

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Michael Tate, Joseph Shuster,
and Jack Ayers, individually and
on behalf of all other individuals
similarly situated,

Plaintiffs,

MEMORANDUM OPINION
AND ORDER
Civil No. 09-2076 (MJD/JJG)

v.

Restaurant Technologies, Inc.,
Jeffery R. Kiesel, John C. Rutherford,
Jonathan O. Grad, Phillip A. Clough,
Robert E. Weil and John Does 1-5,

Defendants.

Robert C. Moilanen, Cory D. Olson and Larina A. Brown, Anthony
Ostlund Baer & Louwagie P.A., and Gregg M. Fishbein, Lockridge Grindal
Nauen P.L.L.P., Counsel for Plaintiffs.

James K. Langdon, Michelle S. Grant and Lola Velazquez-Aguilu, Dorsey
& Whitney LLP, Counsel for Defendants.

This matter is before the Court upon Defendants' motion to dismiss all
claims regarding alleged pre-merger conduct.

The Parties

Defendant Restaurant Technologies, Inc. ("RTI") is a Delaware corporation

that is headquartered in Eagan, Minnesota that provides bulk cooking oil to numerous fast food restaurants. (Complaint ¶ 4.) Plaintiff Michael Tate is a former member of RTI's Board of Directors and is a common shareholder. (Id. ¶ 1.) Tate holds 67,282 shares of RTI common stock for which he paid nearly \$400,000. Plaintiff Joseph Shuster is also a former member of RTI's Board of Directors and holds 82,500 shares of RTI common stock for which he paid nearly \$500,000. (Id. ¶ 2.) Finally, Plaintiff Jack Ayers holds 9,667 shares of RTI common stock for which he paid nearly \$50,000. (Id. ¶ 3.)

Defendant Jeffery R. Kiesel is the current Chief Executive Officer of RTI, and has served in that position since 2005. (Id. ¶ 5.) Defendant Robert E. Weil is the Chief Financial Officer of RTI, and has been since 2007. (Id. ¶ 6.) Defendant Philip A. Clough is a director of RTI, and is also an officer of ABS Capital Partners, which, along with its affiliates, holds RTI preferred stock. (Id. ¶ 7.) Defendant John C. Rutherford became a director of RTI in 2009 and is the founder of Parthenon Capital LLC and its affiliate entities. Parthenon holds mostly RTI preferred stock. (Id. ¶ 8.) Defendant Jonathan O. Grad is a director of RTI and a managing partner of Parthenon. Defendant John Does 1-5 are alleged to have conspired with, and engaged in the wrongful conduct asserted in the

Complaint. (Id. ¶ 10.)

Factual Background

RTI was spun off from MVE Holdings in 1999. (Id. ¶ 19.) RTI's essential business activity is to provide bulk cooking oil to restaurants, but it also picks up used oil - yellow grease - and recycles it. (Id.) From 2004 to 2008, its revenue stream increased dramatically: from \$79 million in 2004 to \$261 million in 2008.

(Id. ¶ 20.) The company's prospects were repeatedly touted by Defendant Kiesel.

(Id. ¶ 21.) For example, in a letter to shareholders, he stated: "2006 was a year we are proud of as evidenced by our growth and profitability gains." (Id.) Similar statements were made about the company's performance for 2007. (Id.)

In order to finance the company's distribution network, after receiving investments from Plaintiffs, RTI engaged in a series of preferred stock offerings.

(Id. ¶ 22.) Parthenon invested heavily in the 2001 A-1 preferred stock series, and continued to invest in the subsequent years. (Id. ¶ 23.) ABS invested in the 2004 A-3 preferred stock offerings, and also continued to invest in later years. (Id.)

Plaintiffs allege that when Parthenon originally invested in 2001, it misrepresented its intentions by suggesting its commitment to preserve the company's independence and culture, rather than assert day-to-day control. (Id.)

¶ 24.) Plaintiffs allege such statements were untrue, however, as Defendant Rutherford soon began to place his own representatives on RTI's Board. By the end of 2004, Parthenon and ABS together controlled a majority interest in RTI. In 2005, Defendant Kiesel was brought in to assume day to day control of RTI, and over time Kiesel ousted all the officers and employees of RTI who had originally founded the company. (Id. ¶ 24.) In November 2005, a Parthenon representative on the RTI Board, Drew Sawyer, when asked about protecting the interests of the RTI common shareholders, candidly stated "F*** the common." (Id. ¶ 25.)

In early 2009, Parthenon appointed Jack Grunwald as an independent director to protect the interests of the common shareholders in connection with the proposed merger/recapitalization. Plaintiffs allege that such appointment was a ruse because the merger/recapitalization was actually designed to wipe out the interests of the common shareholder to the benefit of the companies owned by Defendants Rutherford, Grad and Clough. (Id.)

Plaintiffs further allege that the preferred stock offerings generated many benefits for Parthenon and ABS, including the ability to control the RTI Board of Directors and management of RTI, as well as financial benefits including interest/dividend rates ranging from 20% to 30% per year. (Id. ¶ 26.) This

financial benefit accreted so that by the time the recapitalization/merger took place in 2009, the \$19 million raised in the 2001 A-1 offering had purportedly increased to a value of \$86 million. (Id.)

Plaintiffs allege that the annualized return being accreted on the preferred stock was so great that Parthenon and ABS elected not to have RTI pursue courses of action that would have been beneficial to the company and RTI common shareholders. (Id. ¶ 27.) For example, in 2006, RTI considered an initial public offering (“IPO”), yet Defendants Rutherford, Grad and Clough scuttled it in an effort to maximize the egregious return on the investment made by Parthenon and ABS and did not even advise the RTI Board of their activities. (Id.) Had the IPO taken place, Plaintiffs allege the common shareholders would have received in excess of \$30 per share for their common stock based upon an enterprise valuation of over \$400 million for RTI. (Id.) At that time, an investment banking firm placed a high end enterprise value on RTI at over \$500 million. (Id. ¶ 28) Also, in 2008, another investment banking firm valued RTI at over \$350 million when Defendants sought to put RTI up for sale. (Id.) The proposed sale did not take place, purportedly because of a change in credit markets. (Id.) When the credit markets stabilized, however, Defendants chose to

squeeze out the common shareholders rather than trying to sell the company.

(Id.)

Plaintiffs also allege that Defendant Kiesel recklessly began a process to increase the sale and marketing activities of RTI to build orders, knowing that the creation of a large order backlog would require RTI to acquire additional, expensive funding from Parthenon and ABS, thereby diminishing or eliminating the value of RTI common stock. (Id. ¶ 31.) Defendant Kiesel's alleged mismanagement was so destructive that in February 2008, one RTI Director wrote that it was necessary for RTI to become cash flow sufficient, therefore RTI would have to limit new installs to cash plus equipment financing, that it was necessary to cut the growth rate of the company to avoid bankruptcy and that all stakeholders could not bear more onerous accumulating preferred equity. (Id.) This advice was ignored by Defendants, and Kiesel continued to operate RTI for the interests of Parthenon and ABS. (Id.)

In December 2008, Defendant Kiesel tried to convince the common shareholders that their shares were worthless, and that they should forfeit their shares. (Id. ¶ 32.) Defendants were allegedly contemplating recapitalizing RTI and knew the elimination of the RTI common shareholders would have the

impact of upstreaming even more of the company's assets and prospects to Parthenon and ABS. (Id.) When the common shareholders refused to forfeit their shares, the Defendants implemented the merger/recapitalization in order to eliminate the common shareholder interests altogether. (Id. ¶ 33.)

On May 14, 2009, the company issued proxy materials concerning the plan to recapitalize and merge RTI. (Id. ¶ 34; Langdon Decl., Ex. 1 (Proxy Statement Offering Memorandum).) In these materials, Defendants informed shareholders that due to the current credit crisis and economic recession, the company's financial condition had dramatically deteriorated, which caused the company to default on its Note Purchase Agreement with its lenders. (Id.) To obtain a waiver of the default, \$15 million had to be raised. (Id.) In these materials, the company's worth was represented as \$143 million. (Id.) These materials also represented that the common shares were virtually worthless. (Id.) The proposed recapitalization/merger involved the merger of a subsidiary of RTI into RTI ("New RTI") and the issuance of common stock, a new class of preferred stock such that all existing preferred shareholders and those common shareholders who wished to become shareholders in the New RTI, with the remainder of the common shareholders being cashed out. (Id.; Proxy Materials at

i-ii.) This process also called for the common shareholders to “release” any claims they had against the Defendants in exchange for a conversion of their stock interest. (Comp. ¶ 33.) A de minimus value was placed on the common stock at .13 cents per share.

Plaintiffs allege the proxy materials contained many false and misleading statements. (Id. ¶ 34.) For example, Defendants did not disclose the fact that Robert Baird was paid \$250,000 to conduct a valuation of RTI and that such valuation was based on incorrect assumptions given by Defendants Weil and Kiesel. (Id. ¶ 34(a) and (c).) Plaintiffs further assert that an earlier 2008 valuation provided the company was twice the valuation presented by Robert Baird. (Id. ¶ 34(b).) Plaintiffs also allege the proxy materials failed to disclose positive changes to the company in 2009. (Id. ¶ 34(d).) Other omissions and misrepresentations include lack of detail as to the equity interest that would go to Defendant Kiesel, or why the company needed to engage in self-interest with Parthenon. (Id. ¶ 34(f) and (h).) Plaintiffs allege that such information is of the type that a reasonable shareholder would consider important when deciding how to vote, and materially affected the total mix of information available to shareholders. (Id. ¶ 35.)

On June 9, 2009, Defendant Kiesel sent out supplementary information to RTI shareholders that was false and misleading. (Id. ¶ 36.) For example, Kiesel urged shareholders to read an attached letter from a law firm which stated it was appropriate to obtain releases from the common shareholders, that there was no IPO in 2006, and that RTI's proxy materials had included all material information. (Id.) Plaintiffs allege these statements were false, as Kiesel himself had participated in the 2006 IPO process, and knew that material information, such as positive changes in RTI's McDonald's contract, were not included in the proxy materials. (Id.)

In connection with the vote on the proposed merger/recapitalization, Defendants held an information meeting for shareholders on June 3, 2009. At this meeting, further misrepresentations were made concerning the valuation by Robert Baird - that Robert Baird would say a fair price range of RTI was between \$80 and \$100 million, thus the shareholders were getting more than the company was worth through the proposed merger/recapitalization. RTI had never been valued as low as \$80 million, however, and Defendant Grad misrepresented RTI's value in order to induce shareholders into falsely believing they were getting a good deal through the merger/recapitalization process. (Id. ¶ 37.)

Plaintiffs allege the merger/recapitalization was unfair and flawed in other respects. Defendants claimed to have appointed an independent committee of the RTI Board to evaluate the reasonableness of the recapitalization/merger, but the members of this committee all owned preferred stock and were not independent. (Id. ¶ 38.) One of the law firms that provided advice to this “independent” committee was Parthenon’s own counsel, that drafted the materials for the merger/recapitalization while simultaneously drafting a Management Services Contract for Parthenon. (Id.)

On May 22, 2009, Plaintiffs had asked for additional books and records, but such request was not met until the last minute, and that such production included over 300 pages. While the information showed the recapitalization/merger was grossly unfair, it was not produced in a timely manner before the vote. (Id. ¶ 39.) Requests to delay the vote were rejected by Defendants, because of “alleged” pressures from RTI lenders. (Id.)

At the time of the vote, Plaintiffs allege that the Defendants ignored what was put forth in the proxy materials - that if 10% of the common shareholders voted against the merger/recapitalization, it would not go through. (Id. ¶ 40.) Plaintiffs allege that nearly 40% of the common shares voted against the merger,

and less than a majority of the shares voted against recapitalization. (Id.) The merger nonetheless went through on June 24, 2009. (Id.)

Asserted Claims

Plaintiffs have brought a number of claims against Defendants, on behalf of themselves and others similarly situated. Generally, Plaintiffs allege that Defendants breached their fiduciary obligations as corporate officers and directors to be candid and forthright in their communications with shareholders and the duty of loyalty which prohibits officers and directors from engaging in self-dealing, such as usurping corporate opportunities and looting RTI for their own purposes. Plaintiffs also allege that Defendants tortiously interfered with the ability of others to carry out their fiduciary obligations. Finally, Plaintiffs allege Defendants engaged in an unfair merger process which involved the issuance of fraudulent and misleading offering materials. (Id. ¶ 12.)

Plaintiffs also seek a declaratory judgment that the merger/recapitalization process was unfair, should be declared void and rescinded. Plaintiffs also seek actual and consequential damages against Defendants, individually and jointly, and any other relief the Court deems just.

Standard for Motion to Dismiss

A. Dismissal Pursuant to Rule 12(b)(6)

In considering a motion to dismiss under Federal Rule 12(b)(6), the Court must accept “as true all of the factual allegations contained in the complaint, and review the complaint to determine whether its allegations show that the pleader is entitled to relief.” Schaaf v. Residential Funding Corp., 517 F.3d 544, 549 (8th Cir. 2008). Although detailed factual allegations are not needed, a plaintiff has the “obligation to provide the grounds of his entitlement to relief” requiring “more than labels and conclusions, and a formulaic recitation of the elements of a cause of action...” Bell Atlantic Co. v. Twombly, 550 U.S. 544, 555 (2007). The factual allegations made by a plaintiff must “raise a right to relief above the speculative level.” Id. If the plaintiff does not provide any set of facts that entitle him to relief beyond doubt, a motion to dismiss should be granted. Students for Sensible Drug Policy Found. v. Spellings, 523 F.3d 896, 899 (8th Cir. 2008).

In keeping with these principles a court considering a motion to dismiss can choose to begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth. While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations. When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.

Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950 (2009).

B. Dismissal Pursuant to Rule 12(b)(1)

Where a plaintiff does not have standing to assert the claims within the complaint, the Court does not have subject matter jurisdiction. Accordingly, such claims must be dismissed pursuant to Fed. R. Civ. P. 12(b)(1).

In order to properly dismiss for lack of subject matter jurisdiction under Rule 12(b)(1), the complaint must be successfully challenged on its face or on the factual truthfulness of its averments. In a facial challenge to jurisdiction, all of the factual allegations concerning jurisdiction are presumed to be true and the motion is successful if the plaintiff fails to allege an element necessary for subject matter jurisdiction.

Titus v. Sullivan, 4 F.3d 590, 593 (8th Cir. 1993) (citations omitted). In a factual challenge, the Court may examine evidence outside of the complaint. Id.

Plaintiffs bear the burden of proving that jurisdiction exists. Osborn v. United States, 918 F.2d 724, 730 (8th Cir. 1990).

Defendants assert that to the extent Plaintiffs base any of their claims on pre-merger conduct, such claims are derivative claims. A claim is derivative when the alleged harm is to the corporation, and the benefit from the lawsuit goes to the corporation. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004). Only current shareholders may bring derivative claims,

however. See Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 354 (De. 1988) (“To have standing to maintain a shareholder derivative suit, a plaintiff must be a shareholder at the time of the filing of the suit and must remain a shareholder throughout the litigation.”)

Although Plaintiffs allege in the Complaint that they currently hold common stock in RTI, Defendants assert that Plaintiffs, in fact, tendered their shares in RTI and did not become shareholders in the New RTI when they voted against the merger/recapitalization. (Langdon Decl. Ex. 2.) Because Plaintiffs are not current shareholders, Defendants argue they lack standing to assert derivative claims of RTI. Osborn, 918 F.2d at 730 (no presumptive truthfulness attaches to the complaint when deciding a Rule 12(b)(1) motion and disputed fact issues will not preclude the court from evaluating for itself the merits of jurisdictional claims).

Defendants thus ask this Court to dismiss Counts I-III and V-VI to the extent such claims are based on pre-merger conduct. Defendants further assert that Count IV should be dismissed in its entirety, as such claim is based solely on pre-merger conduct.

