2006 WL 4523622
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United States District Court,
D. Maryland.

Robert H. DANIELS, et al., Plaintiffs
v.
The NEW GERMANY FUND, INC., et al., Defendants.

Civil Action No. MJG–05–1890.
|
March 29, 2006.

Attorneys and Law Firms

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MEMORANDUM AND ORDER

MARVIN J. GARBIS, United States District Judge.

***1** The Court has before it Defendants' Motion to Dismiss [Paper 24] filed pursuant to Rule 12(b)(6) and the materials submitted relating thereto. The Court conducted a hearing and has had the benefit of the arguments of counsel.

I. *BACKGROUND*

A. *The Parties*

The Plaintiffs are shareholders of Defendant New Germany Fund ("the Fund"), a closed-end investment company that specializes in investments in small and mid-cap German companies. Compl. ¶ 28. The individual Defendants are members of the Fund's Board of Directors ("the Board").

A "closed-end" investment fund is one that has a fixed number of shares available for direct purchase only at the initial public offering. Thereafter, investors may purchase shares only from an existing shareholder through a stock exchange on which such shares are listed, much like the shares of other publicly-owned companies. Shares of closed-end funds trade at a substantial discount from the value of the underlying securities held by the fund, known as the net asset value. This is in contrast to an "open-end" fund, "in which the number of shares is not fixed and investors can purchase or redeem shares at current net asset value." *Strougo v. Scudder, Stevens & Clark, Inc.*, 964 F.Supp. 783, 788 (S.D.N.Y.1997).

B. *The Facts*

In January 2000, the Fund adopted a bylaw that set forth certain requirements for individuals interested in becoming elected directors ("the Director Qualifications Bylaw" or simply "the Bylaw"). Specifically, the Bylaw required that candidates for director must have a certain senior-level experience in business, investment, economic, or political matters relating to the German market. According to Plaintiffs, the Bylaw was adopted in bad faith to entrench the Board and not for the benefit of the Fund.

In December 2004, Phillip Goldstein, one of the Fund's shareholders and an investment manager to certain entities that are also shareholders of the Fund, sought approval from the Board to nominate four individuals (including himself) to stand for election as directors of the Fund at the June 2005 annual meeting. However, because Goldstein's slate of candidates did not meet the criteria detailed in the Bylaw, he requested that the Board waive those requirements. The Board declined his request in January 2005.

Plaintiff Robert Daniels, a shareholder of the Fund, filed the complaint in the instant action on June 6, 2005, just weeks before the scheduled meeting. The complaint alleges various breaches of fiduciary duty and violation of the Maryland Corporations and Associations Code.

The Board responded to the complaint by issuing supplemental proxy solicitation materials to its shareholders in advance of the annual meeting. It stated

that the Fund would not treat votes for the Goldstein slate of candidates as "votes cast" to determine which individuals had a plurality of votes cast. As a result, Goldstein chose not to attend the meeting and did not vote the shares.

***2** At the June 2005 annual meeting, the slate of directors that was recommended by management received 7,661,376 votes and was declared elected. Subsequently, Goldstein filed a Form 13D with the Securities and Exchange Commission asserting that he had proxies to vote at least 7,744,533 shares in favor of his slate of nominees, which exceeded the number of votes for management. Goldstein contended that had the Board permitted shareholders' proxies to be voted as instructed and be counted as "votes cast," his slate of nominees would have received a plurality of votes cast.

In the instant case, Plaintiffs seek, *inter alia,* a recount that results in the election of the Goldstein slate or a declaration that the 2005 election results were invalid so that a new election must be held.

By the instant motion, Defendants seek dismissal.

II. *DISMISSAL STANDARD*

The Court must deny a Motion to Dismiss under Rule 12(b)(6) "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson,* 355 U.S. 41, 45–46 (1957) (footnote omitted). "[T]he question is ... whether in the light most favorable to the plaintiff, and with every doubt resolved in the pleader's behalf, the Complaint states any legally cognizable claim for relief." 5B Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1357, at 640 (3d ed.2004). The Court, when deciding a motion to dismiss, must consider the well-pled allegations in a complaint as true and must construe those allegations in favor of the plaintiff. *Jenkins v. McKeithen,* 395 U.S. 411, 421–22 (1969). The Court must further disregard the contrary allegations of the opposing party. *A.S. Abell Co. v. Chell,* 412 F.2d 712, 715 (4th Cir.1969).

III. *DISCUSSION*

Defendants seek dismissal contending that Plaintiffs' claim is time-barred and that, on the merits, the Business Judgment Rule validates the Bylaw.

A. *Statute of Limitations*

Under Maryland law, "[a] civil action at law shall be filed within three years from the date it accrues unless another provision of the Code provides a different period of time within which an action shall be commenced." Md.Code Ann., Cts. & Jud. Proc. § 5–101.

Maryland courts have adopted the "discovery rule" to determine the date of accrual of a plaintiff's claim. *See Frederick Rd. Ltd. P'ship v. Brown & Sturm,* 756 A.2d 963, 973 (Md.2000).

> The discovery rule tolls the accrual of the limitations period until the time the plaintiff discovers, or through the exercise of due diligence, should have discovered, the injury. Thus, before an action is said to have accrued, a plaintiff must have notice of the nature and cause of his or her injury.

Id.

Defendants contend that since the Director Qualification Bylaw was adopted in January 2000, it was then that Plaintiffs' claim of breach of fiduciary duty ripened and began to accrue. Defendants assert that in 2005, the Board merely applied the Bylaw as they were legally required to do in the absence of a timely challenge to the Bylaw.

***3** In *Moran v. Household International, Inc.,* 490 A.2d 1059 (Del. Ch.1985), *aff'd,* 500 A.2d 1346 (Del.1986), shareholders brought suit against the Household corporation alleging that a preferred stock rights dividend plan (known commonly as a "poison pill") unduly restricted the alienability and marketability of the shares. 490 A.2d at 1064. Despite the defendants' argument that the case was not ripe because the poison pill had not yet been applied, the Delaware Court of Chancery held that the mere adoption of the plan affected the shareholders' rights, even in the absence of its actual application, so that their cause of action was in fact ripe. *Id.* at 1072.

In the instant case, Defendants take the position that because Plaintiffs did not sue upon adoption of the Bylaw in 2000, they have effectively waived any right to complain about the implementation of the Bylaw in the

2005 election. The Court finds the argument unsound. If, as alleged by the Defendants, the Bylaw is invalid under Maryland law, the Directors would have a duty not to apply it in 2005 to the detriment of the Plaintiffs. *See Shaker v. Foxby Corp.,* No. 24–C–04–007613, 2005 WL 914385, at *3–4 (Md.Cir.Ct. Mar. 15, 2005) (considering whether corporate management breached its fiduciary duty by enforcing unreasonable or discriminatory by-law provisions). Accordingly, the Court concludes that the instant case is not barred by limitations.

B. *Business Judgment Rule*

Section 2–405.1 of the Maryland Code, Corporations and Associations, [1] sets forth the duties owed to a corporation by its directors. Specifically, the statute requires a director to act in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with the care of an ordinarily prudent person in a like position under similar circumstances. Md.Code Ann., Corps. & Ass'ns § 2–405.1(a)(1)(3). The statute further states that "[a]n act of a director of a corporation is presumed to satisfy" that standard. *Id.* § 2–405.1(e). "A court will overturn a board's decision only if the challenger produces evidence establishing that the directors acted in bad faith ." *Froelich v. Erickson,* 96 F.Supp.2d 507, 520 (D.Md.2000).

Defendants seek to shield themselves from suit by virtue of the Business Judgment Rule. However, they ignore the circumstance that, in a dismissal context, the Court must accept Plaintiffs' pleadings. In the instant case, Plaintiffs have alleged bad faith—a fact that, if proven, strips the protection of the Business Judgment Rule.

In *Shaker v. Foxby Corp.,* Judge Matricciani of the Circuit Court for Baltimore City considered whether corporate bylaws were invalid under Maryland law as unreasonable when applied to challenges to the control of corporate boards of directors. 2005 WL 914385, at *3. Specifically, he held that "the application of notice provisions brings this action within the equitable powers of the Court to determine whether defendants breached their fiduciary duties to the shareholders by enforcing unreasonable or discriminatory by-law provisions against plaintiffs." *Id.* at *4.

***4** The *Foxby* court also considered "what duty the corporation has to ensure fair voting procedures and by whom and how those procedures may be challenged." *Id.* at *4. The court relied on *Blasius Industries, Inc. v. Atlas Corp.,* 564 A.2d 651 (Del. Ch.1988), [2] and stated that "[i]n the present context of shareholder voting rights, ... plaintiffs' claim raises a fundamental issue of corporate governance." *Id.* "The Court believes that the directors owed plaintiff a statutory and common law duty to enact by-laws containing fair voting procedures." *Id.* at *6. The *Foxby* court thus applied *Blasius* to conclude that actions designed primarily to interfere with stockholder voting rights are not afforded protection of the Business Judgment Rule and there is no presumption of validity.

Defendants may well ultimately prevail on the contention that the election procedures themselves were fair. *See Stroud v. Milliken,* 585 A.2d 1306 (Del. Ch.1988); *Aprahamian v. HBO & Co.,* 531 A.2d 1204 (Del. Ch.1987). Defendants may well establish that the Bylaw was adopted in the regular course of the Board's duties, not in response to any direct threat or proxy challenge to the Fund's directors or management, and was the mere codification of the Fund's long-standing practice of having directors with experience in matters concerning German investments. However, they cannot prevail in the instant dismissal context. The Court must assume that, unlike in *Stroud* and *Aprahamian,* the Board's application of the Bylaw together with the execution of its June 2005 election would impact "fair voting procedures." Moreover, the Court must assume, in the present context, that the application of the Director Qualification Bylaw was "clearly unreasonable."

IV. *CONCLUSION*

For the aforementioned reasons:

1. Defendants' Motion to Dismiss [Paper 24] is DENIED.

2. The case shall proceed pursuant to the Scheduling Order to be issued after a conference with counsel.

SO ORDERED, on *Wednesday, March 29, 2006.*

All Citations

Not Reported in F.Supp.2d, 2006 WL 4523622

Footnotes

1 The statute has been referred to as Maryland's codification of the “business judgment rule.” *See* *Indep. Distribs. v. Katz*, 637 A.2d 886, 895 (Md.Ct.Spec.App.1994).

2 The court stated that “Maryland courts would recognize shareholder voting rights as having the same or similar status as recognized by the Delaware cases.” *Id.* at *5.