

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

STEPHEN J. DiLORENZO,)
derivatively on behalf of)
dELiA*S CORP. and)
ALLOY, INC.,)
)
Plaintiff,)
)
v.) Civ. No. 03-841-SLR
)
CHRISTOPHER EDGAR,)
GERALDINE KARESTKY,)
STEPHEN I. KAHN,)
EVAN GUILLEMIN,)
dELiA*S CORP., and)
ALLOY, INC.,)
)
Defendants.)

MEMORANDUM ORDER

At Wilmington, this 24th day of March, 2004, having reviewed the motions of defendants to dismiss (D.I. 10, 13), and the memoranda submitted therewith;

IT IS ORDERED that defendants' motions (D.I. 10, 13) to dismiss are **denied** for the reasons that follow:

1. Plaintiff filed this derivative action on August 27, 2003 alleging violations of § 16(b) of the Securities Exchange Act of 1934, codified at 15 U.S.C. § 78p(b). (D.I. 1) The suit is brought on behalf of dELiA*s Corporation ("dELiA*s") and Alloy, Inc. ("Alloy"), and seeks to recover short-swing profits obtained by defendants Christopher Edgar, Geraldine Karetsky,

Stephen Kahn and Evan Guillemin ("Former Director defendants"). On October 16, 2003, the defendants filed motions to dismiss pursuant to Fed. R. Civ. P. 12(b) 1 and 12(b) (6). (D.I. 10, 13)

2. During the relevant time period, the Former Director defendants were directors of dELiA*s. Kahn was the Chief Executive Officer and Chairman of the Board. Edgar was the Executive Vice President and Vice Chairman. Guillemin was the Chief Financial Officer and Treasurer. On or about May 12, 2003, the Former Director defendants purchased in aggregate 7,297,298 shares of dELiA*s common stock at a price of \$0.37 per share for a total of \$2.7 million. (D.I. 1, ¶ 12) Of this amount Kahn purchased 4,054,054 shares; Karetsky purchased 2,702,703 shares; Edgar purchased 337,838 shares; and Guillemin purchased 202,703 shares. Further, dELiA*s issued to the Former Director defendants a total of 600,000 warrants to purchase shares at \$0.37 a share.

3. On July 30, 2003, dELiA*s entered into an agreement with Alloy to conduct a tender offer for all of the publicly held shares of dELiA*s. At that time, Karetsky and Kahn entered into an agreement to support the merger and tender their shares. Kahn, Edgar and Guillemin each received employment agreements with Alloy upon the effective date of the merger. (Id., ¶ 10, 15)

4. On August 6, 2003, Dodger Acquisition Corp., a direct

wholly owned subsidiary of Canal Park Trust and an indirect wholly owned subsidiary of Alloy, commenced a tender offer for 100% of dELiA*s shares at a price of \$.0928 per share. (Id., ¶ 25; D.I. 12, at ex. 1) Plaintiff contends that the Former Director defendants obtained short-swing profits in violation of § 16(b) as a result of an August 6, 2003 tender-offer by Alloy to dELiA*s shareholders for a cash-out merger between the corporations.

5. During the offer period, plaintiff commenced the present action but did not tender his shares. On September 7, 2003, the merger closed and plaintiff, along with other nontendering shareholders, was cashed-out and his shares canceled. Canal Park Trust is now the sole shareholder of dELiA*s stock. (D.I. 12)

6. Plaintiff was a dELiA*s shareholder at the time of the filing of the complaint. Plaintiff also contends that at the time of the transaction he was an Alloy shareholder and has maintained that interest. Plaintiff seeks a disgorgement of \$4,071,892 in profits received by the Former Director defendants as a result of the transaction. Plaintiff also seeks \$334,800 related to the acquisition of the 600,000 warrants.

7. Defendants' motions to dismiss contend that plaintiff's complaint fails for a lack of standing because he is no longer a shareholder of dELiA*s and because he failed to make demand upon

the corporation's board of directors.

8. **Standard of Review.** In analyzing a motion to dismiss pursuant to Rule 12(b)(6), the court must accept as true all material allegations of the complaint and it must construe the complaint in favor of the plaintiff. See Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts, Inc., 140 F.3d 478, 483 (3d Cir. 1998). "A complaint should be dismissed only if, after accepting as true all of the facts alleged in the complaint, and drawing all reasonable inferences in the plaintiff's favor, no relief could be granted under any set of facts consistent with the allegations of the complaint." Id. Claims may be dismissed pursuant to a Rule 12(b)(6) motion only if the plaintiff cannot demonstrate any set of facts that would entitle him to relief. See Conley v. Gibson, 355 U.S. 41, 45-46 (1957). The moving party has the burden of persuasion. See Kehr Packages, Inc. v. Fidelcor, Inc., 926 F.2d 1406, 1409 (3d Cir. 1991).

9. In considering a motion to dismiss, a court may consider Securities Exchange Commission documents that are expressly relied upon in the complaint. See In re Burlington Coat Factory Sec. Litig, 114 F.3d 1410, 1426 (3d Cir. 1997); Indeck Maine Energy, L.L.C. v. ISO New England Inc., 167 F. Supp. 2d 675 (D. Del. 2001). Further, on a motion to dismiss the court may take judicial notice of the contents of documents required by law to be filed, and actually filed, with federal or state

officials. See Oran v. Stafford, 226 F.3d 275, 289 (3d Cir. 2000); Ieradi v. Myland Lab, Inc., 230 F.3d 594, 600 n.3 (3d Cir. 2000) (citing Fed. R. Evid. 201).

10. **Standing under Section 16(b)**. Section 16(b) establishes strict liability for covered individuals who engage in the sale or purchase of a covered security. 15 U.S.C. § 78p(b). The right of recovery under § 16(b) is held, however, solely by the issuer of the security. Id. A shareholder may bring a derivative action “in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter.” Id.

11. There are three requirements for shareholder standing to bring suit under § 16(b). See Gollust v. Mendell, 501 U.S. 116 (1991). First, the plaintiff must own a security within the meaning of the section. Second, the security held by the plaintiff must be a security of the issuer of the security traded by the covered individual. Third, the plaintiff must own a security of the issuer at the time the § 16(b) action is instituted. Id. at 123-24. Unlike a typical shareholder derivative action, there is not a requirement that the plaintiff maintain continual ownership, only that he has “some continuing financial stake in the litigation” so as to satisfy minimum standing requirements imposed by the jurisdictional limitations

of Article III. See id. at 125.

12. In the present case, plaintiff's complaint alleges that he owned shares of stock issued by dELiA*s at the time he filed the present action. Consequently, plaintiff satisfied the statutory requirements for standing at the time the suit was instituted. Defendants contend, however, that plaintiff is no longer a shareholder and lacks the requisite standing to maintain the suit. Plaintiff argues that his ownership of shares in Alloy provide a basis for his continuing financial interest in the outcome of the litigation.

13. In Gollust, the Supreme Court considered the effect of a stock-exchange merger upon the plaintiff's previously filed § 16(b) action. The unanimous Court concluded that although plaintiff was no longer a shareholder of the issuer, as his stock was exchanged for stock in the new corporation, he nonetheless had the minimal financial interest in the outcome of the litigation to satisfy constitutional concerns. Id. at 126-28. Consequently, under Gollust, where a plaintiff has standing at the commencement of the suit, an involuntary change in his status as a security holder resulting from a restructuring will not affect his standing to maintain the suit so long as minimal constitutional requirements are satisfied through the presence of some financial interest in the outcome of the litigation.

14. In the present case, the major distinguishing factor is

the form of restructuring. Instead of a stock-exchange merger, dELiA*s effectuated a cash-out merger. The court concludes that § 16(b)'s remedial purpose should not be truncated by the legal nuances of the corporate restructuring. A shareholder of a parent corporation has a financial interest, albeit tenuous, in the disgorgement of profits obtained by insiders of a corporate subsidiary. Although Congress did not provide statutory standing for such a party to institute a § 16(b) suit,¹ a shareholder of a parent corporation has a cognizable interest for purposes of satisfying constitutional requirements. See Allen v. Wright, 468 U.S. 737, 751 (1984) ("A plaintiff must allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief."). Consequently, the court concludes that plaintiff satisfies the constitutional requirements to maintain the suit.

15. **Demand.** Defendants also contend that plaintiff does not have standing for failure to satisfy Fed. R. Civ. P. 23.1's

¹Where a shareholder of a parent corporation brings a suit against a subsidiary of the parent under a derivative theory, the suit is referred to as double derivative in nature. Section 16(b) suits premised upon double derivative standing have been rejected by a majority of courts. See Lewis v. McAdam, 762 F.2d 800, 804 (9th Cir. 1985) (concluding that standing does not exist in a cash-stock merger); Untermeyer v. Valhil, Inc., 665 F. Supp. 297, 300-01 (S.D.N.Y. 1987) (concluding that standing does not exist in a cash-out merger). These cases are distinguished, however, because the Supreme Court in Gollust differentiated between standing to institute suit and a sufficient interest to maintain suit. See Gollust, 501 U.S. at 123-24.

requirements for demand. It is clear, however, that Rule 23.1 does not apply to actions brought pursuant to § 16(b). For example, unlike typical derivative actions, the decision to bring a § 16(b) enforcement action does not enjoy protection of the business judgment rule. See Cramer v. General Telephone & Elec. Corp., 582 F.2d 259, 276 (3d Cir. 1978). Similarly, as discussed above, there are no requirements of continuous ownership. See Gollust, 501 U.S. at 124-25.

16. Where demand would have been futile, courts have excused the requirement under § 16(b). See Berkwich v. Mencher, 239 F. Supp. 792, 793-94 (S.D.N.Y. 1965); Grossman v. Young, 72 F. Supp. 375 (S.D.N.Y. 1947). On a motion to dismiss for failure to state a claim, the court must accept as true plaintiff's allegations of demand futility. Id. at 380.

17. In the present case, plaintiff pleads demand futility stating that he "has not made demand on dELiA*s Board of Directors because such demand would be futile in view of Alloy's acquisition of the company and defendants' control of dELiA*s Board." (D.I. 1, ¶ 28) Plaintiff's allegations of control are supported by those documents submitted by defendants in support of their motion to dismiss.² (D.I. 12) Further, had plaintiff

² For example, the Former Director defendants represent four of the eleven members of the former dELiA*s and include three of the four former officers. (D.I. 12, ex. 2 at B-3) Collectively, the Former Director defendants owned 37.8% of the dELiA*s stock.

made a demand, § 16(b) would preclude him from filing suit until either sixty days had passed or the board had rejected his demand. Due to the short timing of the merger, plaintiff's shares would be canceled before he would have been permitted to bring suit. The failure of the dELiA*s board to bring suit on its own behalf after becoming aware of plaintiff's suit also supports plaintiff's futility allegations. See Berkwich, 239 F. Supp. at 794. Consequently, for purposes of resolving the pending motion to dismiss the court finds that plaintiff has sufficiently alleged the existence of demand futility.

Sue L. Robinson
United States District Judge