Michael H. Patterson, Plaintiff	*	IN THE CIRCUIT COURT
v.	*	FOR
Miles R. Patterson Jr., et al., Defendants.	*	BALTIMORE COUNTY
	*	Case No. 03-C-05-005429

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MEMORANDUM AND RULING

Before the court is the Defendants' Motion to Dismiss (16,000), Plaintiff's "Amended and Restated Complaint for Injunctive, and Other Relief" (15,000), under Md. Rule 2-322(b)(2) for failure to state a claim upon which relief can be granted. In ruling on a motion to dismiss for failure to state a claim upon which relief can be granted, "the court must assume the truth of all well-pled facts in the complaint as well as the reasonable inferences that may be drawn from those relevant and material facts." *Porterfield v. Mascari II, Inc.*, 374 Md. 402, 414 (2003). The court may dismiss the complaint only if the well-pled facts and reasonable inferences, viewed in the light most favorable to the plaintiff, fail to afford that party the relief requested." *Id.*

To be well pled, a pleading must follow the requirements in Md. Rule 2-303. Rule 2-303(a) provides that "[a]ll averments of claim…shall be made in numbered paragraphs, the contents of which shall be limited as far as practicable to a statement of a single set of circumstances….Each cause of action shall be set forth in a separately numbered count." Subsection (b) provides that "[e]ach averment of a pleading shall be simple, concise, and direct….A pleading shall contain only such statements of fact as may be necessary to show the pleader's entitlement to relief." Further, subsection (b) explicitly states what is impermissible in

a pleading: "It *shall not* include argument, unnecessary recitals of law, evidence, or documents, or any immaterial, impertinent, or scandalous matter" Md. Rule 2-303 (b) (emphasis added).

I.

In light of the formal requirements imposed by Rule 2-303, the well-pled facts, that for the purposes of ruling on the present motion must be assumed to be true, can be summarized as follows:

Defendant Manor View Farms, Inc. (Corporation) is a closely held corporation organized under the laws of Maryland and is located in Baltimore County.

Prior to April, 2005, Plaintiff Michael H. Patterson and Defendants Miles R. Patterson, Nancy P. Young, and Mary P. Hendrix were the shareholders of all common capital stock issued, outstanding and entitled to be voted in the Corporation. The shareholders are siblings and each held 288 shares. An additional 388 non-voting shares were held by the Corporation as security until such time as the full payment of the purchase price is made under the Stock Purchase Agreement of December 15, 1980.

The current board of directors of the Corporation is comprised of Defendants Miles R. Patterson, Dennis A. Hendrix and Nancy P. Young. Dennis A. Hendrix is Mary P. Hendrix's husband.

The Corporation's charter states that the common stock of the Corporation may not be transferred except after a sequential offering first to the Corporation and then to each stockholder. If the Corporation and the stockholders do not exercise their right of first refusal, the common stock may be sold to others outside the Corporation.

The charter further provides that the charter may be amended only by authorization of the holders of four-fifths of all outstanding stock, by a vote at a meeting or in writing with or without a meeting. This provision includes an amendment changing the terms of outstanding stock.

An appraisal done by RSM McGladrey, Inc. to "value 100% of the stock of the Corporation" was issued on April 4, 2005. The appraisal was not conveyed to the Plaintiff until after 5:00 p.m. on May 11, 2005.

The board of directors met, presumably on April 29, 2005, and called for the issuance of an additional 130 shares of the Corporations Common Stock to all shareholders but Plaintiff. The minutes made of this meeting are undated.

As a result of the issuance of additional common stock, Defendant shareholders each owned 418 shares while Plaintiff only owned 288 shares.

On May 4, 2005, the board of directors met for the purpose of approving Articles of Amendment and to call a special Stockholder's Meeting for Monday, May 16, 2005 at 10:00 a.m. for the purpose of adopting the Articles of Amendment.

The Articles of Amendment called for a reverse stock split, meaning that each share held prior to the reverse stock split would be converted into a 1/418 share. Accordingly, each Defendant stockholder would own one share. Plaintiff would only own a 288/418 share. In addition, the Articles of Amendment provide that a stockholder must own at least one share of corporate stock. The Corporation reserved the right to demand the surrender of any fractional share in return for which the Corporation would make a cash payment to the fractional shareholder in an amount equal to the fair value of the fractional shareholder's common stock.

With the Defendant shareholders in control of slightly over the required 80 percent majority of the Corporation's stock, the Articles of Amendment were passed over Plaintiff's

dissent. Before the reverse stock split, the Articles of Amendment could not pass over Plaintiff's dissent, because the Defendant stockholders only controlled 75 percent of the common stock. The Articles of Amendment effectively called for Plaintiff's removal as a shareholder by buying out his fractional share of the common stock in return for cash payment of the fair value of the stock.

While Paragraph 9 of the Amended and Restated Complaint alleges that the Defendant shareholders' actions were consummated as a result of some sort of plan "to fulfill personal and selfish objectives which do not serve a corporate purpose and which are unfair to the Plaintiff, and intended to circumvent the Corporation's Charter," the motivations of the plan need not be assumed to be true for they are not well-pled facts, but are argument which is prohibited by the language of Rule 2-303(b). In its entirety, Paragraph 9 of the Amended and Restated Complaint reads:

> On or about April 19, 2005 the Majority Shareholders, by and through their control of the Board of Directors, set out upon a course of conduct planned to fulfill personal and selfish objectives which do not serve a corporate purpose and which are unfair to the Plaintiff, which are deceptive, contrary to, and intended to circumvent the Corporation's Charter. These selfish and personal objectives are apparently based upon the Majority Shareholders' common desire to obtain personal, individual tax advantage and at the same time to obviate Plaintiff's rights, by plotting, through the means set forth below (the "Plan") to sell 100% of the Corporation's stock without first having to abide by the Corporation's Charter (which requires that before any transfer could occur, Plaintiff would first be allowed his Right of First Refusal).

Stripped of argument, the only statements of fact alleged in Paragraph 9 can be read as stating: "On or about April 19, 2005 the Majority Shareholders, by and through their control of the Board of Directors, set out upon a planned course of conduct." Nowhere in the Amended and Restated Complaint does the Plaintiff make any statement of fact that, without argument and assumed to be true, would support an inference of "personal or selfish objectives," whatever those objectives

might have been. Neither has the Plaintiff pleaded any facts to support the allegation that the Defendants' intent was to circumvent the charter rather than to act in accordance with the terms of the charter. Nor does the Amended and Restated Complaint set forth any facts that could demonstrate a plan to wrong the Plaintiff or deprive him of his rights under either the charter or law. Defendant makes bald assertions of mal intent on the part of the Defendants unsupported by factual statements as required by Rule 2-303.

Only the well-pled facts and inferences drawn therefrom are to be assumed as true for the purposes of a motion to dismiss for failure to state a claim upon which relief can be granted. Obviously, the Defendants had a plan for their actions. Even without Paragraphs 9 and 10, one can assume that the board of directors and Defendant shareholders planned to eliminate Plaintiff's status as a shareholder in the Corporation by issuing more stock, purchasing that stock themselves to obtain the necessary 80 percent majority of voting shares, and subsequently amending the charter to effectively squeeze Plaintiff out of his shareholder status. However, without any supporting statements of fact, the only inference that can be drawn, even in the light most favorable to the Plaintiff as the non-moving party, is that the Defendants planned to do just as they did, without any wrongful intent or motive.

II.

None of the Counts present any statement of fact creating a claim upon which relief can be granted.

Plaintiff styles Count I (Paragraphs 11-16) as an action for Breach of Fiduciary Duty of Directors and Majority Stockholders.

The only purpose of Paragraph 11 is to illustrate that the Defendants will not be harmed by an injunction, which is argument and not fact. There are facts included within Paragraph 11,

which although not set out in numbered paragraphs as required by Rule 2-303(a), may be considered by the court so as to do "substantial justice" under the mandate of Rule 2-303(e). Those factual allegations set forth in this paragraph, and not occurring elsewhere in the Amended and Restated Complaint, are that the day-to-day business of the Corporation is unaffected by the Plaintiff's holding his stock, there is no impending sale of the Corporation's assets or stock, there are no dissident actions ongoing, or in recent history, which would affect or impede the Corporation's business, and the purpose of Defendants' actions is to "cut out the Plaintiff from his Right of First Refusal and obtain the tax advantages to the personal interests of the Majority Stockholders."

Paragraphs 12 and 13 are impermissible recitals of law and legal argument.

Paragraph 14 is flawed for the same reason that Paragraph 9 is flawed: it provides argumentative conclusions instead of well-pled factual allegations which would lead to those conclusions.

Paragraph 15 avers that Plaintiff has been injured by Defendants' failure to declare dividends and by Defendant's overcompensation. Once again, these statements are conclusive rather than factual.

Paragraph 16 purports to state that Defendants' actions are the proximate cause of Plaintiff's damages, which include "irreparable injury, loss of his stock, loss of fair value and loss of his Right of First Refusal."

According to Plaintiff's memorandum and the legal argument improperly included in the Amended and Restated Complaint itself, Count I is based on two legal theories by which the Defendant may be held liable for breaching a fiduciary duty to the Plaintiff. First, Plaintiff alleges that *Md. Corps. & Assocs. Code Ann.* § 2-405.1 imposes a statutory duty on directors of a

corporation to act in good faith, to act in a manner they reasonably believe to be in the best interests of the corporation, and to act with the care that an ordinarily prudent person in a like position would use under similar circumstances. Second, Plaintiff cites *Cooperative Milk Service, Inc. v. Hepner*, 198 Md. 104 (1951) as holding that when "majority stockholders use their voting power for their own benefit, for some ulterior purpose adverse to the interests of the Corporation and its stockholders as such, they violate their fiduciary obligations."

While Plaintiff is correct that *Md. Corps. & Assocs. Code Ann*. § 2-405.1(a) imposes a duty on directors of a corporation, Plaintiff fails to state a claim under § 2-405.1 upon which relief can be granted for two reasons: (1) the Plaintiff alleges no facts, that if assumed to be true, would overcome the statutory presumption that the act of a director satisfies the standards of subsection (a), and (2) Plaintiff has not brought a shareholder derivative action on behalf of the Corporation, and therefore is barred from asserting a statutory claim because of § 2-405.1(g).

Under *Md. Corps. & Assocs. Code Ann*. § 2-405.1(a), a director "shall perform his duties as a director" in good faith, in a manner the director "reasonably believes to be in the best interests of the corporation," and "with the care that an ordinary prudent person in a like position would use under similar circumstances." It is presumed that a director's action satisfies the standards of care mandated by subsection (a). *Md. Corps. & Assocs. Code Ann*. § 2-405.1(e). Because of this statutory presumption, in order to establish a prima facie cause of action, a prospective plaintiff must allege facts in its complaint that, if proved, would show a lack of good faith, that the director acted in a manner he did not reasonably believe to be in the best interests of the corporation, or that the director did not act with the care that an ordinary person in his position would use under similar circumstances. Here, Plaintiff has not presented any statement

of fact in its Amended and Restated Complaint sufficient to establish a cause of action, even if every statement of fact were true.

Further, Plaintiff is barred from bringing an action against the Defendant directors under this statute because subsection (g) clearly states, "Nothing in this section creates a duty of any director of a corporation enforceable otherwise than by the corporation or in the right of the corporation." Because it is Plaintiff, Michael Patterson who has brought this suit on his own behalf, and he is not suing in the right of the Corporation for any injury done to the corporation, the Defendant directors have no duty to Plaintiff under this section.

Although Plaintiff asserts that the basis for his action is as a shareholder's derivative action, that assertion is incorrect. The purpose of a shareholder's derivative action is to enable individual shareholders to sue on behalf of corporation to protect the corporation's interests from "the misfeasance and malfeasance of 'faithless directors and managers.'" *Danielewicz v. Arnold*, 137 Md. App. 601, 626 (2001) (citing *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 548 (1949)); *see Werbowsky v. Collomb*, 362 Md. 581, 599 (2001) (shareholder's derivative action developed "to enable shareholders to enforce a corporate right that the corporation failed to assert on its own behalf"). In a shareholder's derivative action, the corporation is the real party in interest and the shareholder is merely a nominal plaintiff. *Werbowsky*, 362 Md. at 599. No claims made by the plaintiff on his own behalf may constitute a shareholder's derivative action.

In its Amended and Restated Complaint, Plaintiff fails to make any statement of fact showing any injury or deprivation of a right suffered by the Corporation. As in any suit, there must be an injury in fact in order for a court to grant relief. No relief can be granted where there is no relief needed, and without injury to the Corporation there is no corporate claim for which

relief can be granted. Because there is no corporate claim for which relief can be granted, Plaintiff has no cause of action under *Md. Corps. & Assocs. Code Ann*. § 2-405.1.

Plaintiff also cites *Cooperative Milk Service, Inc. v. Hepner*, 198 Md. 104, 114 (1951) creating a cause of action in cases in which "majority stockholders use their voting power for their own benefit, for some ulterior purpose adverse to the interests of the corporation and its stockholders as such." Plaintiff misconstrues the holding in that case. For a fiduciary duty to be breached in such a situation, the ulterior purpose must be adverse to the interests of the corporation and the corporation's stockholders as the equitable owners of the corporation. It is not sufficient to plead simply that an ulterior purpose exists and that the ulterior purpose is adverse to the individual stockholder. While the Amended and Restated Complaint contends that there are certain injuries to the Plaintiff himself, and that the ulterior purposes are not in the best interest of the Corporation, there is no statement of fact as to what the ulterior motives are of facts that would show that the ulterior purpose is *adverse* to the Corporation's interests.

Plaintiff argues in its memorandum that a "fairness rule" is the appropriate test in a case of a reverse stock split of a closely held corporation that eliminates a minority shareholder according to *Lerner v. Lerner Corp.*, 132 Md. App. 32 (2000) (*Lerner II*). Further, Plaintiff argues that the where the court finds that the reverse stock split is unfair to the minority shareholder, it must order rescission of the action. Plaintiff misconstrues and misapplies the holding in *Lerner II*. The Court of Special Appeals' actual holding in *Lerner II* was that neither a business purpose test nor a fairness test needed to be applied in the case because there was sufficient evidence to conclude that "there were reasons to effect the reverse stock split other than the desire, in and of itself, to oust a minority." *Id.* at 59. Plaintiff, in the present case, argues that there were no reasons to effect the reverse stock split eliminating him as a shareholder other

than the desire to oust him as a minority; however, Plaintiff fails to plead any fact that would lead to that conclusion.

Even if his ouster were the Defendant's goal in effectuating the reverse stock split, Plaintiff would not have a cause of action without additional facts. "[T]he use of a reverse stock split and elimination of fractional shares for the purpose of eliminating minority stockholders, if not within one of the "limited circumstances" discussed above, see Walter J. Schloss Assoc., 73 Md. App. at 743, is permissible under Maryland law. See *Lerner v. Lerner*, 306 Md. 771, 511 A.2d 501 (1986)."

Count II of the Amended and Restated Complaint adds absolutely no factual information to the pleading that was not included in Count I and does nothing more than express argument that is impermissible in a pleading. There is no claim stated in either Counts I or II for which relief can be granted.

The only language in Count III, in addition to the standard incorporation of the factual allegations contained in the previous paragraphs, consists entirely of Paragraph 21: "That the exercise by the Majority Stockholders and the directors of their voting power for their own benefit, to cause stock of the Plaintiff to be diluted, for an ulterior purpose of their own self interest and not the interest of the Corporation, is a violation of their fiduciary duties and obligations." Stripped of all argument, that paragraph simply states the fact that the majority stockholders and the directors exercised their voting power.

Plaintiff styles Count IV as an action for "Fraud by Fiduciary." Plaintiff fails to plead any fact that would satisfy any of the elements of fraud. In Maryland, to recover for fraud, a plaintiff must show:

that (1) the defendant made a false representation to the plaintiff, (2) the falsity

> of the representation was either known to the defendant or the representation was made with reckless indifference to its truth, (3) the misrepresentation was made for the purpose of defrauding the plaintiff, (4) the plaintiff relied on the misrepresentation and had the right to rely on it, and (5) the plaintiff suffered compensable injury as a result of the misrepresentation.

Hoffman v. Stamper, 385 Md. 1, 28 (2005).

In Paragraph 22, Plaintiff, instead of stating facts, argues that the Defendants have no authority to modify the Corporation's charter and that the Plaintiff is entitled to protection against fraudulent or illegal action by the Defendants. There is no fact that, if true, proves any element of fraud.

Paragraph 23 argues that "the dilution of the Plaintiff's stock, as alleged herein, and failure to pay dividends were ulterior purposes, adverse to the minority and self serving to the Defendants" Paragraph 24 further argues that the freeze-out of Plaintiff from his shareholder interest and the failure to pay dividends has "a significantly polar impact" between the Defendants and Plaintiff, and without any factual allegation, states that Plaintiff is damaged somehow as a result. Neither paragraph states any fact that would create a cause of action.

Nothing in Count IV amounts to a factual statement, which, if taken as true for the purposes of a motion to dismiss, would possibly satisfy any of the elements of civil fraud. Count IV fails to state a claim for which relief can be granted.

III.

Just as there has been no factual allegation of injury to the Corporation for which relief can be granted, Plaintiff has not averred any statement of fact showing that he has suffered the type of injury in fact for which relief can be granted.

According to Plaintiff's logic, (1) because the other shareholders of the Corporation and the board of directors issued additional stock to themselves, for which, as Plaintiff does not dispute, they paid fair consideration to the Corporation, (2) then used the extra voting power of those shares to achieve the necessary 80 percent majority to amend the charter, (3) creating the reverse stock split by which Plaintiff's now fractional share was eliminated, and for which Plaintiff was offered cash payment for the fair market value of his share of the Corporation, (4) Plaintiff has suffered an injury by losing his share of the Corporation, which entails a loss of voting rights and a loss of the ability to buy the other shares of the Corporation before they would be sold to outsiders. Plaintiff claims that this injury entitles him to injunctive relief, specifically rescission of the issuance of the 390 additional shares and the rescission of all actions taken at the Stockholder's meeting of May 16, 2005.

The Corporation lawfully issued additional stock to the Defendant shareholders and received adequate compensation for those shares. A corporation "from time to time may issue…Stock of any class authorized by its charter." *Md. Corps. & Assocs. Code Ann*. § 2-201. Plaintiff states no fact in the Amended and Restated Complaint that would show the issuance of additional stock to be unauthorized by its charter. Plaintiff does not allege that the Corporation did not receive fair consideration for the stock.

A reverse stock split is legitimate under statute. A corporation may "amend its charter from time to time in any respect, provided that…If the amendment effects a change in stock or in the rights of stockholders…the amendment shall contain the provisions necessary to effect the change…." *Md. Corps. & Assocs. Code Ann*. § 2-602(a). In addition, a corporation may amend its charter to "[c]hange issued or unissued shares of stock of any class, whether with or without par value, into a different number of shares of the same class or into the same or a different

number of shares of another class, either with or without par value." *Md. Corps. & Assocs*. § 2-602(b)(8). Plaintiff does not allege any violation of this provision.

The Corporation could lawfully amended its charter to change 418 shares of stock into 1 share, and convert 288 shares of stock into fractional share of 288/418 under § 2-602(b)(8). Once Plaintiff's shares were converted into a fractional share, it decided, in accordance with statute, to "[p]ay cash for the fair value of [the] fractional share of stock." *Md. Corps. & Assocs*. § 2-214(a)(4).

Plaintiff has stated no facts that, if true, would support an allegation that the Corporation or its directors have violated any statutory or charter provision. Although the Plaintiff argues (without supporting factual statements) throughout the pleading that the Defendants acted to circumvent the charter, they did not "contravene' the charter. It is technically true that they did go around, or circumvent, the charter's original language through the act of amendment, however they did not go against, or "contravene" the charter by amending the charter without the sufficient majority. Everything the Defendants did was "convenient," or going with, the charter, and with the statutory mandates.

IV.

Defendants, in addition to moving for dismissal, ask the court for sanctions in the form of attorneys' fees and costs under Md. Rule 1-341. In that regard we will do no more than quote the sage comments of the Honorable Howard Chasnow, Retired Judge of the Court of Appeals. Judge Chasnow noted that "in too many cases, the pleadings that evidence the most bad faith and the least justification are motions requesting costs and attorney's fees." *Zdravkovich v. Bell Atlantic-Tricon Leasing Corp.*, 323 Md. 200, 212 (1991).

V.

For the reasons aforestated, it is this 31st day of January 2006, by the Circuit Court for Baltimore County,

ORDERED: that the Defendant's Motion to Dismiss (16,000) be, and it is hereby, **GRANTED**; and futher

ORDERED: that Plaintiff's Amended and Restated Complaint (15,000) be **DISMISSED, WITH LEAVE TO AMEND** within thirty (30) days in order to give the Plaintiff one last opportunity to plead actual facts rather than legal conclusions.

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Lawrence R. Daniels
Judge