017 and February 9, 2017, Medallion's stock price decreased by approximately 35%, dropping from $2.72 to $1.77 per share (Compl. ¶ 55). For reference, Medallion's stock had been valued at $17.73 per share in November of 2013 (*Id.*, ¶¶ 44-45).

On April 4, 2017, Shields sent an inspection demand to Medallion pursuant to Delaware General Corporation Law Section

220 (Inspection Demand) to investigate whether Medallion's fiduciaries allowed or encouraged the Publications (Compl. ¶ 56; April 4, 2017 Stockholder Inspections Demand Letter, Wu Aff. Ex. 4 at Ex. A). The Inspection Demand requested documents relating to the retention of Frigo's services, and documents and communications relating to her articles and posts (Compl. ¶ 4). In response, Medallion provided the Agreement, and stated that the Board did not have any minutes, presentations, or resolutions relating to Frigo (*Id.*, ¶¶ 11, 57). Shields interpreted the response as indicative of the Board's failure to address the Publications (*Id.*, ¶ 58). This action followed.

The Complaint asserts claims against the Director Defendants for breach of fiduciary duty and unjust enrichment (Compl. ¶¶ 75-83). Shields alleges that the Director Defendants allowed, encouraged and assisted with the Publications, and failed to prevent, investigate and rectify the resulting wrongdoing (*Id.*, ¶ 77). He alleges that their actions violated federal securities laws (*Id.*, ¶¶ 6, 77), and caused Medallion's stock price to decline (*Id.*, ¶¶ 45, 61). Moreover, Shields alleges that Alvin Murstein benefitted by selling shares of Medallion stock after the Publications were made (*Id.*, ¶¶ 59-60).

Defendants argue that Shields failed to plead his claims and demand futility with the particularity required under Delaware law, and move this Court to dismiss the Complaint.

Discussion

CPLR 3211 instructs us to construe a complaint liberally and accept the alleged facts as true, giving the plaintiff the benefit of every favorable inference (*522 W 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 152 [2002]). In reviewing a motion to dismiss, however, courts may also consider documents referenced in the complaint (*Alliance Network, LLC v Sidley Austin LLP*, 43 Misc3d 848, 852 n.1 [Sup Ct NY Cnty 2014]). This Court need not accept as true allegations that are flatly contradicted by documentary evidence (*Id.*, at 857).

The parties agree that Delaware law governs the substance of this dispute, as Medallion is incorporated in Delaware (*Asbestos Workers Phil. Pension Fund v Bell*, 137 AD3d 680, 681 [1st Dept 2016]). Under Delaware law, a shareholder derivative complaint must satisfy the particularity requirements of Delaware Chancery Court Rule 23.1[a]:

> The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

The pleading requirements of Rule 23.1 are rigorous, and higher than the standard applicable on a motion to dismiss under the CPLR (*Simon v Becherer*, 7 AD3d 66, 72 [1st Dept 2004]). Conclusory allegations that fail to provide specific facts are insufficient to establish demand futility (*David Shaev Profit*

Sharing Account v Cayne, 24 AD3d 154 [1st Dept 2005]).

Section 141[a] of Delaware General Corporation Law awards broad power to a board of directors to manage a corporation. Delaware law therefore requires shareholders to make a pre-suit demand on the Board to allow it to review the allegations without the encumbrance of litigation (*Aronson v Lewis*, 473 A2d 805, 818 [Del 1984]). If a demand would have been futile, meaning that it would not have been useful under the circumstances, then its absence may be excused (*Id.*).

To withstand the pending motion to dismiss, Shields' allegations must meet the requirements for demand futility articulated in *Rales v Blasband*, 634 A2d 927 [Del 1993] (*Rales*). To satisfy *Rales*, the plaintiff must plead particularized facts showing that a majority of a board of directors faces a substantial likelihood of personal liability, or is beholden to an interested director (*David Shaev Profit Sharing Account v Riggio*, 2014 WL 3350235 [Sup Ct NY Cty July 3, 2014]).

In re Caremark Int'l Inc. Deriv. Litig., 698 A2d 959 [Del Ch 1996] (*Caremark*) provides the applicable test for the substantial likelihood of personal liability where fiduciary duty claims based on the Board's failure of oversight are alleged. To successfully plead a *Caremark* claim, a plaintiff must allege particularized facts showing that the Board [1] "utterly failed to implement any reporting or information system or controls," or

[2] having implemented them, "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention" (*Stone ex rel. AmSouth Bancorp. v Ritter*, 911 A2d 362, 370 [Del 2006]). In so doing, the plaintiff must specify how the directors knew of oversight inadequacies and consciously ignored them (*In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A2d 106, 128 [Del Ch 2009]).

Shields alleges that the Board caused or permitted Medallion to break the law, or failed to establish, implement or oversee a monitoring system to ensure that Medallion abided by the law. But the Complaint unquestionably fails the *Caremark* test. Absent is any detail evidencing the Board's failures of oversight. While Shields cites to a pair of Medallion's internal conduct codes as a standard that the Board should have adhered to, his allegations do not detail the Defendant Directors' actions that failed to adhere to those codes or the law. Shields also does not provide how the Director Defendants would have known that there was an issue with the Publications.

In essence, Shields' allegations rely on the inference that the Board's lack of meeting minutes, resolutions or presentations equals failure of oversight (Compl. ¶¶ 10-11, 56-58). Shields does not provide facts, let alone sufficient particularity, to show that a majority of the Board faces a substantial likelihood

of personal liability.

With regard to the second prong of *Rales*, even if some of the directors were interested, Shields fails to show that a majority of the Board was beholden to an interested director.

Shields argues that Alvin Murstein, Andrew Murstein, Rudnick, Aaron and non-party Tanenbaum were not independent (Compl. ¶ 13). More specifically, Shields asserts that there existed a business transaction between Aaron and Andrew Murstein that made Aaron beholden to Andrew Murstein. Based on an article from 2004, Shields alleges that Murstein loaned $12 million to Aaron to fund a series of fast food restaurant franchises (the Loan), including nine Church's Chicken franchises and three Popeye's franchises (*Id.*). Shields additionally alleges that Aaron and Andrew Murstein both serve as directors for Sports Properties Acquisition Corp., and that Andrew Murstein attended a number of social and business events organized or attended by Aaron (*Id.*).

Under Delaware law, allegations that directors moved in the same social circles or were friends are themselves insufficient to rebut the presumption of independence (*Beam ex rel. Martha Stewart Living Omnimedia, Inc. v Stewart*, 845 A2d 1040, 1051 [Del 2004]). The same applies to allegations that defendants served on the same board together (*In re Pfizer, Inc. Deriv. Sec. Litig.*, 307 FAppx 590, 595 [2d Cir 2009])(applying Delaware law).

While "deeper human friendships" may potentially create reasonable doubt as to independence (*Del. Cty. Emps. Ret. Fund v Sanchez*, 124 A3d 1017, 1022 [Del 2015]), neither alone nor cumulatively are the details of the friendship between Andrew Murstein and Aaron insufficient to suggest such a relationship existed.

While receiving substantial past benefits may make a director feel as though the recipient is beholden to the benefit provider (*In re The Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *7 [Del Ch Mr 27, 2002]), this does not apply where allegations of partiality are based on a benefit that was not actually conferred. At oral argument, this Court advised the parties that, if Defendants were able to show that the Loan was never issued, the Complaint would be dismissed (June 27, 2018 Hearing Tr. 29:17-19).

In response to this Court's request, Defendants' counsel submitted sworn affidavits from Andrew Murstein and Aaron. Plaintiff thereafter withdrew a few, but not all, of the allegations made in the Complaint. As already stated on the record, however, seeing as Defendants furnished the requisite affidavits, Shields has failed to establish that the Board lacked independence.

With regard to Tanenbaum, Shields argues that Tanenbaum previously served as Aaron's personal attorney (Compl. ¶ 74),

meaning that, if Aaron was interested, then Tanenbaum was, too. Shields argues that Tanenbaum would be ethically barred from initiating litigation against Aaron as Aaron's fiduciary (*Id.*). Shields additionally argues that Tanenbaum acts as General Counsel, Vice President and Secretary of AFC Enterprises, Inc., which is the franchisor of the entities that the Loan was intended to franchise, which may have caused Tanenbaum to feel that he owed something to Andrew Murstein (*Id.*). These arguments obviously rely on Aaron being interested, or on the Loan actually having been issued. As already discussed, neither of these allegations is correct.

In a final attempt to salvage his claims, Shields argues that demand was futile because the Board acted in bad faith in failing to timely and meaningfully address unlawful activity related to the Publications. Bad faith, and therefore demand futility, may be established where the complaint successfully alleges that directors failed to take adequate steps to remediate known compliance issues (*Westmoreland Cty. Emp. Ret. Sys. v Parkinson*, 727 F3d 719, 728-30 [7th Cir 2013]). But this is not the case here.

The Complaint fails to support its claims with requisite specificity. Shields makes sweeping statements that the Director Defendants engaged in a conspiracy (Compl. ¶¶ 35-40) without specifying who did what, never mind when, where or how (*In re ITT*

Corp. Deriv. Litig., 588 FSupp2d 502, 511 [SDNY 2008]) ("When alleging misconduct or knowledge of misconduct ... [w]hether the Directors face a substantial likelihood of liability must be determined on a director-by-director basis, and thus Plaintiffs' conflation of all the directors into a single entity is insufficient under Rule 23.1."). Shields' basis for his allegations is again the Board's lack of minutes, resolutions or presentations relating to Frigo in response to his Inspection Demand. A mere theory as to the Board's misconduct is insufficient to meet the particularity requirements of Rule 23.1.

Accordingly, it is hereby

ORDERED that Defendants' motion to dismiss be granted, and it is

ORDERED that the parties settle order on notice.

DATED: November 15, 2018

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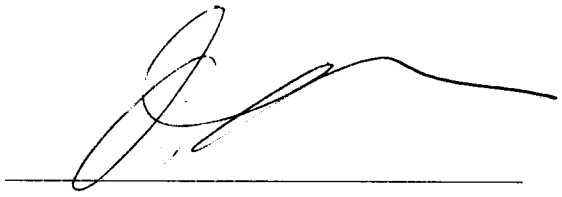

J.S.C.

CHARLES E. RAMOS