

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

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

Civil No. 09-cv-02076 MJD/JJG

Plaintiffs,

**MEMORANDUM OF LAW
IN OPPOSITION TO
PLAINTIFFS' MOTION FOR
PUNITIVE DAMAGES**

v.

Restaurant Technologies, Inc.,
Parthenon Capital LLC, Jeffery R.
Kiesel, John C. Rutherford, Jonathan
O. Grad, Zachary F. Sadek, Phillip A.
Clough and Robert E. Weil,

FILED UNDER SEAL

Defendants.

INTRODUCTION

Plaintiffs would have the Court believe the money they invested ten years ago was pillaged by ravenous venture capitalists who wrongfully appropriated a valuable company for their exclusive benefit. Nothing could be farther from the truth.

The true story of Restaurant Technologies, Inc. ("RTI") is far less dramatic and far more common: a start-up company with a new idea reasonably sets out on a course of substantial growth—a course, as described below, that was charted by the very Plaintiffs now claiming to have been harmed—only to find that raising capital and incurring enormous debt has left it with limited alternatives for survival in a changed economic world and, unfortunately, with no value for those shareholders, like Plaintiffs, who were unwilling to continue investing when the company needed more capital. Indeed, during

the ten years of its existence RTI suffered cumulative losses of over \$143 million. As a result, RTI repeatedly ran through all of its capital and had to attract new equity to survive. When it was unable to fund operations from its original shareholders, RTI hired an investment banking firm who contacted a number of venture capital firms seeking to convince them to provide the funds it needed. Ultimately that process resulted in RTI's Board (which included two Plaintiffs, but no Defendant or representative of any Defendant) negotiating a series of agreements with Parthenon pursuant to which Parthenon made its initial investment—\$16 million of the \$47.2 million it ultimately invested in RTI—to provide RTI with badly needed capital. These agreements provided Parthenon with certain rights that were standard for an investment in a risky start-up like RTI. In addition, RTI repeatedly gave Plaintiffs and other common shareholders the opportunity to invest additional funds on the same economic terms as Parthenon, but Plaintiffs generally chose not to do so even though their ownership percentage obviously declined as a result.

Despite Plaintiffs' narrative to the contrary, the story of RTI is not one of greed and self-dealing but of Defendants' repeated funding of RTI's capital needs, good faith exercise of business judgment, and best efforts in challenging circumstances to create value for all shareholders. That the result of those good faith efforts has been constrained by economic realities is unfortunate, but it is not evidence of wrongdoing and certainly not the stuff of punitive damages.

Plaintiffs' exhibition of snippets of conversation and portions of documents, all taken out of context, then twisted and decorated with adjectives and adverbs, cannot alter

the essential truth. Whatever disappointments they have, however much they disagree with company decisions over the ten years, no matter how strong their belief they could have managed the company better, Plaintiffs were not the victims of any scheme.

Defendants did not take anything from them. Simply put, RTI never was, never became, and is not now as valuable as Plaintiffs hoped. Neither its performance nor the markets ever supported an IPO or sale at a high price. RTI has never been a gold mine for the venture capital investors who risked their capital and for their efforts now must defend themselves against accusations of self-dealing and deceit. Indeed, Parthenon's \$47.2 million investment over nine years was valued, as part of the recapitalization transaction Plaintiffs challenge, at only \$19.8 million. The essential truth is that all investors lost money—a lot of money—and none more than Parthenon.

Defendants will disprove Plaintiffs' claims on the merits at the appropriate time and in the appropriate motion. It is enough for now that Plaintiffs have not met their heavy burden to justify a claim for punitive damages. For one thing, they ignore the fact that the state law governing Defendants' conduct (that of Delaware for fiduciary duty claims and Massachusetts for common law claims) does not allow for punitive damages in a dispute such as this. For another, the actual evidence in the case, as opposed to the dark rhetoric in Plaintiffs' brief, shows that Defendants' conduct was not marked by deliberate disregard for the rights of others. In the absence of prima facie evidence of such deliberate wrongdoing, there can be no claim for punitive damages.

Plaintiffs have over-reached in an apparent attempt to gain strategic leverage. The Court should deny their motion to add a claim for punitive damages and leave the parties instead to focus on the merit—or lack thereof—of Plaintiffs’ claims.

STATEMENT OF FACTS

Plaintiffs’ motion is based on an unfounded conspiracy theory, an approach Plaintiffs are able to support only by reference to a patchwork of isolated, purportedly sinister statements they have taken out of context and twisted beyond their meanings.¹

As the Delaware Chancery Court has observed, however:

All corporate combinations leave in their wake certain artifacts—documents, e-mails, conversations, and notes. If one digs through enough of the rubble of a consummated merger, one will almost invariably find something questionable. A clever corporate archeologist can extrapolate from these suspicious artifacts and concoct a theory of malfeasance, disloyalty, and bad faith. Yet, theories alone cannot lead to liability.

In re Transkaroytic Therapies, Inc., 954 A.2d 346, 349 (Del. Ch. 2009). A fair assessment of whether punitive damages, an extraordinary penalty, is warranted requires context and far more of the truth than Plaintiffs have provided the Court.

The necessary context is set forth below.² It will make ineluctably clear that punitive damages are not warranted in this case.

¹ Plaintiffs seek punitive damages only against (1) Parthenon, a venture capital firm and RTI’s largest shareholder; (2) Mr. Grad, a managing partner of Parthenon and Parthenon’s designee on RTI’s board since 2006; (3) Mr. Sadek, an employee of Parthenon and Parthenon’s designee on RTI’s board since 2008; and (4) Mr. Kiesel, RTI’s CEO since July 2005.

² Because Plaintiffs chose to bring this motion well before the completion of discovery, Defendants have not yet had the opportunity to give their depositions. This Statement of Facts is based on the record elicited thus far—a record that belies the calculated misreading Plaintiffs attempt to impose.

I. RTI WAS A CAPITAL-INTENSIVE START-UP.

RTI is in the business of supplying bulk cooking oil management services to the foodservice industry through proprietary technology and a services-based solution to storing, using, and disposing of cooking oils. (Dkt. #11, Ex. 1 at 53.)³ RTI enters into exclusive long-term contracts with customers to install its system and periodically refill the new oil reservoir and remove waste oil through a specially designed delivery truck. (*Id.* at 53-54.) RTI generates revenues from selling cooking oil, servicing the equipment, and selling waste oil (“yellow grease”). (*Id.* at 54.) In 1999, when it became a stand-alone company, RTI was servicing approximately 275 independent restaurants. By 2009 it had grown into a national company servicing approximately 14,000 restaurants, including nearly 8,000 McDonald’s outlets, through 36 depots covering 42 of the country’s 50 largest metropolitan areas. (*Id.* at 53, 55.)

RTI’s business model requires it to purchase and install its proprietary system at each outlet, establish oil depots and purchase and operate a fleet of delivery vehicles. This requires extensive up-front working capital. Initially, RTI met its capital needs by selling common shares. Its founders marketed those shares to their families and friends and ultimately were able to raise approximately \$10 million. (Declaration of Michelle S. Grant (“Grant Decl.”) Ex. 1 at 25-28; Ex. 4 at 4.)

To fuel its growth the company became a voracious consumer of capital. In 2001, when the \$10 million raised through several offerings of common stock had been

³ Dkt. #11 contains the Proxy Statement Offering Memorandum dated May 13, 2009.

exhausted, the company considered all potential sources of financing, including additional equity and debt.

II. RTI RAISED CAPITAL BY ISSUING PREFERRED SHARES.

After extensive consideration and consultation with financial experts, RTI's board decided that the best alternative for obtaining the capital necessary to pursue the growth strategy they believed, in the exercise of their business judgment, to be best for the company and its shareholders was through the issuance of preferred shares. An investment banking firm retained by RTI, William Blair & Company ("Blair"), then interested Parthenon in the offering.

Among those who approved the preferred shares offering were named Plaintiffs Tate, who served on the board, and Shuster, who as a large shareholder was asked to expressly approve it. (Grant Decl. Exs. 5 & 6.) The decision they made turned out to dictate the company's future course of leveraged growth and a concomitant capital structure—the very course Plaintiffs now contend to be an evil scheme perpetrated on them by Parthenon and its agents.

On terms that even Plaintiffs concede to be typical for venture capital financing of risky start-up companies, Parthenon invested approximately \$16 million in Series A-1 preferred shares. (Grant Decl. Ex. 1 at 34-35; Ex. 2 at 48; Ex. 3 at 22, 39.) Among other things, RTI's board and major shareholders agreed to give Parthenon a liquidation preference together with an accretion rate on the preferred shares that, when the company was sold (an event everyone hoped would occur within just a few years (Grant Decl. Ex. 1 at 34; Ex. 4 at 5-6)), would cause the rate of return on the A-1 shares to have grown at a

compounded rate of 20% per year. (Grant Decl. Ex. 7 at Art. IV, § 3(d)(ii).)⁴ The board and the major shareholders also agreed to give Parthenon the right to designate three members of RTI's then seven-member board and, if RTI ever failed to meet certain financial projections, the right to assume majority control of the board. (Grant Decl. Ex. 8 at § 1.2.)⁵

As was also typical of such financings, the preferred shareholders were given the right to restrict the issuance of additional securities, financings, mergers, acquisitions, sales or other dispositions of assets so that such transactions could occur only with their consent. (Grant Decl. Ex. 9 at Art. VI.) The governing documents, the Securities Purchase Agreement and the Stockholders Agreement, also provided—once again, as is typical for such transactions—that the future exercise by Parthenon of any of its rights under the agreements would not constitute a lack of good faith, a breach of fiduciary duties or unfair dealing. (Grant Decl. Ex. 8 at § 6.3; Ex. 9 at § 9.8.)⁶ Finally, the board and the major shareholders agreed to give Parthenon the right to purchase an additional round of preferred shares (“warrants”) with the same liquidation preference and accretion rate. (Grant Decl. Ex. 5.)

⁴ In the event of an IPO as opposed to a sale, the preferred stock would be converted to common stock, but only if the gross proceeds from the IPO were at least \$35 million and the price per share was at least \$64 per share, which would have been two times the highest initial value of the preferred shares. In any event, the issuance of new shares in connection with an IPO would have required the consent of the preferred shareholders. (*Id.* at § 3(e)(viii) and (ix).)

⁶ All putative class members who hold Series A stock, including Evanson, are parties to the Stockholders Agreement.

At the time of Parthenon's initial investment, shares of the Series A-1 also were offered to all existing shareholders as well as to new potential shareholders; some common shareholders, as well as several new investors including Mr. Evanson, bought these shares. (Grant Decl. Exs. 9-10.) Parthenon's large investment gave it a 43.1% ownership stake in the company. Those common shareholders, including Plaintiffs Tate, Shuster and Ayers, who chose not to participate had their equity ownership diluted.

In late 2002, when the company needed additional financing, Parthenon exercised the warrants and invested another \$5 million (the Series A-2 round). Both Tate and Shuster expressly approved of the Series A-2 round. (Grant Decl. Ex. 11-13.) Parthenon also waived its right to assume majority control of the board when the company failed to meet its projections in late 2002. (Grant Decl. Ex. 14 at 56.) In connection with the exercise of warrants, all existing shareholders were offered the opportunity to purchase common stock at the same price. (*Id.*) Parthenon itself purchased \$2 million in common stock and became one of the largest shareholders of common stock. (*Id.*) Its ownership stake grew to 49.7%.

RTI used the proceeds from the Series A-1 and A-2 issuances to finance its rapid growth. It acquired equipment and delivery vehicles, it hired a sales force, it built depots in several parts of the country, and it paid the costs of buying and installing its system in restaurants. The company focused on developing a relationship with McDonald's and with a variety of local, independent restaurants. Although by the end of 2002 Mr. Tate and Mr. Shuster had ceased any formal role with the company, both of them continued to stay in close contact with company officers and board members. (Grant Decl. Ex. 1 at

67-68; Ex. 2 at 72-76.) In that context, they regularly offered opinions and received information regarding the company's plans and prospects. (*Id.*)

At the time it sought capital from Parthenon in 2001 and from that time onward, RTI attempted to project how much it would grow and how profitable it would become. Management, however, consistently offered projections that turned out to be too rosy. Indeed, results often fell woefully short of management's projections. For example, in the offering memorandum that RTI provided to Parthenon and other investors in 2001, the company projected it would achieve net income (that is, profitability) by 2004. (Grant Decl. Ex. 4 at 7.) Six years later, the company still has yet to achieve net income for any year and has accumulated losses of \$143 million through 2009. (Grant Decl. Ex. 15 at 16.) Similarly, the company projected 25,000 customers by the end of 2006. (Grant Dec. Ex. 4 at 2.) Even today the company only has 14,000 customers, well below those early projections. (Dkt. #11, Ex. 1 at 55.)

Plaintiffs concede the issuance of the Series A-1 and A-2 preferred shares was in the company's best interests. (*See* Am. Compl. ¶ 30.) What they choose not to acknowledge, however, is that the terms on which those shares were sold, terms which became contractual rights evidenced in the company's certificate of incorporation, meant that for the common shares to continue to have value the company needed to grow its revenue—and its profitability—so that there would be money left after the preferred shares, the value of which was growing every year with the accretion right, were paid out upon a sale. The longer it took for that to happen, the more the value of the preferred

shares would grow and the more the size of the acquisition price would have to grow for the common shares to have any value.

III. RTI'S GROWTH STRATEGY DICTATED A NEED FOR MORE WORKING CAPITAL THROUGH LOANS AND ADDITIONAL PREFERRED OFFERINGS.

To build out its business (including the many oil depots a national presence required), RTI required substantially more capital than the initial equity offerings could provide. The company accordingly pursued, on a basis its then CFO John Ruelle described as nearly continuous, debt financing from various sources. (Grant Ex. 3 at 66, 66-68; Ex.16 at 5.) RTI financed its vehicles through manufacturers and much of its equipment through sellers. (Grant Dec. Ex. 3 at 66-67.) Working capital came from loans, for which RTI had to pledge its receivables and other assets. (*Id.*) In every case, RTI's continuing inability to meet its financial projections adversely affected its ability to obtain capital, decreasing the amount readily available and increasing the cost of what it could obtain.

In late 2003, RTI's board (on which Parthenon still had only three of seven seats) decided, after again receiving advice from Blair, to issue another round of preferred shares (Series A-3). (Grant Decl. Ex. 16.) The board considered this the best means available in the circumstances to raise the additional capital the company's growth required. (Grant Decl. Ex. 3 at 61.) The company determined that if it were to slow its growth rate it could achieve net income profitability and become cash flow positive sooner, but believed the long term business opportunity supported an accelerated rollout plan. (Grant Decl. Ex. 16 at 3-4.) Because Parthenon did not wish to increase its stake in

the company and in an effort to get the most attractive price possible, Blair presented the offering to several venture capital firms. (Grant Decl. Ex. 17.) ABS Capital presented the best offer and invested \$13 million; Parthenon invested an additional \$9.9 million. (Grant Decl. Ex. 18 at 37-38.) Parthenon's ownership fell to 46.5%.

In exchange for their investments in the A-3 shares, Parthenon and ABS each received the right to designate a board member (giving Parthenon the right then to designate four of the board's seven members) and to received the same liquidation and accretion rate that the earlier preferred shares carried. (Grant Decl. Ex. 19 at § 1.2; Ex. 7 at Art. IV, § 3(d)(ii).)⁷ Although under the Stockholders Agreement Parthenon could declare any offering to be exempt, and not offer it to other shareholders, (Grant Decl. Ex. 19 at § 2.5), it agreed that the same financial terms be offered to all shareholders as well as to new potential shareholders; a very few common shareholders purchased A-3 shares. (Grant Decl. Ex. 18 at 38-39.) Those common shareholders who chose not to participate in the offering, including Plaintiffs, had their equity ownership diluted proportionately.

IV. RTI'S PURSUIT OF CONTINUED GROWTH: THE ONLY MEANS FOR SUCCESS.

Plaintiffs concede that the issuance of the Series A-3 shares also was in the company's best interests. (*See* Am. Compl. ¶ 30.) They avoid discussing, however, the

⁷ The additional board seat obtained by Parthenon went to Mr. Grunewald, who was a large common shareholder and had been on the board since 2000 as a designee of the common shareholders. (Grant Decl. Ex. 19 at § 1.2.) Prior to his appointment to fill a Parthenon-designated board seat, Mr. Grunewald was not affiliated with Parthenon in any way and Parthenon only came to know him as a result of his membership on the board of directors at the time of Parthenon's initial investment. Parthenon's only relationship with Mr. Grunewald has been as a director of RTI.

impact of those terms on the capital structure of the company and, in particular, on the common shares. As before, investors willing to risk their money to keep RTI in business and to help it continue to grow acquired the contractual right to be first in line for payment and to have their shares grow in value. Accordingly, the longer it took for the company to achieve the returns and the stability necessary to make itself an attractive candidate for purchase (either through a sale or IPO), the higher its value would have to be for the common shares to achieve any return.

At the same time, the capital raised through these early equity offerings was not sufficient to fuel the increasing growth necessary to the company's survival and to fund operations. This meant the company had to increase its debt as well, which increased debt service payments which, in turn, required an increase in cash flow to fund them. Indeed, by the time it issued the A-3 preferred shares in February 2004, RTI's debt exceeded \$25 million. (Grant Decl. Ex. 20 at 2.)

During 2004, the company raised \$28.5 million of external financing to fund debt service of approximately \$5 million, growth of \$14.6 million, cash used in operations (excluding interest) of approximately \$4.0 million and maintain a solid cash position for future growth. (*Id.* at 5.) The company generated approximately \$1 million of EBITDA during 2004 and based on the net debt and accreted value of the preferred stock at the time, the company's enterprise value would have had to be more than approximately \$93 million—or a multiple of 93 times EBITDA—for the common shares to have value. (*Id.* at 3.) The growth, and the financing to fund that growth, was therefore necessary to achieve EBITDA levels that would return any value to the common shareholders.

It was in this circumstance that Parthenon found itself, after having invested nearly \$33 million in three years, owning approximately 45.6% of RTI and having the right to designate a majority of its board. Contrary to what Plaintiffs' theory presumes, this point in time did not become a line of demarcation. In fact, the RTI story from this point forward is in many ways the same as that which came before—and was largely dictated by what came before: although RTI hired a new CEO in July 2005, Mr. Kiesel, who had a different management philosophy and a more national chain restaurant-oriented strategy than his predecessor, the company continued the growth dictated by its earlier financing decisions, continued to incur additional debt and continued to raise additional equity capital.⁸ It also continued to miss its financial projections, adversely affecting its ability to obtain capital.

By December 2005, when RTI, on the advice of its investment bankers, again sought more equity capital, the company's existing investors were justifiably skeptical about the projections provided in conjunction with the capital raise. As such, to raise \$10 million, \$4.4 million of which came from Parthenon, RTI had to offer for its Series A-4 shares not only a liquidation preference but an accretion rate of 27.5%, which would be adjusted downward if the company achieved its projections (thus aligning the investors' interests with those of the company). (Grant Decl. Ex. 22; Ex. 7 at Art. IV, § 3(d)(ii).) In conjunction with that Series A-4 offering the company expanded its board to nine members, of which Parthenon obtained the right to designate five members. (Grant Decl.

⁸ The former CEO, Mr. Plooster, who had founded the company, remained as President through 2008. Mr. Shuster was unhappy and wrote a letter to the board complaining about this management change. (Grant Decl. Ex. 21.)

Ex. 23 at § 1.2.) As in the earlier offerings, Parthenon allowed the same financial terms to be offered to all shareholders; several common shareholders and some new investors purchased those shares. (Dkt. #11, Ex. 1 at Ex. F.) Parthenon's ownership stake in the company dropped to 45.1% and those common shareholders who chose not to participate, including Plaintiffs, had their equity ownership again diluted proportionately.

In 2006 the company was able to refinance its primary debt obligation and to obtain a larger loan through Sankaty Financial Advisors, LLC and MCG Capital, LLC. This enabled the company to acquire more capital without having to further dilute existing shareholders' equity. By then, RTI's total debt stood at over \$33 million. (Grant Decl. Ex. 24 at 2.) Sankaty and MCG drove a hard bargain, imposing high interest rates and more demanding covenants in exchange for the larger loan, but the company considered the terms sufficiently acceptable to obtain the capital it needed to pursue the growth necessary to achieve profitability. (Grant Decl. Ex. 25.)

That same year, the company met with several investment bankers for exploratory discussions about a potential IPO. A few investment banking firms offered a preliminary, indicative valuation of RTI based on the company's own overly optimistic financial forecasts and the favorable market conditions during that period. (Grant Decl. Ex. 26.) It became clear, however, that once again the company would not meet its own forecasts and did not have enough national accounts at the time. (Grant Decl. Ex. 3 at 123-124.) This undermined the basis for the earlier preliminary valuations and eliminated the possibility of a successful offering. As a result, the company never retained any investment banking firm or law firm to begin work on an IPO. (*Id.*) Instead,

the company decided it needed to improve its own operations and finances. Later in 2007, Mr. Kiesel and Mr. Ruelle, the company's longtime CFO, decided that because of their differences it was best that Mr. Ruelle leave the company. (*Id.* at 232.)

The departure of Mr. Ruelle upset Tate and Shuster, who complained to the board. (Grant Decl. Exs. 27-28.) Upon learning of their dissatisfaction, RTI's long-time chair (Mr. Larson) and a Parthenon principal (Mr. Rutherford, who was not a board member at the time) met with Tate and Shuster to discuss their concerns. Plaintiffs were not mollified, however, and continued to express their extreme dissatisfaction with the business course charted by management and the board. (Grant Decl. Ex. 29.)

V. RTI ATTEMPTS A SALE IN 2008 AND ENCOUNTERS SEVERE FINANCIAL DIFFICULTIES.

In early 2008, the new CFO, Mr. Weil, discovered that because of the way certain expenses initially had been accounted for by the previous CFO, the 2007 financial statements would have to be materially adjusted. (Grant Decl. Ex. 30.) This came as a shock to management and the board; it also exacerbated the extent of the margin by which the company had yet again missed its financial projections for the year.

The necessary adjustments erased nearly \$1.5 million in EBITDA and left the company in violation of debt covenants with its senior lenders, Sankaty and MCG. (Grant Decl. Ex. 31 at 12.) These lenders then demanded and received more onerous terms, including a higher interest rate, in exchange for forgiving the defaults, modifying the covenants and extending additional funds. (*Id.* at 12-13; Ex. 32.)

RTI's debt service burden accordingly became even more substantial. This in turn required RTI to pursue further growth to generate sufficient cash flow to make the increasingly large interest payments. And the increased level of debt ate into the equity in the company, affecting those shareholders lowest in the capital structure—the holders of common shares—the most.

The additional funds Sankaty and MCG provided in early 2008 were not sufficient to meet the company's growth needs. This prompted the board to decide in March 2008, after retaining the Blair investment banking firm for assistance, that the best available alternative was to issue more equity in the form of Series B-1 preferred shares. Parthenon agreed to invest \$3.9 million at a higher price per share, but with a steeper accretion rate. (Grant Decl. Ex. 33; Ex. 7 at Art. IV, § 3(d)(i).) Blair told the board that given the company's financial condition those terms were fair. (Grant Decl. Ex. 34.)

Parthenon made clear that it had no desire to increase its investment in the company and was only participating in this round of financing at the request of the company. (Grant Decl. Ex. 35.) Without this participation, the company would have been crippled and would have faced a substantial risk of insolvency. (*Id.*) As in the earlier offerings, Parthenon allowed all shareholders to invest on the same financial terms; a number of common shareholders chose to purchase shares. (Grant Decl. Ex. 36;

Dkt. #11, Ex. 1 at Ex. F.)⁹ Those common shareholders, like Plaintiffs, who chose not to participate had their equity ownership diluted proportionately. Parthenon's stake in the company fell to 43.8%.

To make matters worse, in May 2008, Cargill, the company's oil supplier, notified RTI that because of RTI's continued financial losses and weak balance sheet, RTI was no longer satisfying Cargill's credit requirements. (Grant Decl. Ex. 37.) Cargill required RTI to provide it with an irrevocable letter of credit in the amount of \$7.5 million within two weeks. (*Id.*) RTI was able to negotiate it down to \$5 million. (*Id.*) Parthenon pledged most of the money for the letter of credit, which could have been drawn upon if RTI failed at any time to make payments to Cargill within 20 days. (*Id.*) It did so at a 1% interest rate that is not payable until a change of control of the company. (*Id.*) Had Parthenon not voluntarily agreed to do so, the company's financial survival would have been jeopardized.

By that time, RTI had retained Blair to evaluate its strategic alternatives. (Dkt. #11, Ex. 1 at i.) The board decided that pursuing a sale of the company was in the best interests of the shareholders. It commissioned Blair to run a robust sales process, which

⁹ Although Parthenon had the opportunity to purchase these shares a few months before the remaining shareholders, this was due to the company's emergency need for cash and in accordance with the Stockholders Agreement, which allowed such advance issuances so the company could obtain capital in desperate circumstances. (Grant Dec. Ex. 23 at § 2.6.)

it did. Blair solicited nearly 200 prospective acquirers and provided further information to the 27 who showed any interest. (Dkt. #11, Ex. 1 at ii.)¹⁰

The process resulted in two preliminary bids in early October 2008, [REDACTED], each of which was conditioned due diligence and further negotiation. (Grant Decl. Ex.38.) As it turned out, neither bid led to fruition: world credit markets collapsed in mid-October, leaving no financing available to bidders.

[REDACTED] (Grant Decl. Ex. 39.) As a result of these events, by the end of October 2008 the company terminated its auction process. (Grant Decl. Ex. 40.) That same month, the company borrowed the remaining \$5 million available under its agreement with Sankaty and MCG. (Grant Decl. Ex. 31 at 13.)

It was in this context that company officers and board members reached the conclusion that the common shares had become essentially valueless. Because of the passage of time and the level of debt the company had incurred, the contractually-dictated capital structure waterfall upon a liquidation event simply would never reach the common shareholders; in fact it would only partially cover the amount owed to the holders of the Series A shares (of which Parthenon itself owned the majority). This was so because at the end of 2008, RTI had \$114 million in debt and nearly \$200 million in accreted equity.

¹⁰ In the B-1 offering memorandum provided to all shareholders in May 2008, the company informed shareholders it had engaged Blair to pursue a sale of the company. (Grant Decl. Ex. 36 at 23-24.) It also explicitly stated that sale proceeds would have to be at least \$265 million for common shareholders to receive any distribution. (*Id.*)

In accordance with the terms of its certificate of incorporation, a sale of the company would have had to generate more than \$314 million to provide common shareholders with any value. (Grant Decl. Ex. 31 at 2.)

This stark reality led Mr. Kiesel, at the request of Mr. Larson and Grunewald, two large common shareholders, to confirm in writing that the shares were valueless and could be forfeited to RTI if holders wished to take a tax write-off for 2008 on their shares. (Grant Decl. Ex. 41.) Upon receiving this letter from Mr. Kiesel, certain of the named Plaintiffs as well as several other common shareholders complained that the common shares *must* have value. (Grant Decl. Exs. 42-43.)

In the fourth quarter of 2008, however, RTI encountered even more significant cash flow problems. The company experienced an unprecedented volatility in yellow grease prices, which dropped almost \$0.30 in three months, hitting a low of \$0.11 per pound in December 2008. (Grant Decl. Ex. 44 at 3.) This translated into a material revenue loss. At the same time, the economic crash led RTI's customers to slow payments considerably and, in the case of some, to default entirely, which led to substantial write-offs and a cash liquidity crisis. (*Id.* at 4) RTI's actual EBITDA for the year came in at less than half of what the company had projected—and told its lenders. (*Id.*) The result was that for the second time that year, RTI found itself in violation of debt covenants with its lenders and in dire need of additional cash. (Grant Decl. Ex. 31 at 13.)

By late December, the board began considering strategic alternatives to address the situation and undertook efforts to negotiate with the lenders to cure the default. In the

meantime, Parthenon invested an additional \$3.6 million in Series B-2 shares, which the company desperately needed to meet immediate working capital needs and the February 2009 interest payment on its debt, and facilitated the retention of efficiency consultants to help the company reduce its cost structure. (Grant Decl. Exs. 45-46.)¹¹

Sankaty and MCG told the company it needed a large infusion of equity to cure the default. (Dkt. #11, Ex. 1 at i.) By early 2009, they demanded weekly conference calls with management to receive reports of what management was doing to address the situation and, in particular, to find a source for the additional equity. (Grant Decl. Ex. 47.) The lenders threatened to pursue their rights, including the right to make RTI pay off its entire debt at once (which was impossible given the company's low cash flow). Affidavit of Robert E. Weil ¶ 9 (Dkt. #75.) Were the lenders to have done so, the company would have been required to pursue a restructuring or liquidation in bankruptcy.

VI. A SPECIAL COMMITTEE DETERMINES THAT A RECAPITALIZATION MERGER IS THE BEST ALTERNATIVE AVAILABLE.

Against the backdrop of the poor credit markets and economy, the lenders' demand for more equity before they would waive the covenant defaults, and the fact that the company was not worth enough to leave the common shares with any value (and even the Series A shares with much value), Parthenon worked with management, including Messrs. Weil and Kiesel, to create an economic model to fairly value the company.

¹¹ The board required—and Parthenon agreed to—a sunset on the ability to convert the shares to any new equity issued by the company. The board also stated its intention to offer the Series B-2 preferred shares to all shareholders at a later date, which was done as part of the Recapitalization Merger. (Grant Decl. Ex. 45.)

(Grant Decl. Ex. 48.) That model took into consideration the much changed credit and equity markets and more realistic financial projections for RTI's performance in 2009 and beyond. It showed that the company was worth only approximately \$140 million, which after payment of all debt was far less than enough to repay the original amount Parthenon (and the other investors in the preferred shares) had invested in the company (even without any accretion) and far below the amount necessary to provide any value to the common shareholders. (Grant Decl. Ex. 49 at 27.) The valuation was consistent with, indeed more positive than, the internal valuations Parthenon and ABS had done. (Grant Decl. Exs. 50-51.)

Having determined the company was not worth nearly what it had already invested, Parthenon—which was under no obligation to make any additional investment—concluded that to recover some value it would be willing to provide the additional equity capital the lenders were demanding, thereby avoiding a bankruptcy or other liquidation, but only on conditions it believed appropriate to reduce the likelihood of even further losses.

Parthenon thus was willing to put in additional equity, but only if there was a recapitalization of RTI's equity structure. (Dkt. #11, Ex. 1 at i.) This recapitalization involved the merger of a subsidiary into RTI and the issuance of common stock and a new class of preferred stock by the surviving entity. To determine the value that each shareholder received in the new entity, the \$140 million enterprise value was divided among the existing classes of stock. The Series B-2 stock was converted into the new class of preferred stock with a much lower accretion rate—8%. (*Id.* at 33). The Series B-

1 (in which Parthenon and other shareholders participated) was converted into common stock at its accreted value (the \$9.1 million invested had accreted to \$12.2 million). (*Id.* at 15-16.) Going forward, these shareholders will no longer receive any preference or accretion. The Series A shareholders were given common shares in the surviving entity at approximately 5% of accreted value. (*Id.*)

The common shareholders were given the choice of receiving: (1) common shares in the surviving entity on a stepped down basis (representing in the aggregate 2% of the recapitalized value of the equity), (2) cash equal to \$.13 per share, or (3) warrants. (Dkt. #11, Ex. 1 at 17.) The allocation of any value at all to common shares represented a pragmatic effort to assuage what everyone understood would be the disappointment of the common shareholders and to lessen the probability that some of them might choose to sue (as many had already sent letters complaining about the company's and Parthenon's actions). The intent of the warrants, which were the equivalent of options having value only if the company was sold at a sufficiently high price that the pre-recapitalization waterfall covered the common, was to allow common shareholders to maintain, if they so desired, a substantially similar position in the company to what they held before the recapitalization. (Dkt. #11, Ex. 1 at 17-18.) If Plaintiffs believed the company was worth more than the recapitalization value, they could have chosen these warrants and maintained their position. They chose not to.

Contrary to Plaintiffs' assertion, the company did not label the recapitalization a liquidation event under its certificate of incorporation. If that were the case, the common shareholders would not have received anything. Rather, the transaction terms were

negotiated among RTI, Parthenon, ABS, and the lenders; ultimately, the final terms were those the company's largest shareholders required before they would invest the additional money the lenders demanded be put into the company. (Dkt. #11, Ex. 1 at i.)

The board designated a special committee comprised of Mr. Kiesel and two long-time members not affiliated with Parthenon (Mr. Larson, who was the largest common shareholder, and Mr. Grunewald, who also held common shares) to decide whether the proposed transaction was in the shareholders' best interest. After careful study and some (admittedly mostly unsuccessful) negotiations over various terms (Grant Decl. Ex. 52.), and after obtaining an independent investment banking firm's confirmation that the enterprise value the company had calculated for purposes of the recapitalization was fair (Grant Decl. Exs. 53-54), the special committee recommended proceeding with the proposed recapitalization merger transaction and the issuance of new Class Z preferred shares (together, the "Recapitalization Merger"). (Grant Decl. Ex. 55.) At the same time, and contingent on the new infusion of equity into the company through the Class Z shares and a commitment by those purchasing Class Z shares to invest \$4 million of additional capital if required, Sankaty and MCG agreed to amend the lending agreement, waiving the previous defaults. (Grant Decl. Ex. 63.)

The special committee considered consummating the Recapitalization Merger by written action of the majority shareholders, which could have been done given Parthenon's and ABS's ownership of the majority of outstanding shares, but decided it best to have all shareholders vote on the transaction. Its goal was to educate shareholders sufficiently so they understood, and accepted, the economic reality that all of them were

going to lose money and that those who had not continued to finance the company's efforts (and held only common shares) would lose most of their investment. (Grant Decl. Ex. 56.)

On April 25, 2009, the board concurred that the Recapitalization Merger be put to shareholders for a vote on June 12, 2009. (Grant Decl. Ex. 57.) In the board's view, by providing both new equity and the opportunity to cure the defaults, the Recapitalization Merger would enable the company to remain under the control of its shareholders, rather than the lenders.¹²

On May 13, 2009, RTI provided a Proxy Statement Offering Memorandum to all shareholders describing the Recapitalization Merger. (Dkt. #11, Ex. 1.) The Proxy explained the circumstances in which RTI found itself and the board's reasoning in supporting the proposed transaction. As the Proxy explained, in accordance with the terms of RTI's certificate of incorporation, a sale of the company would by then have had to generate more than \$332.9 million (excluding any brokerage and legal fees) to provide common shareholders with any value. (Dkt. #11, Ex. 1 at i.)¹³ In response to a later books and records demand from disaffected common shareholders who had retained

¹² In late April 2009, Parthenon voluntarily invested an additional \$2.4 million to fund the company's operations, including its May 2009 interest payment, until the Recapitalization Merger closed. (Grant Decl. Ex. 58 at RTI037543.)

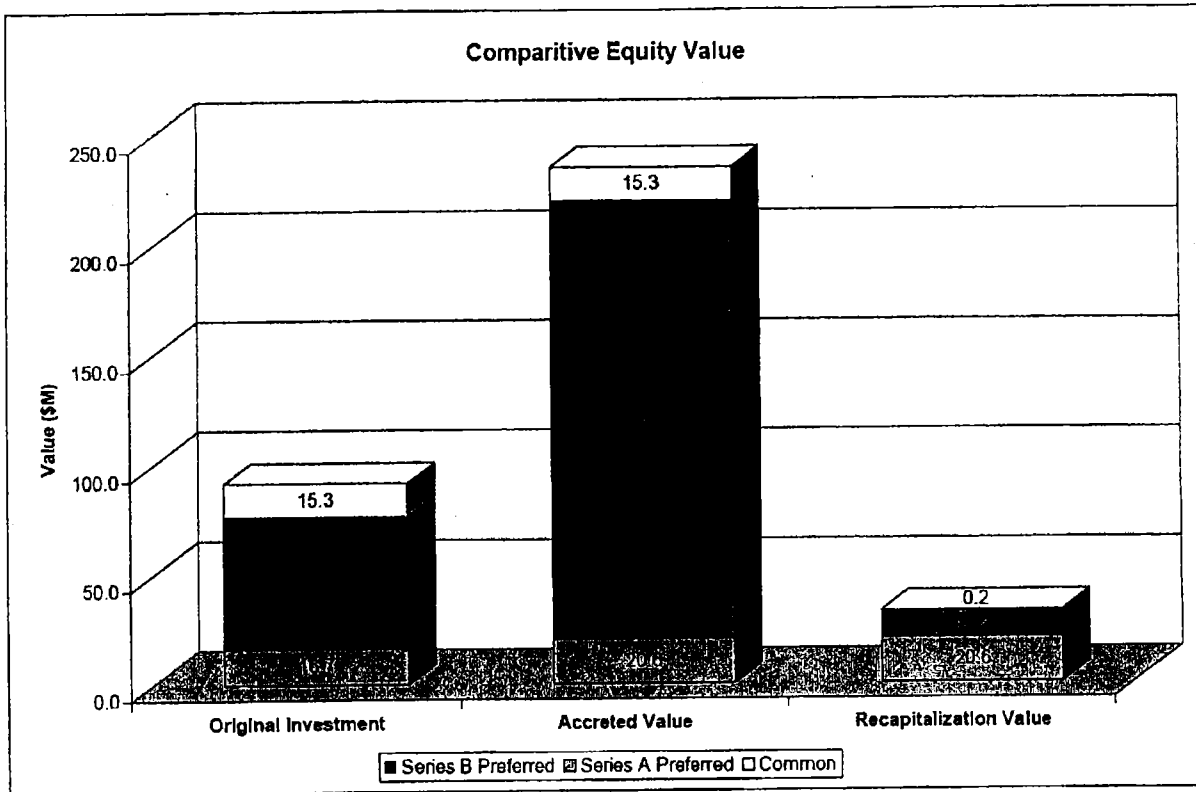
¹³ Even if only the Series A-1, A-2 and A-3 shares are considered—all of which Plaintiffs concede to have been in the company's best interest and none of which are being challenged in this lawsuit—and the Series A-4, B-1 and B-2 investments completely ignored, a sale of RTI still would have had to generate more than \$289 million before common shareholders would receive any money. (Dkt. #11, Ex. 1 at i.)

counsel, including Plaintiffs here, the company produced thousands of pages of documents. (Grant Decl. Ex. 59.)

In early June, RTI held an informational meeting for shareholders at which, consistent with the Proxy, management presented details regarding RTI's financial circumstances and answered questions. (Grant Decl. Ex. 49.) Throughout this period, the weekly calls with the lenders continued and the company faced relentless pressure to consummate the transaction.

The transaction was approved by approximately 86% of all shareholders. (Grant Decl. Ex. 60.) Although RTI had the right pursuant to Section 5.02 of the Merger Agreement to reject the transaction if more than 10% of the common shareholders dissented, it chose to waive that right, and proceeded on June 24, 2009 to close the transaction. (Grant Decl. Ex. 61.) All assenting preferred shareholders (save for Series B-2), and those common shareholders who wished (instead of receiving cash or warrants), became common shareholders of the new entity. Under the new capital structure Parthenon's ownership stake in the company became 62.5%. Parthenon's ownership interest would have remained at approximately 45% if all shareholders had been willing to continue to invest in the company alongside it.

The dollar impact on the various classes of shareholders was dramatic:



Mr. Larson lost over \$2 million; Mr. Grunewald lost \$125,000; Mr. Kiesel lost money on his preferred shares and all of his incentive plan grants. Parthenon lost its \$2 million invested in common shares and 78% of its original \$35.3 million invested in Series A shares.

VII. RTI'S CURRENT STATUS.

In 2009, RTI came close to meeting, for the first time, its (more realistic) financial projections. (Grant Decl. Exs. 15 & 48.) As a result, and based on advice from its investment banking firm regarding the improvement in the credit and equity markets and the fact that the company's debt will come due in early 2012 and should be refinanced while the credit markets are strong, RTI's board has decided to attempt, once again, to sell the company. (Affidavit of Kenneth D. Larson ¶¶ 2-3 (Dkt. #76.) It has engaged

Blair to advise it and to assist in the process. (*Id.*) [REDACTED]

[REDACTED]

[REDACTED]

ARGUMENT

Plaintiffs' request to add a claim for punitive damages should be denied because this extraordinary remedy is not available under applicable law. Plaintiffs assume that Minnesota law applies, but they are mistaken. As shown below, Delaware law, which applies to Plaintiffs' fiduciary duty claims, does not award punitive damages for such claims, making Plaintiffs' request futile. Similarly, Massachusetts law, which does not allow punitive damages for common law claims, applies to Plaintiffs' claims against Defendants Parthenon, Grad and Sadek and thus renders Plaintiffs' request futile. Even under Minnesota law Plaintiffs' motion should be denied because they have not established a prima facie case of "clear and convincing evidence" that Defendants acted with "deliberate disregard for the rights or safety of others." Minn. Stat. § 549.20.

I. PLAINTIFFS' MOTION TO AMEND IS FUTILE UNDER APPLICABLE LAW AND SHOULD BE DENIED.

A. This Court Must Deny the Motion to Amend If It Seeks to Assert Futile Claims.

This Court must deny a motion to amend when the proposed amendment would be futile. *See, e.g., Seelye v. Fisher*, Civ. No. 06-2848, 2007 WL 951604, at *7 (D. Minn. March 29, 2007). Where punitive damages are unavailable on particular claims as a matter of law, this Court has denied a plaintiff's request to amend to seek such relief. *See, e.g., In re Lutheran Bhd. Variable Ins. Pro. Sales Practice Litig.*, No. 99-MD-1309,

2004 WL 909741, at *7 (D. Minn. Apr. 28, 2004) (denying plaintiffs' motion to amend in connection with a Minnesota Consumer Fraud Act claim because punitive damages were not available under that cause of action). As shown below, Plaintiffs' motion to amend is futile because under applicable law, punitive damages are not available.

B. Plaintiffs' Motion to Amend to Add A Punitive Damages Claim In Connection With Their Breach of Fiduciary Claims Against All Defendants is Futile Under Delaware Law.

1. Under Delaware Law, Punitive Damages Are Not Available for Breach of Fiduciary Duty Claims.

Breach of fiduciary duty claims under Delaware law are considered equitable claims that must be brought in the Chancery Court "without possibility of punitive damages." See *Albert v. Alex. Brown Management Services*, Nos. C.A. 04C-05-250, C.A. 04C-05-251, 2004 WL 2050527, at *6 (Del. Super. Ct. Sept. 15, 2004). The Chancery Court has repeatedly concluded that it does not have the authority to award punitive damages. See *Beals v. Washington Int'l, Inc.*, 386 A.2d 1156, 1159-60 (Del. Ch. 1978) (concluding that it did not have authority to authorize an award of punitive damages for a breach of fiduciary duty); *In re Tri-Star Pictures, Inc. Litig.*, CIV. A. No. 9477, 1990 WL 82734, at *8 (Del. Ch. June 14, 1990) ("[p]unitive damages are not recoverable in equity"); *Xperex Corp. v. Viasystems Techs. Corp., LLC*, Civ. A. No. 20582-NC, 2004 WL 3053649, at *4 n. 13 (Del. Ch. July 22, 2004) (describing a party's counterclaim seeking punitive damages in the Chancery Court as "frivolous"). Indeed, Defendants have not found a Delaware case awarding punitive damages against controlling shareholders or officers and directors for breach of fiduciary duty.

2. Because Delaware Law Applies to the Fiduciary Duty Claims Alleged Against Defendants, the Amendment Would Be Futile.

As Plaintiffs appear to agree, and the Court has already decided, Delaware law applies to the merits of Plaintiffs' fiduciary duty claims.¹⁴ See, e.g., Pl. Memo. at 30-31; Memo. Opinion and Order (Docket No. 54) at 17-22. Application of Delaware law is consistent with the long-recognized Minnesota rule that the rights of a company's shareholders are governed by the law of the company's state of incorporation, which for RTI is Delaware. See *Erickson-Hellekson-Vye Co. v. A. Wells Co.*, 15 N.W.2d 162, 168 (Minn. 1944). Because Delaware law governs the merits of Plaintiffs' fiduciary duty claims, it should also govern the availability of punitive damages for such claims. See *Rupp v. Thompson*, No. C5-03-347, 2003 WL 24176126, at *12 (Minn. Dist. Ct. Oct. 30, 2003) (because the company was incorporated in Colorado, "Colorado law will therefore ultimately determine the acts, if any, for which Plaintiffs may recover punitive damages and the measure of such damages"); cf. *Minnesota Pet Breeders, Inc. v. Schell & Kampeter, Inc.*, 843 F. Supp. 506, 519 (D. Minn. 1993) (punitive damages is an element of substantive law, so state law governs).

¹⁴ According to their motion, Plaintiffs seek to amend their complaint to add punitive damages against Parthenon for breach of fiduciary duty and conversion, against Grad for breach of fiduciary duty, against Sadek for breach of fiduciary duty and misrepresentation, and against Kiesel for breach of fiduciary duty and misrepresentation. See Pl. Mem. at 33. Although Plaintiffs purport to base their request for punitive damages on allegations of fraud, Plaintiffs do not have a "fraud" claim. See, e.g. Am. Compl., ¶ 77 ("Defendants Sadek and Kiesel acted either negligently *or* with intent to defraud") (emphasis added).

Accordingly, Delaware law should apply to determine whether punitive damages are available for the breach of fiduciary duty claims against Defendants. As shown above, they are not, and the motion should thus be denied as futile.

C. Plaintiffs' Motion to Amend to Add A Punitive Damages Claim In Connection With Their Claims Against Parthenon, Grad, and Sadek is Futile Under Massachusetts Law.

1. Under Massachusetts Law, Punitive Damages Are Not Available In Connection With Common Law Claims.

Under Massachusetts law, punitive damages are not allowed unless statutorily authorized. *Int'l Fid. Ins. Co. v. Wilson*, 443 N.E.2d 1308, 1317 n.20 (Mass. 1983); *see also Santana v. Registrars Of Voters*, 398 Mass. 862, 867 (1986) (“[p]unitive damages or exemplary damages are not allowed in Massachusetts except under statutory authority”); *Hood v. City of Boston*, 891 F. Supp. 51, 53 (D. Mass. 1995) (same). As a result of this long-established rule, Massachusetts courts regularly dismiss punitive damages claims arising in connection with common law claims. *See Computer Systems Eng'g, Inc. v. Qantel Corp.*, 740 F.2d 59, 70 (1st Cir. 1984) (Massachusetts law does not provide for punitive damages for common-law fraud); *Tele-Connections, Inc. v. Perception Tech. Corp.*, Civ. A. No. 88-2365-S, 1990 WL 180707, at *3 (D. Mass. 1990) (same as to fraudulent inducement); *Frisone v. Bear Stearns & Co.*, No. 82-1439-MA, 1983 WL 1313, *5 (D. Mass. 1983) (dismissing punitive damages claim asserted in connection with Massachusetts common law claim).

2. Because Massachusetts Law Applies to the Claims Alleged Against Parthenon, Grad, and Sadek, the Amendment Would Be Futile.

This Court should apply Massachusetts law to the claims asserted against Defendants Parthenon, Grad, and Sadek for two reasons.¹⁵ First, courts recognize that “[w]hen the primary purpose of a rule of law is to deter or punish conduct, the States with the most significant interests are those in which the conduct occurred and in which the principal place of business and place of incorporation of defendant are located.” *See Keene Corp. v. Ins. Co. of N.A.*, 597 F. Supp. 934, 938 (D.D.C. 1984); *see also In re Air Crash Disaster Near Chicago, Illinois*, 644 F.2d 594, 613 (7th Cir. 1981). Under this rationale, Massachusetts law should apply to the claims against Defendants Parthenon, Grad and Sadek because Parthenon’s principal place of business is in Boston, Massachusetts, while Messrs. Grad and Sadek are alleged to be its employees. *See Am. Compl.*, ¶¶ 10-12. In addition, the allegedly wrongful scheme amongst Parthenon, Grad, and Sadek originated in Parthenon’s Massachusetts office.

Second, applying Minnesota’s choice-of-law analysis, Massachusetts law should apply to the claims against Parthenon, Grad, and Sadek. *See, e.g., Birnstill v. Home Savings of Am.*, 907 F.2d 795, 797 (8th Cir. 1990) (“the district court must follow the choice of law rules of the state in which it sits in order to determine which state’s substantive law applies”). Here, an actual conflict exists between the laws of Minnesota and Massachusetts regarding the remedies available to plaintiffs for their common law

¹⁵ To the extent Plaintiffs are seeking to assert a punitive damages claim in connection with their misrepresentation claim against Kiesel, Plaintiffs have failed to make the required prima facie showing under Minnesota law, as set forth in Section II(C)(5).

claims; Minnesota may permit an award of punitive damages under limited circumstances while Massachusetts allows them only if expressly authorized by statute. *See Burks v. Abbot Labs.*, 639 F. Supp. 2d 1006, 1012 (D. Minn. 2009) (noting the existence of a conflict in similar circumstances).

In these circumstances, Massachusetts law may be constitutionally applied because, as shown above, the state “ha[s] a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair.” *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 313 (1981); *Jepson v. Gen'l Cas. Co. of Wis.*, 513 N.W.2d 467, 469 (Minn. 1994). In addition, the five-factor test used to determine which state law to apply favors the application of Massachusetts law because Massachusetts has a strong interest in regulating the conduct of Defendants Parthenon, Grad and Sadek who allegedly hatched their wrongful scheme from Massachusetts.¹⁶

Accordingly, Massachusetts law should apply to determine whether punitive damages are available for claims against Parthenon, Grad, and Sadek. As shown above, they are not.

¹⁶ The factors include: “(1) predictability of the result; (2) maintenance of interstate order; (3) simplification of the judicial task; (4) advancement of the forum’s governmental interests; and (5) application of the better rule of law.” *Jepson*, 513 N.W.2d at 470.

II. ALTERNATIVELY, PLAINTIFFS HAVE FAILED TO SATISFY THE THRESHOLD REQUIREMENTS UNDER MINN. STAT. § 549.20 TO ASSERT PUNITIVE DAMAGES CLAIMS.

Even if the Court were to evaluate Plaintiffs' motion under Minnesota law, the motion should be denied because Plaintiffs have not met the high standard imposed by Minn. Stat. § 549.20.

A. Minnesota Law Permits Punitive Damages in Very Limited Circumstances.

Under Minnesota Law, “[p]unitive damages are an extraordinary remedy to be allowed with caution and within narrow limits.” *Nhep v. Roisen*, 446 N.W.2d 425, 427 (Minn. Ct. App. 1989). An award of punitive damages constitutes an “extreme punishment.” *Veniek v. Textron, Inc.*, 479 N.W.2d 719, 723 (Minn. Ct. App. 1992). “The very power of the remedy demands that judges exercise close control over the imposition and assessment of punitive damages.” *Lewis v. Equitable Life Assur. Soc’y of the U.S.*, 389 N.W.2d 876, 892 (Minn. 1986). Because of the severity of the remedy, plaintiffs amend their complaint to claim punitive damages, but only if the Court finds that there is “*clear and convincing evidence* that the acts of the defendant show *deliberate disregard* for the rights or safety of others.” Minn. Stat. §§ 549.191; 549.20 subd. 1(a) (emphasis added).

While Plaintiffs suggest that the mere invocation of a breach of fiduciary duty, conversion, or fraud claim is enough to show that an award of punitive damages is available, *see* Pl. Mem. at 29, they are incorrect. There must be evidence of conduct that is egregious and “deliberate” to succeed on their motion to amend. *See Jensen v. Walsh*,

623 N.W.2d 247, 249-50 (Minn. 2001). Moreover, shareholder claims have not been the kinds of claims for which Minnesota courts have allowed the “extreme punishment” of punitive damages. Indeed, outside the unique context of a closely held corporation, which RTI is not, Plaintiffs have not cited, and Defendants have not found, an analogous Minnesota case in which punitive damages were deemed appropriate for shareholder claims.¹⁷

B. The Court Must Review Only Admissible Evidence In Context And Must Consider It In Its Entirety.

Plaintiffs argue that this Court should simply accept their version of the facts as true, without weighing the evidence. Pl. Mem. at 28. But this is not the proper standard: the court “must ascertain whether a jury could reasonably find that [the] plaintiff proved his case by the quality and quantity of evidence required by Minnesota law.” *Morrow v. Air Methods, Inc.*, 884 F. Supp. 1353, 1358 (D. Minn. 1995). Plaintiffs must present “clear and convincing evidence” of deliberate disregard, which requires more than a

¹⁷ The only case that Plaintiffs cite in support of their contention that punitive damages are available for breach of fiduciary duty claims is *Evans v. Blesi*, 345 N.W.2d 775, 779 (Minn. Ct. App. 1984), which involved a closely held corporation. Minnesota courts have repeatedly recognized that only in the unique circumstances of a closely held corporation, where the shareholders are effectively partners and owe each other fiduciary duties, can there be a basis for a punitive damages claim. See *Harris*, 421 N.W.2d at 353.

preponderance of the evidence” and “will be shown [only] where the truth of the facts asserted is ‘highly probable.’” *Weber v. Anderson*, 269 N.W.2d 892, 895 (Minn. 1978).¹⁸

Plaintiffs must satisfy this evidentiary burden before they can plead punitive damages; the Court cannot grant their motion on a wait-and-see basis. *See McKenzie v. N. States Power Co.*, 440 N.W.2d 183, 184 (Minn. Ct. App. 1989). Contrary to Plaintiffs’ suggestion, then, “the function of the Court is to do more than ‘rubber stamp’ the allegations in the [m]otion papers. The Court must independently ascertain whether there exists prima facie evidence that the defendant acted with a deliberate disregard of the rights or safety of others.” *Ulrich*, 848 F. Supp. at 868-69.

Furthermore, the Court must review the admissible evidence in context. *See Ulrich*, 848 F. Supp. at 875. While this analysis does not involve credibility rulings or cross-examination of proof, it does require the court to review the evidence in total, rather than just a plaintiff’s pre-selected, self-serving excerpts. *See Olson v. Snap Prods., Inc.*, 29 F. Supp. 2d 1027, 1033 n.1 (D. Minn. 1998) (noting that the court’s role would amount to a rubber stamp if the court were to allow the plaintiff to exclude certain testimony simply because the plaintiff failed to submit it as evidence); *Ansari v. NCS Pearson, Inc.*, Civ. No. 08-5351, 2009 WL 2337137, at *11 (D. Minn. July 23, 2009) (noting that “a court must still scrutinize the record before it”).

¹⁸ The Minnesota Legislature interposed this onerous threshold because of the potential for abuse inherent in such punitive damages claims. *See Shetka v. Kueppers, Kueppers, Von Feldt & Salmen*, 454 N.W.2d 916, 920 (Minn. 1990) (noting that punitive damages “are a windfall to the plaintiff. Our concern is to assure that an award of punitive damages functions as intended . . . [and] not to extort exorbitant settlement awards.”).

In other words, the court should disregard Plaintiffs' "hodge-podge of largely disconnected documents which, like snapshots of different scenes, foreclose any responsible attempt to see the whole." *Berczyk v. Emerson Tool Co.*, 291 F. Supp. 2d 1004, 1012 (D. Minn. 2003). Of course, "with snippets from one document, when appended to another, some apparitions seem vaguely visible," and therefore the Court must be presented "not with nebulous shadows, but with a requisite showing undergirded by clear and convincing evidence." *Id.* at 1013. Here, Plaintiffs' motion presents only shadows of nebulous conduct that, when placed in its proper context, does not rise to the level of "deliberate disregard."

C. Plaintiffs Allegations Fail to Allege a Proper Basis for an Award of Punitive Damages Under Minnesota Law.

The purported evidence on which Plaintiffs base their request is, when viewed in the proper context, clearly not sufficient under Minnesota law to impose a punitive damages claim. Indeed, under the review now mandated by *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), to determine whether an allegation is sufficient to state a claim, those scattered contentions on which Plaintiffs rely—not just to state a claim but to seek the extraordinary remedy of punitive damages—would not survive scrutiny. Viewed in the context set forth in the Statement of Facts above, a reasonable, and perfectly innocent, business judgment explanation for the challenged conduct is more likely than the malicious self-dealing Plaintiffs conjure. We take Plaintiffs' primary contentions one at a time.

1. Parthenon's status as a controlling shareholder.

The premise of Plaintiffs' contentions about Parthenon—that it controlled RTI and used that control to increase its ownership stake to the detriment of the common shareholders—is demonstrably false. Until the time of the Recapitalization Merger in June 2009, Parthenon took pains merely to maintain—not to increase—its ownership. Not until then did Parthenon ever have more than 50% ownership of RTI.¹⁹ Not until February 2004 did Parthenon even have the ability to designate the majority of the board of directors, and even then two of the members it designated were not affiliated with it.

In any event, Delaware law has long recognized that controlling shareholders have rights and need not slight those rights to bestow an unwarranted benefit on minority shareholders. *See, e.g., Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 598 (Del. Ch. 1986) (stating that the law “does not, absent a showing of culpability, require that . . . controlling shareholders sacrifice their own financial interest in the enterprise for the sake of the corporation or its minority shareholders”); *see also Williams v. Geier*, 671 A.2d 1368, 1380-81 (Del. 1996) (noting that stockholders, even a controlling stockholder bloc, “may properly vote in their own economic interest, and majority stockholders are not to be disenfranchised because they may reap a benefit from corporate action which is regular on its face”).

Being a controlling shareholder, even playing an active role in shepherding one's investment, therefore cannot be grounds for the imposition of punitive damages.

¹⁹ Plaintiffs offer no factual support whatsoever for their bald assertion that ABS—an entirely separate entity with interests different from those of Parthenon—can be lumped together with Parthenon as a single controlling shareholder.

2. Parthenon's purported "self-dealing."

The full record provides the context necessary to understand the challenged actions of Parthenon and its agents Messrs. Grad and Sadek. Within that context, as set forth more fully in the Statement of Facts above, it is readily apparent that board members and Parthenon consistently were aware of and sensitive to the company and to all its shareholders, including the common, and that they acted appropriately in pursuing reasonable alternatives to fund the company's necessary growth and to maximize its value.²⁰ The common shares' loss in value was the natural result of RTI's early financing decisions (decisions made by Plaintiffs Tate and Shuster), its growth strategy and the changed economy in which the company found itself. It is not the result of any self-dealing by Parthenon, as a closer look at Plaintiffs' allegations regarding the potential IPO and the preferred share rights illustrates.

Plaintiffs fault Parthenon for not having caused RTI to consummate an IPO in 2006 or 2008, but the fact is that the decision to improve RTI's financial performance before pursuing an IPO was a reasonable one. As the record shows, RTI's inability to meet projections and the deteriorating state of the equity markets overall worked against a successful IPO.

Pursuing an IPO at a time when the company had demonstrated its inability to meet its own projections would have been ruinous for all shareholders. Because insiders generally are unable to sell all their shares in the IPO and are required to await the

²⁰ Even the exhibits Plaintiffs include, were the Court to read them in their entirety, demonstrate the absence of malice and the interest in maximizing value for all shareholders. (See, e.g., Alton Aff. Exs. 16, 17, 19, 22, 28, 30, 32, 34, 40, 43, 46.)

passage of several months before doing so, all RTI's shareholders would have been dependent on a robust secondary market, which in turn would have been driven by the company's ability to meet market expectations for performance (crystallized in the form of projections). That the company did not meet its projections—the very projections on which the IPO share price would have been based—is not in dispute; indeed, it missed them dramatically in both 2006 and 2008. Performance such as that would have ravaged the secondary market, leaving all shareholders with little value.

Similarly, Parthenon's still unfulfilled desire to exercise its contractual rights to a liquidation preference and to receive an accretion rate on its investments—rights granted them as far back as 2001 (with Plaintiffs' express approval)—cannot constitute improper self-dealing and certainly does not evidence the deliberate wantonness necessary to justify punitive damages. Delaware law specifies that even a controlling shareholder may exercise its contractual rights—such as the entitlement to liquidation preferences and accretion—without creating a breach of fiduciary duty. *See Jedwab*, 509 A.2d at 598; *Williams*, 671 A.2d at 1380-81. Indeed, the Stockholders Agreement, to which certain members of the putative class are a party, expressly bars breach of fiduciary duty claims based on the exercise of those contractual rights. (Grant Decl. Ex. 33 at § 6.3.) Moreover, Parthenon at every turn allowed all other shareholders to invest additional funds on the same financial terms as it had.

In short, nothing about the challenged conduct supports a charge of self-dealing, and nothing about it evinces a deliberate disregard for the rights of others. Parthenon's

conduct, rather, was simply good faith business decisions made in accord with the law. They cannot be the basis for a claim of punitive damages.

3. The recognition that Plaintiffs might someday sue.

Given the fact that by late 2008 Plaintiffs had vigorously and repeatedly expressed their dissatisfaction, in person and in writing, with management and the board, and given the further fact that the economic reality was that the common shares had lost much, if not all, of their value, it is not surprising that any board member, including Mr. Grad and Mr. Sadek, would have been cognizant of the potential for litigation in the event of any future transaction. It certainly does not bespeak evil intent, or an admission of wrongdoing, that they would reference that potential in addressing matters of corporate governance.

It is neither atypical nor improper for board members to seek to minimize legal risk. *See Malpiede v. Townson*, 780 A.2d 1075, 1085 (Del. 2001) (“Except in egregious cases, the threat of personal liability for approving a merger transaction does not in itself provide a sufficient basis to question the disinterestedness of directors because the risk of litigation is present whenever a board decides to sell the company.”). Evidence that they were aware of, and considered, the potential that common shareholders might—as they did—sue, does not a prima facie case for punitive damages against Mr. Grad, Mr. Sadek or Parthenon make.

4. Parthenon's pursuit of the purportedly manipulative recapitalization merger.

The heart of Plaintiffs' contentions lies in the Recapitalization Merger and is based on the presumptions that their shares had great value and that Parthenon by that transaction usurped that value. Neither presumption is true. The capital structure in existence since 2001 and the company's heavy debt burden, evaluated in the then-current economic environment, meant that the common shares had no value unless and until the company brought at least \$332.9 million in a liquidation. (Dkt. #11, Ex. 1 at i.) In no circumstance could a valuation reach that lofty height. Even if the Series B-1 and B-2 offerings about which Plaintiffs are so exercised (and the A-4 offering as well) were ignored, the valuation would have to reach at least \$289 million to reach the common shares. (*Id.*) Mr. Grad's use of the word "cram-down," a technical word of art, in this circumstance is not evidence of malice but instead a mere shorthand for the economic reality.

The \$140 million enterprise valuation to which Plaintiffs point as evidence of deliberate disregard was the result of careful modeling and consideration applied to changed circumstances. Plaintiffs have not offered any admissible evidence that its accuracy was off by a magnitude of two. Higher preliminary valuations, derived from manifestly inaccurate financial projections in 2006, before the economy had changed and before RTI had become as debt-encumbered as it was by 2009, are not proof that the valuation calculated in 2009, one blessed as fair by an independent investment banking firm with no incentive to sully its reputation by lying, was "fabricated" or even materially

inaccurate. In fact, as the record shows, that valuation was materially accurate and hurt all shareholders proportionally, including Parthenon as well as Plaintiffs.

Allegations about the bargain Parthenon drove before it would commit millions more of its dollars to a company in desperate straits are similarly bereft. Yes, the terms of the deal, including the recapitalization's impact on common and Series A shareholders, the management fees, and the desire to be rid, through a release, of the specter of a lawsuit by disgruntled shareholders, were steep. But Parthenon was under no obligation to confer benefits on other shareholders to its detriment. And the special committee, peopled by shareholders not beholden to Parthenon, in its good faith exercise of business judgment determined it was better that the company take those terms than suffer the alternative of turning the keys over to its lenders. Plaintiffs may question that judgment, but they cannot transmogrify it into the deliberate disregard necessary to justify imposing the extraordinary penalty of punitive damages.

Nor do the allegations regarding the purported insufficiency of the Proxy disclosure, and the discussions at an information session for shareholders, both of which Defendants undertook voluntarily (given their right to have accomplished the transaction without the need for a full vote of all shareholders), support Plaintiffs' conspiracy theory. The Proxy fairly presents the circumstances in which RTI found itself and the economic rationale for the Recapitalization Merger. As shown by their decision to vote against the transaction, none of the named Plaintiffs was misled by the Proxy. (*See* Dkt. #11, Ex. 2.)

And none of the purported omissions was material to the investment decision shareholders were called to make.²¹

In any event, even ignoring the Recapitalization Merger's impact and assuming that the common and Series A shareholders still held their original shares, the economic reality would still be the same: [REDACTED]

[REDACTED]

In sum, the Recapitalization Merger was anything but a "manipulative" "sham." Parthenon's pursuit of the transaction and RTI's consummation of it were neither procedurally nor substantively wrongful. Viewed in the full context, as this Court must do, Plaintiffs have not established the requisite prima facie evidence of deliberate disregard necessary to allege punitive damages claims.

5. Kiesel's knowledge of the management incentive plan.

The sole personal allegation in support of the request for punitive damages against Mr. Kiesel—that he knowingly misrepresented his entitlement to certain options under the management incentive plan to be instituted after the recapitalization—is demonstrably incorrect. The broader record reflects that although Mr. Kiesel certainly had discussed his incentive compensation, it had not been established and was not granted until well after the transaction was consummated, when the Board's compensation committee voted

²¹ The internal drafts on which Plaintiffs rely for their attack reflect not an intent to deceive but rather a concern about consistency and the desire not to be unfairly optimistic in a situation that for the holders of common shares and even the Series A shares called for anything but hope.

and approved the grant. (Grant Decl. Ex. 62.) It also reflects that in the recapitalization process, Mr. Kiesel lost all his previous option grants.

Moreover, the Proxy clearly disclosed that Mr. Kiesel would likely receive options under the new plan to be adopted after the Recapitalization Merger. (Dkt. #11, Ex. 1 at 13.) The fact that a specific number was not disclosed, when the Board would not be called on to consider an award until months later, when unforeseen circumstances could have altered expectations, and at that later time could have made any grant it deemed warranted (or none), is not only materially accurate but also without malice.


In sum, there is no factual support whatsoever for the imposition of punitive damages against Mr. Kiesel.

CONCLUSION

For all the reasons set forth above, Defendants respectfully request that Plaintiffs' Motion for Punitive Damages be denied with prejudice.

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