

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No. SACV 08-00790-CJC(ANx)

Date: December 4, 2008

Title: HARTLEIB v. SIRIUS SATELLITE RADIO et al.

PRESENT:

HONORABLE CORMAC J. CARNEY, UNITED STATES DISTRICT JUDGE

Nancy Boehme
Deputy Clerk

N/A
Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFF: ATTORNEYS PRESENT FOR DEFENDANT:

None Present

None Present

PROCEEDINGS: (IN CHAMBERS) ORDER GRANTING WITH LEAVE TO AMEND DEFENDANTS' MOTION TO DISMISS [filed 11/17/08].

Having read and considered the papers presented by the parties, the Court finds this matter appropriate for disposition without a hearing. *See* FED. R. CIV. P. 78; LOCAL RULE 7-15. Accordingly, the hearing set for Monday, December 8, 2008, at 1:30 p.m. is hereby vacated and off calendar.

Introduction

Defendants Sirius Satellite Radio, Inc. (“Sirius”), XM Satellite Radio Holdings, Inc. (“XM”), and Interoperable Technologies LLC, (“Interoperable”) and several officers and directors of the three companies (collectively, the “Defendants”) move to dismiss, pursuant to Federal Rules of Civil Procedure 12(b)(6), 23.1 and 12(b)(9), Plaintiff Michael Hartleib’s derivative claims for violations of the federal Racketeering and Corrupt Organizations Act (“RICO”), breach of fiduciary duty, and violations of the Sherman Act, and a direct claim for breach of fiduciary duty. For the following reasons, Defendants’ motion is GRANTED WITH LEAVE TO AMEND.

Standard of Review

A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) tests the legal sufficiency of the claims asserted in the complaint. The issue on a motion to dismiss for

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failure to state a claim is not whether the claimant will ultimately prevail, but whether the claimant is entitled to offer evidence to support the claims asserted. *Gilligan v. Jamco Dev. Corp.*, 108 F.3d 246, 249 (9th Cir. 1997). When evaluating a Rule 12(b)(6) motion, the district court must accept all material allegations in the complaint as true and construe them in the light most favorable to the non-moving party. *Mayo v. Gomez*, 32 F.3d 1382, 1384 (9th Cir. 1994). Rule 12(b)(6) is read in conjunction with Rule 8(a), which requires only a short and plain statement of the claim showing that the pleader is entitled to relief. FED. R. CIV. P. 8(a)(2). Dismissal of a complaint for failure to state a claim is not proper where a plaintiff has alleged “enough facts to state a claim to relief that is plausible on its face.” *Bell Atl. Corp. v. Twombly*, 127 S.Ct. 1955, 1974 (2007). In keeping with this liberal pleading standard, the district court should grant the plaintiff leave to amend if the complaint can possibly be cured by additional factual allegations. *Doe v. United States*, 58 F.3d 494, 497 (9th Cir. 1995).

Furthermore, Federal Rule of Civil Procedure 23.1 sets out the pleading requirements for a shareholder to file a derivative action on behalf of a corporation. It requires that a derivative plaintiff state with specificity either that he made a demand on the corporate defendant before filing suit or the reasons why he did not make such a demand. FED. R. CIV. P. 23.1.

Background

This case arises from the competition, cooperation, and eventual merger of the two providers of satellite radio service in the United States: XM and Sirius. (First Amended Compl. (“FAC”) ¶ 6-10.) In February 2000, Sirius and XM formed a joint venture—Interoperable—to develop a radio that could receive either XM or Sirius signals. (FAC ¶ 31.) The Federal Communication Commission (“FCC”) prohibited them from simply merging their two allotments of the spectrum, instead requiring XM and Sirius to jointly develop and market an interoperable satellite radio receiver. (FAC ¶ 22.) Mr. Hartleib alleges that XM and Sirius developed an interoperable radio. (FAC ¶ 61.) Mr. Hartleib alleges that XM and Sirius fraudulently represented that they were planning to release an interoperable radio when they had no intention of doing so while concealing their true intention to merge the two companies to shareholders’ detriment. (FAC ¶¶ 7-10.) Despite this alleged wrongdoing, the Department of Justice approved the Sirius/XM merger, which went forward in June 2008. (FAC ¶ 69.)

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Mr. Hartleib filed causes of action for violations of RICO and the Sherman Act, and for breach of fiduciary duty as a derivative suit on behalf of the shareholders of Sirius. He did not file a demand with the Sirius Board of Directors prior to filing his complaint. (FAC ¶ 11.) Mr. Hartleib also filed a direct cause of action against Sirius directors for breach of fiduciary duty. (FAC ¶¶ 202-205.)

Analysis

1. Derivative Claims

Mr. Hartleib has not made any demand upon the Board of Directors of Sirius to obtain the relief he seeks in this lawsuit. He has also failed to allege with sufficient specificity the reasons that issuing such a demand on Sirius would have been futile. Mr. Hartleib has filed seven of his eight claims against Sirius as as shareholder derivative actions on Sirius' behalf.

Federal Rule of Civil Procedure 23.1 sets out the pleading requirements for derivative actions such as Mr. Hartlieb's action. It states that a complaint must:

(3) state with particularity:

(A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and

(B) the reasons for not obtaining the action or not making the effort.

FED. R. CIV. PRO. 23.1. Because Sirius is incorporated in Delaware, the Court will use that state's law to determine whether Mr. Hartleib has adequately pleaded the reasons that filing a demand with Sirius would have been futile. *Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 108-109 (1991).

The Delaware Supreme Court's ruling in *Rales v. Blasband* provides the standard for determining whether a plaintiff has satisfied the requirements of pleading that it would have been futile for the plaintiff to issue his demands to a corporation. *Rales* applies when, as in the present case, "a business decision was made by the board of a

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company, but a majority of the directors making the decision have been replaced.” *Rales v. Blasband*, 634 A.2d 927, 933-944 (Del. 1993). In this case, the actions at issue began in 2002 and culminated in June 2008, when Sirius and XM merged. (FAC ¶¶ 25, 68.) However, seven of Sirius’ twelve board members were seated in August 2008. (Def.’s Brf. at 4; Def.’s Req. for Judicial Notice Ex. A.) Therefore, *Rales* provides the correct rule to use:

[It] is appropriate in these situations to examine whether the board that would be addressing the demand can impartially consider its merits without being influenced by improper considerations. Thus, a court must determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand. If the derivative plaintiff satisfies this burden, then demand will be excused as futile.

Rales, 634 A.2d at 934. To show futility, the plaintiff must meet a higher burden than he must on a typical motion to dismiss under Rule 12(b)(6). “Mere notice pleading is insufficient to meet the plaintiff’s burden to show demand excusal in a derivative case.” *Guttman v. Huang*, 823 A.2d 492, 499 (Del. Ch. 2003.)

Mr. Harteib marshals several arguments in an attempt to create reasonable doubt about the current board’s ability to exercise independent judgment in this case: (1) Sirius’ non-responsiveness to his shareholder activism before the merger took place shows that making a formal demand to the current, post-merger board would have been futile; (2) all of Sirius’ board members knew of, benefitted from, and participated in efforts to conceal the alleged racketeering activity associated with Sirius, XM and Interoperable and, therefore, breached their fiduciary duties, making them subject to criminal and civil liability if their misdeeds came to light; (3) each board member authorized or permitted false statements to be disseminated on their behalfs; (4) each board member would be forced to sue him or herself if he or she allowed this action to go forward; (5) Mel Karmazin, board member and chief operating officer of Sirius, received and continues to receive substantial monetary compensation and other benefits from Sirius, making him biased; (6) Sirius board member Gary Parsons was board chairman and chief executive officer of XM before the merger, so he cannot possess disinterested business judgment

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about the merger; (7) board members Joan Amble, Eddy Hartenstein, James Holden, and James Moone are members of Sirius' audit committee and, therefore have a conflict of interest; and (8) current board members have failed to take the necessary actions to rectify the harm allegedly inflicted on the shareholders by the wrongdoing asserted in this case. (FAC ¶¶ 108-158.) These arguments do not create a reasonable doubt that a majority of the current board of directors would not be able to respond disinterestedly to a demand from Mr. Hartleib.

The majority of Mr. Hartleib's arguments to show the futility of making a demand on the current Sirius board are based on generalized, not specific allegations. Although the complaint identifies alleged fraud and wrongdoing committed by Defendants, it does not state how each specific Sirius director was responsible for those actions. For instance, it would be helpful if Mr. Hartleib could show how a majority of the current directors, as individuals, approved of an allegedly fraudulent statement or action or committed some wrongdoing that would make them unable to exercise independent judgment in this case. Generalized statements alleging that "each board member" knew of some wrongdoing will not suffice to meet the heightened standards of Rule 23.1. *See Guttman v. Huang*, 823 A.2d 492, 503 (Del. Ch. 2003) (finding that "particularized allegations of fact detailing the precise roles that these directors played at the company, the information that would have come to their attention in those roles, and any indication as to why they would have perceived the accounting irregularities" would help support a finding of futility). Such generalized allegations are even more ineffective in situations, like this one, where the majority of the board was not empanelled at the time of the alleged wrongdoing. The changeover in board membership further undermines the relevance of Mr. Hartleib's argument that Sirius's lukewarm response to his shareholder activism before the merger shows that its current board cannot be trusted to exercise independent judgment. The Court also fails to see the relevance of directors' membership on the audit committee. Furthermore, Mr. Hartleib cannot escape the demand requirement simply by asserting that the a majority of the board bears liability in the action because a majority of board members are named as defendants in his suit.¹

¹ Because Mr. Hartleib has not sufficiently pleaded that making a demand upon the Sirius board would be futile, it is unnecessary for the Court to rule on whether Mr. Hartleib's pleadings otherwise state claims upon which relief could be granted. However, Mr. Hartleib should not construe this as the Court's tacit approval of the sufficiency of the pleadings. Mr. Hartleib would be well advised to further review his pleadings, taking Defendants' arguments into account, if he chooses to amend and re-file his claims.

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2. Direct Claim for Breach of Fiduciary Duty

As in his first complaint, Mr. Hartleib’s claim directly against the officers and directors fails because he has not alleged harm to himself outside of the injuries suffered by all shareholders. *See Feldman v. Cutaia*, 951 A.2d 727 (Del. 2008) (holding that a claim that the plaintiff is harmed in the same way that all other shareholders are harmed is a derivative, not a direct, claim). Those actions alleged in ¶¶ 87-94 of the FAC—that Defendants delayed the deployment of an interoperable radio and trading on that information—are not actions aimed at or suffered by Mr. Hartleib as an individual, rather, they are actions suffered identically by all shareholders. (FAC ¶¶ 87-94.) The only damages Mr. Hartleib points to as result of these actions are Mr. Hartleib’s loss of value in his Sirius stock. This is identical to the loss suffered by all other shareholders. Because *Feldman* requires that a plaintiff in a direct suit show that he has “suffered some individualized harm not suffered by all of the stockholders at large,” and Mr. Hartleib has failed to show that he has suffered special losses beyond a reduction in the value of his stock, Mr. Hartleib’s direct claim fails. *Feldman*, 951 A.2d at 733.

Conclusion

For the foregoing reasons, Defendants’ motion to dismiss Mr. Hartleib’s claims is GRANTED WITH LEAVE TO AMEND. Mr. Hartleib has twenty days leave to amend its complaint consistent with this order. Defendants have twenty days thereafter to file a responsive pleading.

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