

STATE OF NORTH CAROLINA
MECKLENBURG COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
No: 10 CVS 5321

PATRICK SMITH, Derivatively on Behalf of
Nominal Defendant HORIZON LINES, INC.,

Plaintiff,

v.

CHARLES G. RAYMOND, M. MARK
URBANIA, GABRIEL SERRA, R. KEVIN
GILL, GREGORY GLOVA, NORMAN Y.
MINETA, DAN A. COLUSSY, JAMES G.
CAMERON, WILLIAM J. FLYNN, VERN
CLARK, ALEX J. MANDL, THOMAS P.
STORRS, JOHN V. KEENAN, and
ROBERT ZUCKERMAN,

Defendants,

and

HORIZON LINES, INC.,

Nominal Defendant.

**DEFENDANTS HORIZON LINES, INC., CHARLES G. RAYMOND, M. MARK
URBANIA, JOHN V. KEENAN, ROBERT ZUCKERMAN, BRIAN W. TAYLOR, AND
JOHN HANDY'S JOINT OPENING MEMORANDUM OF LAW IN SUPPORT OF
THEIR MOTION TO DISMISS**

DATED: May 27, 2010

TABLE OF CONTENTS

	<u>Page(s)</u>
TABLE OF AUTHORITIES	iii
PRELIMINARY STATEMENT	1
STATEMENT OF FACTS	4
ARGUMENT.....	13
I. DELAWARE LAW, WHICH GOVERNS PLAINTIFF'S CLAIM, REQUIRES PLAINTIFF TO MAKE DEMAND ON THE HORIZON LINES BOARD OF DIRECTORS.....	13
A. Delaware Law Controls Plaintiff's Claim.....	13
B. The Demand Requirement Serves Important Corporate Governance Purposes.....	14
II. THE COMPLAINT SHOULD BE DISMISSED BECAUSE PLAINTIFF FAILED TO PLEAD PARTICULARIZED FACTS DEMONSTRATING THAT DEMAND IS EXCUSED.....	16
A. Demand Futility Must Be Pled With Particularity.....	16
B. The One-Step <i>Rules</i> Test Applies To Plaintiff's Claim.....	17
C. Plaintiff Has A Heavy Burden Of Pleading With Particularity That A Majority Of The Directors Faced A Substantial Likelihood Of Liability.....	19
D. Plaintiff Cannot Plead A Substantial Likelihood Of Liability Because The Directors Are Protected From Liability By Article VII Of Horizon Lines' Certificate Of Incorporation.	20
E. The Complaint Does Not Allege Facts With Particularity To Show That The Director Defendants Confront A "Substantial Likelihood" Of Liability With Respect To Plaintiff's Oversight Claim.	22
III. PLAINTIFF'S SHAREHOLDER DERIVATIVE CLAIM AGAINST DEFENDANTS RAYMOND, URBANIA, KEENAN, HANDY, TAYLOR AND ZUCKERMAN SHOULD BE DISMISSED UNDER RULE 12(B)(6) FOR FAILURE TO STATE A CLAIM.....	30
A. The Complaint Also Fails To Satisfy The Rule 12(b)(6) Standard.....	30

B.	The Complaint Fails To State A Non-Exculpated Claim Against Raymond.	31
C.	The Complaint Fails To Plead A Claim Against Any Of The Officer Defendants.	31
	CONCLUSION.....	34
	RULE 15.8 CERTIFICATION.....	35

TABLE OF AUTHORITIES

	<u>Page(s)</u>
CASES	
<i>Agostino v. Hicks</i> , 845 A.2d 1110 (Del. Ch. 2004)	15
<i>Aronson v. Lewis</i> , 473 A.2d 805 (Del. 1984)	19
<i>Ash v. McCall</i> , C.A. No. 17132, 2000 Del. Ch. LEXIS 144 (Del. Ch. Sept. 15, 2000)	22
<i>In re Baxter Int'l, Inc. S'holder Litig.</i> , 654 A.2d 1268 (Del. Ch. 1995)	19, 21
<i>Bell Atl. Corp. v. Twombly</i> , 550 U.S. 544 (2007)	27
<i>Bluebird Corp. v. Aubin</i> , 657 S.E.2d 55 (N.C. Ct. App. 2008)	13
<i>Bridgeport Holdings, Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings, Inc.)</i> , 388 B.R. 548 (Bankr. D. Del. 2008)	31, 32
<i>In re Caremark Int'l Inc. Derivative Litig.</i> , 698 A.2d 959 (Del. Ch. 1996)	passim
<i>In re Citigroup, Inc. S'holder Derivative Litig.</i> , 964 A.2d 106 (Del. Ch. 2009)	passim
<i>City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.</i> , C.A. No. 08-969, 2009 U.S. Dist. LEXIS 106186 (D. Del. Nov. 13, 2009)	11, 28
<i>City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.</i> , C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714 (D. Del. May 18, 2010)	passim
<i>Classic Coffee Concepts, Inc. v. Anderson</i> , 2006 NCBC 21 (N.C. Super. Ct. Dec. 1, 2006)	13, 30
<i>CTS Corp. v. Dynamics Corp. of Am.</i> , 481 U.S. 69 (1987)	13

<i>David B. Shaev Profit Sharing Account v. Armstrong</i> , No. 1449-N, 2006 Del. Ch. LEXIS 33 (Del. Ch. Feb. 13, 2006), <i>aff'd mem.</i> , 911 A.2d 802 (Del. 2006)	23, 26
<i>In re Dow Chem. Co. Derivative Litig.</i> , C.A. No. 4349-CC, 2010 Del. Ch. LEXIS 2 (Del. Ch. Jan. 11, 2010).....	18, 22, 24, 30
<i>Egelhof v. Szulik</i> , 2006 NCBC 4 (N.C. Super. Ct. Mar. 13, 2006)	passim
<i>Fink v. Komansky</i> , No. 03CV0388, 2004 U.S. Dist. LEXIS 24660 (S.D.N.Y. Dec. 8, 2004).....	19, 26
<i>Fink v. Weill</i> , No. 02 Civ. 10250(LTSRLE), 2005 U.S. Dist. LEXIS 20659 (S.D.N.Y. Sept. 19, 2005).....	26
<i>Grimes v. Donald</i> , 673 A.2d 1207 (Del. 1996)	16, 19
<i>Grobow v. Perot</i> , 539 A.2d 180 (Del. 1988)	17
<i>Guttman v. Huang</i> , 823 A.2d 492 (Del. Ch. 2003).....	23, 24, 25
<i>Halpert Enters., Inc. v. Harrison</i> , 362 F. Supp. 2d 426 (S.D.N.Y. 2005)	25, 26
<i>Kamen v. Kemper Fin. Servs., Inc.</i> , 500 U.S. 90 (1991)	14, 15
<i>Knopf v. Semel</i> , No. C 08-3658 JF (PVT), 2010 U.S. Dist. LEXIS 35925 (N.D. Cal. Mar. 17, 2010).....	20
<i>Levine v. Smith</i> , C.A. No. 8833, 1989 Del. Ch. LEXIS 160 (Del. Ch. Nov. 27, 1989, revised May 21, 1990), <i>aff'd</i> , 591 A.2d 194 (Del. 1991)	16
<i>Levine v. Smith</i> , 591 A.2d 194 (Del. 1991)	14, 15, 19

<i>In re LTL Shipping Servs. Antitrust Litig.</i> , No. 1:08-MD-01895-WSD, 2009 U.S. Dist. LEXIS 14276 (N.D. Ga. Jan. 28, 2009)	28
<i>MCG Capital Corp. v. Maginn</i> , C.A. No. 4521-CC, 2010 Del. Ch. LEXIS 87 (Del. Ch. May 5, 2010)	21
<i>Nolte v. Capital One Fin. Corp.</i> , 390 F.3d 311 (4th Cir. 2004)	20
<i>Pantry, Inc. v. Citgo Petroleum Corp.</i> , 2009 NCBC 1 (N.C. Super. Ct. Jan. 22, 2009)	4, 30
<i>Pogostin v. Rice</i> , 480 A.2d 619 (Del. 1984)	17, 19
<i>In re Pozen S'holders Litig.</i> , 2005 NCBC 7 (N.C. Super. Ct. Nov. 10, 2005)	14, 15
<i>Rales v. Blasband</i> , 634 A.2d 927 (Del. 1993)	passim
<i>Rattner v. Bidzos</i> , C.A. No. 19700, 2003 Del. Ch. LEXIS 103 (Del. Ch. Sept. 30, revised Oct. 7, 2003)	16
<i>Stone v. Ritter</i> , 911 A.2d 362 (Del. 2006)	23
<i>Stroock, Stroock & Lavan LLP v. Dorf</i> , 2010 NCBC 3A (N.C. Super. Ct. Feb. 17, 2010)	31
<i>In re Topps Co. S'holders Litig.</i> , 924 A.2d 951 (Del. Ch. 2007)	13
<i>VantagePoint Venture Partners 1996 v. Examen, Inc.</i> , 871 A.2d 1108 (Del. 2005)	13
<i>White v. Panic</i> , 783 A.2d 543 (Del. 2001)	14
<i>Wood v. Baum</i> , 953 A.2d 136 (Del. 2008)	17, 21, 25

In re Xethanol Corp. Derivative Litig.,
No. 06 Civ. 15536, 2007 U.S. Dist. LEXIS 60082 (S.D.N.Y. Aug. 16, 2007)26

AUTHORITIES

8 *Del. C.* § 102(b)(7)20
N.C. Gen. Stat. Ann. § 55-7-47 (2009)13, 14

Nominal defendant Horizon Lines, Inc. ("Horizon Lines" or the "Company"), and defendants Charles G. Raymond, M. Mark Urbania, John V. Keenan, Robert Zuckerman, Brian W. Taylor, and John Handy submit this brief in support of their motion to dismiss Plaintiff's Verified Shareholder Derivative Complaint (the "Complaint", cited herein as "Compl. ¶ ____").

PRELIMINARY STATEMENT

Plaintiff, an alleged shareholder of Horizon Lines, purports to bring this shareholder derivative action on behalf of Horizon Lines against certain of its current and former officers and directors. Plaintiff does not sue in his own right, but seeks to cause *the Company* to attempt to recover damages from these directors and officers resulting from expenses incurred because of the federal government's announcement in April 2008 of an antitrust investigation into alleged price fixing. As a result of that investigation, three of the Company's former employees in its Puerto Rico tradelane group (the "Puerto Rico Tradelane Employees") have entered guilty pleas to a violation of Section 1 of the Sherman Act. The gist of the Complaint is that the Board of Directors of Horizon Lines (the "Board") and certain officers purportedly failed to exercise appropriate oversight by consciously disregarding alleged illegal price fixing by employees.

Because Plaintiff purports to assert corporate rights, special threshold pleading rules must be satisfied before he can acquire standing to pursue the Company's claims. Specifically, under Delaware law, which applies here because Horizon Lines is a Delaware corporation, Plaintiff was required to make a demand on the Board to bring this lawsuit before seeking to pursue legal claims belonging to the Company. The only situation in which this pre-suit demand is excused is where the directors are incapable of making an impartial decision regarding the litigation, thereby rendering the demand "futile." In order to preserve the board of

directors' authority over a corporation's legal rights, Delaware law requires that allegations of demand futility be pleaded with particularity.

Where, as here, a plaintiff brings a claim alleging that the board of directors failed to exercise appropriate oversight, the demand futility exception is satisfied only where "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.'" *Egelhof v. Szulik*, 2006 NCBC 4 ¶ 45 (N.C. Super. Ct. Mar. 13, 2006) (quoting *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)) (emphasis in original). "The focus of the *Rales* test is on 'the disinterestedness and the independence of a majority of the board of directors in responding to a demand.'" *Id.* (citation omitted).

The Complaint does not come close to alleging that the *majority* of the Company's Board was conflicted. Plaintiff's sole basis for alleging that the directors were incapable of impartially considering his demand is a conclusory assertion that each director faces liability for the breach of fiduciary duty claims asserted in the Complaint. (Compl. ¶ 125) It is well settled, however, that "demand will be excused on the possibility of personal director liability only in the rare case when a plaintiff is able to show director conduct that is 'so egregious on its face that . . . a substantial likelihood of director liability therefore exists.'" *In re Citigroup, Inc. S'holder Derivative Litig.*, 964 A.2d 106, 121 (Del. Ch. 2009) (quoting *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984)). This is not such a rare case. Indeed, the Delaware courts have described a claim based on a failure to exercise oversight as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re Caremark Int'l Inc. Derivative*

Litig., 698 A.2d 959, 967 (Del. Ch. 1996). Here, in particular, the Complaint fails to plead with particularity that the Company's directors face a substantial likelihood of liability.

Plaintiff's derivative claim hinges on the contention that the directors must have known that the Puerto Rico Tradelane Employees were fixing prices and consciously disregarded that wrongdoing, but the Complaint contains no specific factual allegations to support that contention. Instead, Plaintiff asserts that the directors must have known of the price fixing due to a purported "red flag" – the Company was raising its shipping rates and fuel surcharges when demand for its Puerto Rico shipping services was "soft." According to Plaintiff, the ability to raise rates in a soft market is "economically illogical," so the directors must have known that the rate increases were the result of price fixing. This very same allegation was made by a shareholder who filed a securities class action against the Company and certain officers in the District of Delaware and was rejected by that court. *See City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *50-53 (D. Del. May 18, 2010). The federal court in Delaware held that "it is far from clear that Horizon's rate increases were suspicious under the circumstances that existed during the class period." *Id.* at *53. That same reasoning applies here as well – there was nothing suspicious about Horizon Lines' rate increases. Rising or stable prices are economically logical in a highly concentrated market, especially where, as here, the largest producer of shipping services has declared bankruptcy and ceased operations.

As Plaintiff has made no particularized allegations of fact to support his contention that the directors knew of the alleged price fixing by the Puerto Rico Tradelane Employees, he has failed to adequately allege that the directors faced a substantial likelihood of liability. As a result, there is no excuse for Plaintiff's failure to make a pre-suit demand on the

Board for all of his claims, and the Complaint should therefore be dismissed. Moreover, and for the same reasons, the Complaint fails to state a claim under Rule 12(b)(6) of the North Carolina Rules of Civil Procedure and should be dismissed on that ground as well.

STATEMENT OF FACTS¹

Competition in the Container Shipping Industry in the Jones Act Tradelanes

Nominal defendant Horizon Lines is a Delaware corporation that, through its direct and indirect subsidiaries, operates a container shipping business that transports cargo between the mainland United States and Alaska, Hawaii, Guam and Puerto Rico. (Compl. ¶¶ 2, 37) The Alaska, Hawaii and Puerto Rico tradelanes that Horizon Lines operates within are subject to the Jones Act, which requires that commercial vessels operating between states of the United States and certain United States territories, including Puerto Rico, possessions or non-contiguous states be built and registered in the U.S., manned by predominantly U.S. crews and owned and operated by U.S. citizens. (*Id.* ¶¶ 37-39, 45)

Due to the requirements of the Jones Act, the Puerto Rico tradelane is a "highly concentrated oligopoly" with just three other companies, Sea Star, Crowley Liner Services, Inc. and Trailer Bridge, Inc., operating within it. (Compl. ¶¶ 38, 81) The other tradelanes in which Horizon Lines operates are also highly concentrated with few competitors. (*See id.* ¶¶ 31-33) In the Alaskan tradelane, the only significant competitor is Totem Ocean Trailer Express, Inc. ("TOTE"). (*Id.* ¶ 31) In the Hawaii and Guam tradelanes, Horizon Lines' only significant competitor is Matson Navigation Company, Inc. ("Matson"). (*Id.* ¶ 32)

¹ Solely for the purposes of this motion, the Statement of Facts assumes the truth of the factual allegations made in the Complaint (although they are vigorously disputed as matters of fact), but not Plaintiff's conclusory allegations. *See Pantry, Inc. v. Citgo Petroleum Corp.*, 2009 NCBC 1 ¶ 44 (N.C. Super. Ct. Jan. 22, 2009).

Plaintiff contends that employees of Horizon Lines purportedly conspired with the Company's small number of competitors within its various tradelanes to fix prices and seeks to hold the Board and senior management responsible for that alleged price fixing. As discussed below, however, the few facts alleged in the Complaint are insufficient to show that either the directors or senior management were aware of any alleged price-fixing activities.

The Board's Oversight of the Company's Compliance with Laws and Regulations

Horizon Lines is currently managed by an eight-member Board composed overwhelmingly (seven out of eight) of non-employee independent directors. (Compl. ¶¶ 11-17) Each of the seven "outside" directors – Dan A. Colussy, James G. Cameron, Norman Y. Mineta, William J. Flynn, Vern Clark, Alex J. Mandl, and Thomas P. Storrs – has had a distinguished career independent of Horizon Lines. The only member of management who serves on the Board is Horizon Lines' CEO, Charles Raymond. (*Id.* ¶ 6)

Even the facts alleged in the Complaint show that the directors took their obligations to Horizon Lines and its shareholders seriously. All of the directors are alleged to have regularly attended Board meetings. In addition to attending these meetings, the directors regularly received monthly communications about the Company from the CEO and written materials from the Company in advance of the board meetings. (*See, e.g., id.* ¶¶ 101-02, 104-14, 116-17)

The Complaint also acknowledges that the Board developed systems designed to ensure the Company's compliance with legal and regulatory requirements. Plaintiff concedes that the Board created a three-member audit committee (the "Audit Committee") and tasked that committee with reviewing the effectiveness of the Company's procedures for monitoring and compliance with all applicable laws and regulations. (*Id.* ¶¶ 28-29) In carrying out that function,

among other things, the Audit Committee periodically meets with the independent auditor, the internal audit department, and management in separate executive sessions to discuss any matters that the Audit Committee or these groups believe should be discussed. (*Id.* ¶ 29)

The Board has caused the Company to adopt a written Code of Business Conduct and Ethics (the "Code of Conduct") that "describes standards of conduct for all employees, officers and directors of Horizon Lines, Inc. and its subsidiaries" (Compl. ¶ 25) The Complaint admits that the Code of Conduct put in place by the Board "is designed to deter wrongdoing and promote . . . [c]ompliance with applicable governmental laws, rules and regulations." (*Id.*) Further, the Code of Conduct put in place by the Board expressly warns all employees that "[i]t is Company policy to comply with all applicable antitrust laws including state laws and laws of other countries where the Company does business." (*Id.* ¶ 26) The Code of Conduct specifically advises all employees that price fixing among competitors is "clearly wrong" and "strictly prohibited by Company policy." (*Id.*)

The Antitrust Investigation

On April 17, 2008, the Department of Justice ("DOJ") executed search warrants at Horizon Lines and other shipping companies' offices. (Compl. ¶¶ 45, 46) That same day, Horizon Lines announced that it was the subject of an investigation being conducted by the DOJ. (*Id.* ¶ 46) After conducting an extensive investigation, on October 1, 2008, the DOJ charged three employees in Horizon Lines' Puerto Rico group – Gabriel Serra, R. Kevin Gill and Gregory Glova – with violating the Sherman Act by allegedly conspiring with Horizon Lines' competitors in the Puerto Rico tradelane to fix prices. (*Id.* ¶ 47) The Puerto Rico Tradelane Employees subsequently pleaded guilty. (*Id.* ¶ 48)

The Complaint describes the alleged price-fixing conspiracy in the Puerto Rico Tradelane by quoting from the plea agreements of the three Puerto Rico Tradelane Employees. The Complaint alleges that excerpts from the plea agreements indicate that the Puerto Rico Tradelane Employees were the organizers or leaders of the alleged conspiracy. (Compl. ¶ 49) According to the Complaint, the Puerto Rico Tradelane Employees engaged in "discussions and attend[ed] meetings with representatives of one or more competing providers of Puerto Rico freight services." (*Id.*) At these meetings, the Puerto Rico Tradelane Employees reached agreements with competitors in Puerto Rico "to allocate customers, rig bids submitted to government and commercial buyers, and to fix the prices of rates, surcharges and other fees" (*Id.*) The plea agreements are not alleged to contain any such allegations about the Horizon Lines' directors or senior management.

The Complaint also contains a few select quotes from the transcript of the sentencing hearing for the Puerto Rico Tradelane Employees. In that transcript, a government lawyer states that Gill provided the DOJ with "contemporaneous documents evidencing his and others' involvement in the conspiracy" (Compl. ¶ 57) The Complaint, however, does not identify any of these documents. Again, the Complaint also points to statements by Serra and Glova at the sentencing hearing in which they mention communications with "other senior executives" or "senior executives." (*Id.* ¶¶ 55-56) The Complaint does not identify any of these senior executives. In fact, the direct quotes from Serra and Glova do not even state whether these unnamed persons were employees of Horizon Lines or were executives of a competitor who participated in the alleged conspiracy.

The Alaska and Hawaii/Guam Tradelanes

The Complaint tries to portray the alleged antitrust violations as going beyond the Puerto Rico tradelane into the Alaska and Hawaii/Guam tradelanes, but this assertion relies entirely on conclusory allegations. For example, the Complaint alleges, without referencing any specific facts, that Horizon Lines conspired with TOTE in the assessment of fuel surcharges in the Alaskan tradelane. (Compl. ¶ 69) The Complaint lacks any allegations of specific meetings between named Horizon Lines employees and employees of TOTE. Rather, Plaintiff merely asserts that Horizon Lines and TOTE kept their "fuel surcharges in lockstep with each other in order to increase their revenues along the trade route." (*Id.*)

The Complaint's allegations regarding the Hawaii/Guam tradelane are also conclusory. (*Id.* ¶ 74) As with the Alaska tradelane, the Complaint merely asserts that Horizon Lines and Matson "initiated the same fuel surcharges, and both increased the frequency with which they increased fuel surcharges." (*Id.* ¶¶ 75-76) The Complaint does not contain any specific allegations regarding meetings or communications between Horizon Lines and Matson regarding prices or competition in the Hawaii/Guam tradelane. (*See id.* ¶¶ 70-79)

The Conclusory Allegations Regarding the Individual Defendants

In an attempt to implicate the Board and senior management in the alleged antitrust conspiracy, the Complaint uses a rote pleading style of alleging that "Horizon, with the knowledge and approval of the Individual Defendants, conspired with" competitors in the Puerto Rico, Alaska and Hawaii/Guam tradelanes. (Compl. ¶¶ 31-33; *see also id.* ¶¶ 2, 59, 69-70, 77,

79-80) The Complaint fails to back up that assertion with even a single particularized allegation linking any of the directors or senior executive officers to the alleged antitrust conspiracy.²

Instead, Plaintiff points to unremarkable internal documents that merely show that management gave regular reports to the Board regarding the Company's performance in its three main tradelanes. (Compl. ¶ 100)³ According to the Complaint, the CEO sent a monthly letter to directors and senior executive officers of the Company updating them about the financial performance of the Company, which included information regarding shipping rates, volumes and fuel surcharges. (*Id.*) None of these monthly letters from the CEO stated or even suggested that any of the shipping rates, volumes or fuel surcharges had been set by illegal means. In addition, the minutes of Board or Audit Committee meetings, as well as materials distributed in advance of such meetings, show that the directors frequently received information regarding the Company's financial performance, including shipping rates, volumes or fuel surcharges. (*See, e.g., id.* ¶¶ 103, 105, 107, 109, 111, 114-16) The Complaint does not allege that any of the minutes or presentations indicate that any of the shipping rates, volumes or fuel surcharges had been set by illegal means.

Plaintiff nevertheless asserts that the mere fact that the Board received updates regarding the Company's financial performance, which typically included a discussion of rates, volumes and fuel surcharges, demonstrates that they must have known that these rates and fuel

² The Complaint states that executives of Sea Star were also targeted by the DOJ investigation. (*See* Compl. ¶¶ 50-51)

³ Plaintiff obtained the internal documents cited in the Complaint by making use of a Delaware statute that allows a shareholder to inspect books and records of the corporation if the shareholder can demonstrate a proper purpose for the inspection. (Compl. ¶¶ 95-99) After Plaintiff made a demand to inspect books and records, the Company voluntarily produced over 1,000 pages of Board materials after negotiating an appropriate confidentiality agreement with Plaintiff. (*See id.*)

surcharges were being fixed with the Company's competitors. Plaintiff leaps to this conclusion based on just the fact that rates and fuel surcharges were rising at a time when shipping volumes were decreasing. (Compl. ¶¶ 100, 118; *see also id.* ¶ 103 ("[T]he defendants present were aware that the Company was able to continue to raise shipping rates within the market notwithstanding the 'softness.'"))

Plaintiff's theory – that the Company's increased shipping rates and fuel surcharges in a "soft" market constituted an "economically illogical result" – is deeply flawed. It was hardly unusual for the Company to have been able to charge higher fuel surcharges during a time period of unprecedented increases in fuel prices. In addition, in a highly concentrated market, such as the Puerto Rico tradelane, rising or stable prices are a common lawful phenomenon, not an indicator of illegal price-fixing.

Indeed, if Plaintiff's theory were valid – that anyone who knew that Horizon Lines was raising rates at a time when the Puerto Rico market was "soft" must have known that those rate increases resulted from illegal price-fixing – then *anyone* with access to Horizon Lines' SEC filings, *including Plaintiff himself*, would have been aware of the alleged conspiracy. The Complaint acknowledges that Horizon Lines' CEO and CFO repeatedly told investors that the Company was continuing to get rate increases in Puerto Rico despite softness in that market. (*See* Compl. ¶ 89 (alleging that the CEO told investors: "I would say that in the case of Puerto Rico, even though that market is a little light, we're continuing to get rate increases"); *id.* ¶ 90 (alleging that the CFO told investors: "that the Company was able to achieve price increases in Puerto Rico in 2007 'even though volume softness existed in 2007,' and that there was 'no reason for us to believe that that will change in 2008'")) While the Company's investors were privy to this same supposedly "economically illogical" information regarding price increases and

soft market conditions, Plaintiff states that they had no knowledge of the alleged price-fixing. *See* Compl. ¶ 92 ("Unbeknownst to the Company's shareholders and the public until the announcement of the DOJ Investigation, the only way that Horizon was able to raise rates in the weak Puerto Rico economy was through its illegal conspiracy to allocate customers, rig bids and fix prices within the Puerto Rico Trade Route."). Plaintiff's conclusion regarding the shareholders' knowledge is plainly correct – that mere knowledge of price increases and soft shipping volumes does not constitute knowledge that those price increases must have resulted from illegal activities; however, the Plaintiff's reasoning regarding shareholder knowledge also applies to the directors and senior executives.

A Shareholder Securities Lawsuit Has Been Dismissed

While the Complaint references the settlement of a private antitrust action, it fails to even acknowledge a highly relevant shareholder lawsuit arising out of very similar facts. In a securities class action filed in the United States District Court for the District of Delaware, a Horizon Lines Shareholder alleged that the Company and certain of its officers and employees engaged in violations of the Securities and Exchange Act of 1934. *See City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2009 U.S. Dist. LEXIS 106186, at *2 (D. Del. Nov. 13, 2009). The central theme of the securities class action is essentially identical to Plaintiff's theory in this action – that senior management of the Company must have known about the alleged antitrust conspiracy because the Company was experiencing rate increases in a soft market. *See id.* *51. The federal court in Delaware has twice dismissed the securities class action (the second time with prejudice) and squarely rejected the contention that senior management must have known of the alleged price fixing in Puerto Rico because the Company was able to increase prices in "soft" market conditions. *See id.* *52 (ruling "Plaintiffs .

. . plead no facts showing that either Raymond or Keenan or Urbania was made aware of the conspiracy or had access to information which would have allowed them to discover it."); *City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *57 (D. Del. May 18, 2010) ("[P]laintiffs have simply not provided any facts to support a conclusion that either Raymond, Urbania, Keenan, Handy, or Taylor were aware of the conspiracy, or should have been aware of it, prior to the disclosure of the Department of Justice investigation in April of 2008.").

ARGUMENT

I. DELAWARE LAW, WHICH GOVERNS PLAINTIFF'S CLAIM, REQUIRES PLAINTIFF TO MAKE DEMAND ON THE HORIZON LINES BOARD OF DIRECTORS.

A. Delaware Law Controls Plaintiff's Claim.

The Complaint concerns the duties that directors and officers of a Delaware corporation owe to the corporation and its stockholders. Under the internal affairs doctrine, the law of the state of incorporation – Delaware – controls such claims. *Bluebird Corp. v. Aubin*, 657 S.E.2d 55, 63 (N.C. Ct. App. 2008).⁴ Furthermore, because this is a corporate derivative action, the North Carolina Business Corporations Act expressly provides that Delaware law governs the case. N.C. Gen. Stat. Ann. § 55-7-47 (2009)⁵; *Egelhof v. Szulik*, 2006 NCBC 4 ¶ 41

⁴ The internal affairs doctrine provides that only one state – the state of incorporation – "should have the authority to regulate a corporation's internal affairs" between its directors and shareholders to avoid conflicting demands. *Bluebird Corp. v. Aubin*, 657 S.E.2d 55, 63 (N.C. Ct. App. 2008); see generally *Classic Coffee Concepts, Inc. v. Anderson*, 2006 NCBC 21 ¶ 88 (N.C. Super. Ct. Dec. 1, 2006) (noting that the internal affairs doctrine holds that "the law of the incorporating state should normally be applied to matters involving the internal affairs of a foreign corporation") (citation omitted). "[T]he internal affairs doctrine protects the justified expectations of the parties with interests in the corporation." *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005) (citation omitted); *In re Topps Co. S'holders Litig.*, 924 A.2d 951, 962 (Del. Ch. 2007) (applying internal affairs doctrine and noting that states have "no legitimate interest in regulating the internal affairs of foreign corporations") (citing *Edgar v. MITE Corp.*, 457 U.S. 624, 645-46 (1982)); see also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987) ("A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.").

⁵ Section 55-7-47 specifically provides:

In any derivative proceeding in the right of a foreign corporation, the matters covered by this Part shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation except for the matters governed by G.S. 55-7-43, 55-7-45, and 55-7-46.

(N.C. Super. Ct. Mar. 13, 2006) ("Because Red Hat is a Delaware corporation, this Court applies Delaware law in determining whether Plaintiff's failure to make demand should be excused.") (citations omitted); *In re Pozen S'holders Litig.*, 2005 NCBC 7 ¶ 82 (N.C. Super. Ct. Nov. 10, 2005) (granting motion to dismiss for failure to make demand under Delaware law where company was incorporated in Delaware).

B. The Demand Requirement Serves Important Corporate Governance Purposes.

Delaware corporate law requires that a Plaintiff make demand on a corporation's board of directors or plead with particularity why demand is futile and, therefore, excused. The demand requirement is not a merely a procedural formality, but it is an "important 'stricture[] of substantive law.'" *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991) (citation omitted); *see also Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96-97 (1991) ("[T]he function of the demand doctrine in delimiting the respective powers of the individual shareholder and of the directors to control corporate litigation clearly is a matter of 'substance,' not 'procedure.'" (citation omitted); *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993). It arises from the "basic principle of corporate governance that the decisions of a corporation – including the decision to initiate litigation – should be made by the board of directors or the majority of shareholders." *Kamen*, 500 U.S. at 101 (quoting *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 530 (1984)). *Accord White v. Panic*, 783 A.2d 543, 546-47 (Del. 2001); *see also In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009) ("The purpose of the demand requirement is not to insulate defendants from liability; rather, the demand requirement and the strict requirements of factual particularity . . . 'exist[] to preserve the primacy of board decision-

N.C. Gen. Stat. Ann. § 55-7-47 (2009). Sections 55-7-43 (stay of proceedings), 55-7-45 (discontinuance or settlement), and 55-7-46 (payment of expenses) are not at issue for purposes of this motion. N.C. Gen. Stat. Ann. §§ 55-7-43, 45-46.

making regarding the legal claims belonging to the corporation.") (citation omitted). It bears emphasis that when a shareholder files a derivative suit, he is not bringing a claim on his own behalf to enforce a claim he personally possesses, but has brought suit "to enforce a *corporate* cause of action." *Kamen*, 500 U.S. at 95 (quoting *Ross v. Bernhard*, 396 U.S. 531, 534 (1970)) (emphasis in original). As the Delaware Court of Chancery has explained, equity will allow a shareholder to sue in his own name for the benefit of the corporation only after he has exhausted all other remedies with the corporation:

[A] derivative action may not be pursued if the corporation is willing and able to assert the suit on its own behalf, *i.e.*, the complaining shareholder must give the board of directors the opportunity to manage the litigation to its satisfaction or the board of directors must for some reason be incapable of pursuing the litigation.

Agostino v. Hicks, 845 A.2d 1110, 1116 (Del. Ch. 2004).

Under Delaware law, a stockholder's ability to prosecute a derivative suit "is limited to situations where the stockholder has demanded that the directors pursue the corporate claim and they have wrongfully refused to do so or where demand is excused because the directors are incapable of making an impartial decision regarding such litigation." *Rales*, 634 A.2d at 932 (citation omitted); *Pozen*, 2005 NCBC 7 ¶ 43 ("[The] purpose [of the demand requirement] is to ensure that the derivative action remains an exception to the general rule that the appropriate party to bring suit is the corporation acting through its directors.") (citing *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984)); *Levine*, 591 A.2d at 200 ("Under Delaware law, a derivative suit is also a qualified or conditional remedy by reason of its 'potential for conflict between the directors' power to manage the corporation and the shareholders' power to sue derivatively.") (citation omitted).

The demand requirement serves other purposes as well. It constitutes "a 'form of alternate dispute resolution,' that requires the stockholder to exhaust 'his intracorporate

remedies" rather than seek "immediate recourse to litigation." *Rales*, 634 A.2d at 935 (quoting *Aronson*, 473 A.2d at 811-12); *see also Rattner v. Bidzos*, C.A. No. 19700, 2003 Del. Ch. LEXIS 103, at *21 (Del. Ch. Sept. 30, revised Oct. 7, 2003) ("The hurdle of proving demand futility also serves an important policy function of promoting internal resolution, as opposed to litigation, of corporate disputes and grants the corporation a degree of control over any litigation brought for its benefit.") (citations omitted). The demand requirement also serves to "deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms" *Grimes*, 673 A.2d at 1207, 1217 (del.1996). A motion to dismiss for failure to make demand "is not intended to test the legal sufficiency of the plaintiff's substantive claim. Rather, its purpose is to determine who is entitled, as between the corporation and its shareholders, to assert the plaintiff's underlying substantive claim on the corporation's behalf." *Levine v. Smith*, C.A. No. 8833, 1989 Del. Ch. LEXIS 160, at *17 (Del. Ch. Nov. 27, 1989, revised May 21, 1990), *aff'd*, 591 A.2d 194 (Del. 1991).

II. THE COMPLAINT SHOULD BE DISMISSED BECAUSE PLAINTIFF FAILED TO PLEAD PARTICULARIZED FACTS DEMONSTRATING THAT DEMAND IS EXCUSED.

A. Demand Futility Must Be Pled With Particularity.

Plaintiff did not make a pre-litigation demand prior to commencing this action, contending instead that demand is excused because it would have been "futile." (Compl. ¶¶ 123, 125) In order to survive a motion to dismiss for failure to make demand, Plaintiff "must plead facts *with particularity* that demonstrate the reasons why demand would have been futile." *Egelhof v. Szulik*, 2006 NCBC 4 ¶ 43 (N.C. Super. Ct. Mar. 13, 2006) (quoting *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000)) (emphasis added). It is well settled that "[p]leadings in

derivative suits . . . must comply with stringent requirements of factual particularity that differ substantially from . . . permissive notice pleading.'" *Id.* (citation omitted).

B. The One-Step *Rales* Test Applies To Plaintiff's Claim.

Delaware courts have established two tests for determining demand futility: the "*Aronson*" test and the "*Rales*" test. Where a board's decision is at issue, whether demand is excused is governed by the two-step *Aronson* test, pursuant to which particularized facts must be alleged that "raise a reasonable doubt as to (i) director disinterest or independence or (ii) whether the directors exercised proper business judgment in approving the challenged transaction." *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988) (citing *Aronson*, 473 A.2d at 814); *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984). Where "directors are sued derivatively because they have failed to do something (such as a failure to oversee subordinates)," a different test – the *Rales* test – applies, because no business judgment has been made, and thus the second prong of the *Aronson* test is inapplicable. *Rales v. Blasband*, 634 A.2d 927, 934 n.9 (Del. 1993); *see also Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008) (the *Rales* test "applies where the subject of a derivative suit is not a business decision of the Board but rather a violation of the Board's oversight duties").

Here, the Complaint does not challenge any actual decisions made by the Board: there are no allegations that the Board passed resolutions setting the rates that the Company charged its customers or voted to instruct the Puerto Rico Tradelane Employees to collude with Horizon Lines' competitors. Rather, Plaintiff's claim is based on an alleged failure of the duty of oversight: *i.e.*, the Board allegedly had sufficient information at its disposal that it knew or should have known that certain employees were violating Company policy and engaging in price fixing. In the exact words of the Complaint, the directors "were well aware that Horizon was

continually raising shipping rates and fuel surcharges despite pronounced 'softness' in its markets, and [therefore] they knew the reason for this economically illogical result was that the Company was engaged in illegal antitrust conspiracies." (Compl. ¶ 118) Because Plaintiff does not challenge any actual decisions made by the Board, but challenges the alleged failure of the directors to prevent illegal conduct, the *Rales* test applies to determine whether demand is excused. *In re Dow Chem. Co. Derivative Litig.*, C.A. No. 4349-CC, 2010 Del. Ch. LEXIS 2, at *43-44 (Del. Ch. Jan. 11, 2010) (applying *Rales* standard to claim alleging directors allowed company employees to engage in bribery and insider trading).⁶

Under the *Rales* test, the Court examines "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 the demand." *Egelhof*, 2006 NCBC 4 ¶ 45 (quoting *Rales*, 634 A.2d at 934) (emphasis in original). "The focus of the *Rales* test is on 'the disinterestedness and the independence of a majority of the board of directors in responding to a demand.'" *Id.* (quoting *Rattner v. Bidzos*, C.A. No. 19700, 2003 Del. Ch. LEXIS 103, at *26-27 (Del. Ch. Sept 30, revised Oct. 7, 2003)). Under both the *Aronson* and the *Rales* tests, the

⁶ The Complaint contains a wholly conclusory allegation that all of the individual defendants "breached their fiduciary duties of loyalty and good faith by, among other things, knowingly engaging in an illegal conspiracy to suppress and eliminate competition in all three of [Horizon's] principal markets. . . ." (Compl ¶ 128). This wholly conclusory assertion does not identify any action of the Board endorsing or authorizing price fixing. Rather, other allegations in the Complaint make clear that Plaintiff's claim is based on the directors' purported awareness of a supposed red flag. (*See id.* ¶ 118) In any event, a wholly conclusory allegation of director knowledge is insufficient to excuse demand. *See In re Citigroup Shareholders Litig*, 964 A.2d 106, 127 (Del. Ch. 2009) (holding conclusory allegations that directors "must have consciously ignored warning signs or knowingly failed to monitor the Company's risk . . . are not sufficient to state a claim for failure of oversight . . .").

disqualifying interest or lack of independence must afflict a *majority* of the corporation's directors. See *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996); *Rales*, 634 A.2d at 930, 936-37; *Levine v. Smith*, 591 A.2d 194, 205 (Del. 1991). As explained below, the Complaint fails to satisfy the *Rales* test for demand futility and, therefore, must be dismissed.

C. Plaintiff Has A Heavy Burden Of Pleading With Particularity That A Majority Of The Directors Faced A Substantial Likelihood Of Liability.

The Complaint identifies just one purported conflict of interest by the directors that purportedly excuses demand – that each director is supposedly "incapable of making an independent and disinterested decision to vigorously prosecute this action because each of the directors faces a substantial likelihood of liability for breaching their fiduciary duties" (Compl. ¶ 125) It bears emphasis that "[i]t is settled law that demand is not excused because plaintiff pleads that directors would have to sue themselves thereby 'placing the litigation in hostile hands.'" *Fink v. Komansky*, No. 03CV0388, 2004 U.S. Dist. LEXIS 24660, at *21 (S.D.N.Y. Dec. 8, 2004) (citations omitted); accord *Aronson v. Lewis*, 473 A.2d 805, 818 (Del. 1984); *Pogostin*, 480 A.2d at 625 ("[W]e note that the plaintiffs' bootstrap allegations of futility, based on claims of directorial participation in and liability for the wrongs alleged, coupled with a reluctance by directors to sue themselves, were laid to rest in *Aronson* . . .").

A "mere threat" of personal liability does not render a director interested. See *Aronson*, 473 A.2d at 815. Rather, "[d]irectors who are sued for failure to oversee subordinates have a disabling interest when 'the potential for liability is not "a mere threat" but instead may rise to "a substantial likelihood."'" *In re Baxter Int'l, Inc. S'holder Litig.*, 654 A.2d 1268, 1269 (Del. Ch. 1995) (citation omitted, emphasis added). In other words, "demand will be excused on the possibility of personal director liability only in the rare case when a plaintiff is able to show

director conduct that is 'so egregious on its face that . . . a substantial likelihood of director liability therefore exists.'" *Citigroup*, 964 A.2d at 121 (quoting *Aronson*, 473 A.2d at 815).

As explained below, here, Plaintiff's burden of pleading a substantial likelihood of liability is especially high for two reasons: (i) the Company's shareholders have adopted a provision in the certificate of incorporation that immunizes the directors from monetary liability for negligence or even gross negligence; and (ii) the standard of liability for an oversight claim is itself "quite high." *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996). Indeed, as previously noted, the Delaware courts have described a claim based on a failure to exercise oversight as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Id.* at 967.

D. Plaintiff Cannot Plead A Substantial Likelihood Of Liability Because The Directors Are Protected From Liability By Article VII Of Horizon Lines' Certificate Of Incorporation.

Horizon Lines' shareholders, acting pursuant to authority granted under Section 102(b)(7) of the Delaware General Corporation Law, 8 *Del. C.* § 102(b)(7) ("Section 102(b)(7)"), have adopted a provision in the Company's certificate of incorporation that exempts Horizon Lines' directors from personal liability for monetary damages in cases, such as this one, that are based on allegations of negligence or gross negligence. *See* Ex. A (Horizon Lines, certificate of incorporation) Art. VII.⁷ This provision is dispositive of the disinterest of Horizon Lines' directors because Plaintiff's contention is that the directors are interested is based upon the

⁷ The Court may take judicial notice of a publicly filed corporate document such as Horizon Lines' Certificate of Incorporation (which is filed with Delaware's Secretary of State's office). *See Nolte v. Capital One Fin. Corp.*, 390 F.3d 311, 317 n.* (4th Cir. 2004) (taking judicial notice of SEC filings); *Knopf v. Semel*, No. C 08-3658 JF (PVT), 2010 U.S. Dist. LEXIS 35925, at *19 n.3 (N.D. Cal. Mar. 17, 2010) (taking judicial notice of publicly filed certificate of incorporation).

assertion that the directors "face[] a substantial likelihood of liability for breaching their fiduciary duties." (Compl. ¶ 125)

Under Delaware law, "[w]hen the certificate of incorporation exempts directors from liability, the risk of liability does not disable them from considering a demand fairly unless particularized pleading permits the court to conclude that there is a substantial likelihood that their conduct falls outside the exemption." *In re Baxter*, 654 A.2d at 1270; *see also Wood*, 953 A.2d at 141 ("Where directors are contractually or otherwise exculpated from liability for certain conduct, 'then a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts.'") (quoting *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003)) (emphasis in original). Section 102(b)(7) contains three exceptions to the broad immunity provided by an exculpatory charter provision such as Article VII; it cannot bar recoveries for: "(i) breaches of the duty of loyalty, (ii) acts or omissions not in good faith or which involve intentional misconduct or knowing violations of the law, or (iii) transactions from which the director derives an improper personal benefit." *MCG Capital Corp. v. Maginn*, C.A. No. 4521-CC, 2010 Del. Ch. LEXIS 87, at *69 (Del. Ch. May 5, 2010) (citing 8 *Del. C.* § 102(b)(7)).

Here, the alleged wrongdoing in this case does not fall within one of those exceptions. Plaintiff does not contend that the members of the Board engaged in wrongful self-dealing (duty of loyalty) or received an improper personal benefit. Thus, the only question is whether the directors acted in bad faith or engaged in intentional or knowing violations of law.

In order to satisfy the bad faith or intentional misconduct exception to Section 102(b)(7), a plaintiff must "plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had 'actual or constructive knowledge' that their conduct was legally

improper." *Citigroup*, 924 A.2d at 125 (quoting *Wood*, 953 A.2d at 141). Accordingly, Plaintiff can only come with this exception by "alleging with particularity that a director *knowingly* violated a fiduciary duty or failed to act in violation of a *known* duty to act, demonstrating a *conscious* disregard for her duties." *Id.* (emphasis in original). Here, the Complaint contains no such particularized allegations, but merely asserts, in a conclusory manner, that the directors acted "knowingly" and not in "good faith." (Compl. ¶¶ 125, 128) Such conclusory allegations have been consistently rejected as insufficient by the Delaware courts. *See, e.g., In re Dow Chem. Co. Derivative Litig.*, C.A. No. 43499, 2010 Del. Ch. LEXIS 2, at *45 (Del. Ch. Jan. 11, 2010) (dismissing oversight claim on demand grounds due to absence of particularized allegations of bad faith); *Citigroup*, 964 A.2d at 128 (Del. Ch. 2009) (same); *Ash v. McCall*, C.A. No. 17132, 2000 Del. Ch. LEXIS 144, at *3 (Del. Ch. Sept. 15, 2000) (same).

E. The Complaint Does Not Allege Facts With Particularity To Show That The Director Defendants Confront A "Substantial Likelihood" Of Liability With Respect To Plaintiff's Oversight Claim.

Plaintiff's claim that the directors should have prevented the alleged price fixing carried out by Company employees is governed by the strict standard set forth in *Caremark*, where the Delaware Court of Chancery stated:

Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . *only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists –* will establish the lack of good faith that is a necessary condition to liability. Such a test of liability – lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight – is quite high.

In re Caremark, 698 A.2d at 971 (emphasis added).

Caremark establishes "a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their

duties in good faith. Put otherwise, the decision premises liability on a showing that the directors were conscious of the fact that they were not doing their jobs." *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003). Thus, in order to plead an oversight claim, a complaint must contain "well-pleaded facts to suggest a reasonable inference that a majority of the directors consciously disregarded their duties over an extended period of time." *David B. Shaev Profit Sharing Account v. Armstrong*, No. 1449-N, 2006 Del. Ch. LEXIS 33, at *4 (Del. Ch. Feb. 13, 2006), *aff'd mem.*, 911 A.2d 802 (Del. 2006).

The Delaware Supreme Court has explained that a *Caremark* claim "draws heavily upon the concept of director failure to act in good faith." *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006). The *Stone* opinion held that in order to plead such a *Caremark* claim – and likewise to excuse demand based upon director interest due to a "substantial likelihood of liability" in connection with such a claim – a complaint must plead that:

(a) the directors *utterly failed* to implement any reporting or information system or controls; or (b) having implemented such a system or controls, *consciously failed to monitor* or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that *the directors knew that they were not discharging their fiduciary obligations*. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.

Id. at 370 (internal citations omitted; emphasis added; original emphasis omitted). The Complaint contains no allegations, particularized or otherwise, that could satisfy either method of pleading a *Caremark* claim.

First, the Complaint does not allege "an utter failure to attempt" to put a monitoring system in place. On the contrary, the few specific facts alleged in the Complaint show that the Board adopted policies and procedures to ensure compliance with applicable laws

and regulations. For example, the Complaint alleges that Horizon Lines had in place a written Code of Conduct that expressly prohibits price fixing. (Compl. ¶¶ 25-27) The Complaint also avers that the Board tasked its Audit Committee with reviewing the effectiveness of the Company's compliance procedures and that the Audit Committee met numerous times between 2006 and 2008. (*See id.* ¶¶ 103, 115) The allegations in the Complaint also show that the directors monitor the Company's performance by receiving regular communications from the CEO, holding frequent Board meetings, and receiving packets of information regarding the Company's performance in advance of those meetings. (*See, e.g.*, ¶¶ 100-02, 104, 106-08, 110-13, 117)⁸

As the Delaware Court of Chancery's recent decision in *In re Dow Chemical Co. Derivative Litigation* confirms, these types of allegations actually undercut a claim based on an alleged failure to exercise oversight. 2010 Del. Ch. LEXIS 2. In dismissing a *Caremark* claim based on an alleged failure to prevent employees from engaging in bribery, the Delaware court noted that the company's directors had carried out their oversight function because they "set up policies to prevent improper dealing with third parties." *Id.* at *50 n.85. The court further stated that the plaintiff "cannot simultaneously argue that the board 'utterly failed' to meet its oversight duties yet had 'corporate governance procedures' in place without alleging that the board failed to monitor its ethics policy or its internal procedures." *Id.* Here, similarly, the Complaint concedes that Horizon Lines had policies and procedures in place, but does not allege with particularity

⁸ Delaware law does not allow shareholder plaintiffs to second-guess the directors' business judgment about the type of systems and controls needed. *See In re Caremark*, 698 A.2d at 970 ("Obviously the level of detail that is appropriate for [a corporate reporting and] information system is a question of business judgment" not subject to second-guessing by shareholder plaintiffs); *Guttman*, 823 A.2d at 506-07 (complaint failed to plead oversight claim where it did not plead particularized facts regarding board's monitoring systems).

that the Board or its Audit Committee failed to monitor those policies or procedures. Second, Plaintiff has not alleged particularized facts demonstrating that a majority of the directors consciously ignored "red flags" of wrongdoing. Indeed, even where a board is sued for having failed to prevent conduct that was criminal or fraudulent, courts repeatedly have refused to excuse demand based on conclusory allegations that directors ignored "red flags."

The Delaware Court of Chancery's decision in *Guttman* is instructive. In *Guttman*, a company had issued false financial statements that were later corrected through a restatement, and the plaintiffs sought to hold the board responsible for alleged lack of oversight of company accounting systems. 823 A.2d at 505-06. In dismissing the complaint on demand grounds, the court held that the allegations in the complaint did not suggest that the directors faced a substantial likelihood of liability. *Id.* at 507. The court reasoned that the complaint was:

[E]mpty of the kind of fact pleading that is critical to a *Caremark* claim, such as contentions that the company lacked an audit committee, that the company had an audit committee that met only sporadically and devoted patently inadequate time to its work, *or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation.*

Id. (emphasis added). The *Guttman* opinion notes that "the complaint does not plead a single fact suggesting specific red – or even yellow – flags were waved at the outside directors." *Id.* Courts applying Delaware law have emphasized that "red flags" "are only useful when they are either waved in one's face or displayed so that they are visible to the careful observer." *Wood*, 953 A.2d at 143 (quoting *In re Citigroup Inc. S'holders Litig.*, No. 19827, 2003 Del. Ch. LEXIS 61, at *8 (Del. Ch. June 5), *aff'd mem. sub nom. Rabinovitz v. Shapiro*, 839 A.2d 666 (Del. 2003)).⁹

⁹ See also *Halpert Enters., Inc. v. Harrison*, 362 F. Supp. 2d 426, 432-33 (S.D.N.Y. 2005) (dismissing oversight claims where complaint "never, except with conclusory allegations,

Here, the Complaint's supposed "red flag" argument consists of claims that materials from the Company in advance of Board meetings and presentations made at Board and committee meetings show that the directors "knew that Horizon [Lines] results were being driven by the illegal antitrust conspiracy." (Compl. ¶ 100) The key indicator, according to the Complaint, is that the materials discussed raising rates and increasing fuel surcharges while simultaneously stating that demand in the shipping markets was "soft." (*Id.*) Plaintiff devotes paragraphs in the Complaint to what was written to members of the Board regarding rates, surcharges, and the market for shipping in the various tradelanes. (*See id.* ¶¶ 100-17) Plaintiff argues that "absent an anticompetitive conspiracy, it makes no sense that market conditions could be 'soft' with shipping volumes decreasing, yet Horizon [Lines] is able to continuously raise its rates." (*Id.* at ¶ 100) Thus, Plaintiff reasons, "the Individual Defendants knew that Horizon's results were being driven by the illegal antitrust conspiracy." (*Id.*) As explained below, however, this purported "red flag" was no flag at all.

In the first instance, the Complaint avers that Horizon Lines operated in highly concentrated oligopolistic markets. (Compl. ¶ 38 ("Jones Act . . . restrictions result in an

conveys that the [alleged] scheme occurred with the Board's knowledge or systemic failure to engage in proper oversight," and the plaintiff "offered no specific allegations suggesting that the directors knew of the nature of JPM Chase's dealings with Enron, or that they disregarded 'red flags'"); *Fink v. Weill*, No. 02 Civ. 10250 (LTSRLE), 2005 U.S. Dist. LEXIS 20659, at *4, 15 (S.D.N.Y. Sept. 19, 2005) (allegation that "Citigroup engaged in an extensive series of unlawful and fraudulent transactions, principally with Enron" insufficient to plead a substantial likelihood of liability because "Plaintiff fail[ed] entirely to proffer particularized allegations of any of the Defendants' knowledge of or involvement in any of these transactions"); *Komansky*, 2004 U.S. Dist. LEXIS 24660, at *11 (dismissing oversight claims "[w]here plaintiff has 'not pled with particularity that the directors ignored obvious danger signs of employee wrongdoing' but instead base his claim 'on a presumption that employee wrongdoing would not occur if directors performed their duty properly'") (citation omitted); *In re Xethanol Corp. Derivative Litig.*, No. 06 Civ. 15536, 2007 U.S. Dist. LEXIS 60082, at *16 (S.D.N.Y. Aug. 16, 2007) (same); *In re Citigroup*, 2003 Del. Ch. LEXIS 19827, at *6-7; *David B. Shaev Profit Sharing Account*, 2006 Del. Ch. LEXIS 33, at *18 (same).

oligopolistic but competitive market"); *id.* ¶ 65 ("Competition within the market is limited by the Jones Act, substantial upfront costs, and a substantial lag time between deciding to enter and actually being able to enter the market. . . ."); *id.* ¶ 66 ("[T]he markets in which we operate have been less vulnerable to over capacity and volatility than international shipping markets.))

Stable or increasing rates are neither unusual nor unexpected in such markets. Courts have long recognized that in an oligopolistic market, a rational competitor setting its own prices will consider the likely reactions by its competitors, which discourages price-cutting and can lead to parallel, but lawful, behavior. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 553-54 (2007) ("Even 'conscious parallelism,' a common reaction of 'firms in a concentrated market [that] recogniz[e] their shared economic interests and their interdependence with respect to price and output decisions,' is 'not in itself unlawful.'") (citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993)). While this parallel conduct may produce stable or even rising prices, the Supreme Court has held that allegations of parallel conduct are insufficient to create even "plausible" grounds to infer that the conduct is the result of an illegal agreement. *See id.* at 556-57 ("Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality."). Thus, it is simply not unreasonable that the members of the Board would not attribute stable or rising prices to the result of an illegal price-fixing conspiracy in the Puerto Rico tradelane, especially when the largest competitor has declared bankruptcy and exited the market. (Compl. ¶ 84) Likewise, parallel conduct with regard to fuel surcharges, which Plaintiff claims was "concerted" activity on the part of the competitors in the Alaska and Hawaii/Guam tradelanes (*id.* ¶¶ 69, 74), does not indicate that participants in those markets were engaging in collusive behaviors in contravention of the U.S. antitrust laws; such conduct is logical during a

time of unprecedented increases in fuel costs. *See In re LTL Shipping Servs. Antitrust Litig.*, No. 1:08-MD-01895-WSD, 2009 U.S. Dist. LEXIS 14276, at *37-38 (N.D. Ga. Jan. 28, 2009).

Moreover, Plaintiff's theory that rising rates in a "soft" market automatically means that anticompetitive behavior was occurring is not sound. Indeed, the exact same argument regarding the purported knowledge of price fixing by Raymond, Keenan, Urbania, and later, Handy and Taylor, was made by the shareholder plaintiff in the securities action in the District of Delaware and was twice rejected by that Court. *See City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2009 U.S. Dist. LEXIS 106186, at *51-53 (D. Del. Nov. 13, 2009); *City of Roseville Employees' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *51-54 (D. Del. May 18, 2010).

In the securities lawsuit, the plaintiff claimed that even if defendants Raymond, Keenan, Urbania, Handy and Taylor were not directly involved in the alleged price-fixing conspiracy, they were reckless in failing to discover it because there were "red flags" in that "at a time of economic downturn and low shipping volume, the rate increases that Horizon was obtaining in the Puerto Rico market, which constitutes a significant portion of Horizon [] [Lines'] business, should have alerted the individual defendants to the price-fixing conspiracy." *City of Roseville*, 2010 U.S. Dist. LEXIS 48714, at *50. The court, in rejecting plaintiff's argument, held that "it is far from clear that Horizon's rate increases were suspicious under the circumstances that existed during the class period." *Id.* at *53. The court further held that even if Raymond, Keenan, Urbania, Handy and Taylor were to have found the rate increases suspicious, there were "no facts to establish that any of those defendants had access to information which, had they looked into it, would have confirmed the existence of the conspiracy." *Id.* The court again held, as it had in its first dismissal, "it is the covert nature of a

price-fixing conspiracy which distinguishes this case from those where an executive-defendant's examination of routine financial data or other internal company information would have informed him of the falsity of his statements." *Id.* at *53-54 (citing *City of Roseville*, 2009 U.S. Dist. LEXIS 106186, at *55).

Now, in this derivative suit, Plaintiff similarly suggests, without any specifically-pled allegations, that the directors should have been aware of this covert activity. Thus, the reasoning of *City of Roseville* applies with equal force to this Complaint.

It is likewise unpersuasive that the monthly letters sent from Horizon's CEO that Plaintiff claims "specifically discuss increases in shipping rates, and fuel surcharges in each of Horizon's three primary trade routes" were any indication to the directors that illegal price fixing was occurring. (Compl. ¶ 100) The plaintiff in the *City of Roseville* case included in its amended complaint a protracted discussion about the establishment of the price-fixing conspiracy, a lengthy discourse on management's history of working together, and an allegation that Serra reported directly to Handy and that Gill reported directly to Taylor. The District of Delaware held that these reporting relationships did not indicate that Raymond, Keenan, Urbana, Handy and Taylor must have known, or were reckless in not knowing, that certain individuals within the Company were engaging in an illegal price-fixing scheme. *City of Roseville*, 2010 U.S. Dist. LEXIS 48714, at *54. Here, Plaintiff has not alleged that the directors received any communications other than normal board and committee packages and monthly letters from Raymond, who is not alleged to have had knowledge of any of the alleged price fixing. Moreover, the information in the monthly letters and board packages was the same type

of information that was publicly disclosed to the Company's investors, whom Plaintiff claims were completely unaware of the covert activities. (Compl. ¶ 92)¹⁰

Because the Complaint does not contain particularized allegations that show the directors would have faced a substantial likelihood of liability, Plaintiff cannot circumvent the demand requirement, and the Complaint should be dismissed.

III. PLAINTIFF'S SHAREHOLDER DERIVATIVE CLAIM AGAINST DEFENDANTS RAYMOND, URBANIA, KEENAN, HANDY, TAYLOR AND ZUCKERMAN SHOULD BE DISMISSED UNDER RULE 12(B)(6) FOR FAILURE TO STATE A CLAIM.¹¹

A. The Complaint Also Fails To Satisfy The Rule 12(b)(6) Standard.

A complaint must be dismissed under North Carolina Civil Court Rule 12(b)(6) when it "fails to allege the substantive elements of some legally cognizable claim, or where it alleges facts which defeat any claim." *Classic Coffee Concepts, Inc. v. Anderson*, 2006 NCBC 21 ¶ 83 (N.C. Super. Ct. Dec. 1, 2006). While well-pled allegations are considered by the court as true, in cases such as this, where a plaintiff cannot prevail upon any set of facts that are sufficient to state a claim under some legal theory, the court will dismiss the claim. *Pantry, Inc. v. Citgo Petroleum Corp.*, 2009 NCBC 1 ¶¶ 44-45 (N.C. Super. Ct. Jan. 22, 2009). In addition,

¹⁰ The purported "red flags" for the Alaska and Hawaii/Guam tradelanes are even weaker. The fact that three former Horizon Lines' employees pled guilty to alleged antitrust violations in the Puerto Rico tradelane does not suggest that the directors should be on notice of similar activity in the other markets in which the Company operates. The Delaware Court of Chancery recently addressed a similar "red flag" argument. In *Dow*, the plaintiffs claimed that the board should have known of an alleged bribery scheme undertaken by a management team because other allegations of bribery had been made regarding other managers in a different country in the past. *Dow*, 2010 Del. Ch. LEXIS 2, at *48-49. The court rejected that argument as "too attenuated" to support a *Caremark* claim. *Id.* at *49.

¹¹ Horizon Lines does not move to dismiss the Complaint pursuant to Rule 12(b)(6) and does not join in this section of the brief.

conclusions of law and "deductions of facts" will not be admitted. *Stroock, Stroock & Lavan LLP v. Dorf*, 2010 NCBC 3A ¶ 23 (N.C. Super. Ct. Feb. 17, 2010) (granting motion to dismiss for failure to state a claim). As explained below, the Complaint fails to state a claim upon which relief should be granted against Raymond, Urbania, Keenan, Handy, Taylor and Zuckerman.

B. The Complaint Fails To State A Non-Exculpated Claim Against Raymond.

The claims against Raymond, Horizon Lines' Chairman of the Board, should be dismissed because, as explained *supra* pp. 20-22, he is protected from monetary liability for claims of breach of fiduciary duty by Article VII of the Company's Certificate of Incorporation and Plaintiff's claims do not fall within the three exceptions to that immunity. The Complaint does not allege, except with bald conclusions, that he was aware of any facts that would have caused him to know of the alleged price fixing. Rather, the Complaint merely alleges he knew that Horizon Lines was raising shipping rates and fuel surcharges during a time of "soft" shipping volume in the Puerto Rico tradelane, which, as explained above, does not support the conclusion that he must have known of the alleged price fixing. (*See* pp. 26-30). Accordingly, the claims against Raymond should be dismissed for failure to state a claim.

C. The Complaint Fails To Plead A Claim Against Any Of The Officer Defendants.

Plaintiff's claims against the non-director defendants, Keenan, Urbania, Handy, Taylor and Zuckerman (the "Officer Defendants") should also be dismissed for failure to state a claim.

Because "[d]ifferent corporate offices obviously hold different responsibilities[,]" in order to plead a claim for breach of fiduciary duty against a corporate officer, the complaint must identify "which office and which responsibilities each defendant allegedly held"

Bridgeport Holdings, Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings, Inc.), 388 B.R.

548, 573 (Bankr. D. Del. 2008). The Complaint fails to plead a breach of duty against the Officer Defendants because it contains only a cursory summary of each person's job title without any description of the particular obligations and duties of that job. (*See* Compl. ¶¶ 7, 18-21) Thus, here, as in *Bridgeport*, the Complaint should be dismissed for failing to identify each Officer Defendant's particular duties, much less how he failed to comply with those duties. *See Bridgeport*, 388 B.R. at 573 ("Without stating which office and which responsibilities each defendant allegedly held, it is not possible to discern what a particular defendant did or failed to do in the exercise of due care in his capacity as holder of that office.").

Instead of pleading each Officer Defendant's duties and how he purportedly failed to carry out those duties, the Complaint lumps all of the Officer Defendants together with the directors and makes no distinction between their relative responsibilities. (*See* Compl. ¶ 24 (reciting boilerplate and nonspecific statement regarding the purported duties of "officers and directors of the Company"))¹² But the broad and generalized duty of oversight described in paragraph 24 of the Complaint "typically applies to directors and not to officers." *Bridgeport*, 388 B.R. at 574. As a result, *Caremark* liability does not typically extend to corporate officers. *Id.* Here, Plaintiff offers no reason why the Court should not apply the general rule that officers are not liable for oversight claims as there are no allegations that any Officer Defendant's job responsibilities gave him specific oversight of the alleged price-fixing activities.

Moreover, even if officers could be exposed to liability under a *Caremark* theory, the claims against the officers are based solely on the fact that they received copies of the CEO's monthly CEO letter, which mentioned increases in shipping rates and fuel surcharges. (*See, e.g.,*

¹² Plaintiff's cursory treatment of the Officer Defendants is illustrated by the fact that Handy and Taylor were not even included in the case caption.

Compl. ¶¶ 100-02, 104, 106-08, 110-13, 117) As explained above, these facts alone were not "red flags" that provided notice of the alleged price fixing conspiracy. Thus, the Complaint also fails to plead knowing participation in the alleged price-fixing against the Officer Defendants and, therefore, the claims against them should be dismissed.

CONCLUSION

For the foregoing reasons, defendants Horizon Lines, Raymond, Urbania, Keenan, Zuckerman, Taylor, and Handy's motion to dismiss should be granted in its entirety and the Complaint should be dismissed with prejudice.

This the 27th day of May, 2010.

/s/ A. Jordan Sykes
John H. Cobb, NCSB No. 17052
A. Jordan Sykes, NCSB No. 35599
McGUIREWOODS LLP
100 North Tryon Street, Suite 2900
Charlotte, North Carolina 28202-4011
Tel: (704) 373-8999
Fax: (704) 373-8935
E-mail: jcobb@mcguirewoods.com
E-mail: jsykes@mcguirewoods.com

OF COUNSEL:

Anthony W. Clark
Paul J. Lockwood
Nicole A. DiSalvo
SKADDEN, ARPS, SLATE
MEAGHER & FLOM LLP
One Rodney Square
Post Office Box 636
Wilmington, Delaware 19899
Tel: (302) 651-3000
Fax: (302) 651-3001
(*Pro Hac Vice* admission anticipated)

*Attorneys for Defendants Charles G. Raymond,
M. Mark Urbania, John V. Keenan, Robert
Zuckerman, Brian W. Taylor, and John Handy
and Nominal Defendant Horizon Lines, Inc.*

RULE 15.8 CERTIFICATION

Counsel for defendants Charles G. Raymond, M. Mark Urbania, John V. Keenan, Robert Zuckerman, Brian W. Taylor, and John Handy and nominal defendant Horizon Lines, Inc. certifies that the foregoing brief complies with the word limitations set forth in the Court's May 21, 2010 Order.

/s/ A. Jordan Sykes

A. Jordan Sykes

CERTIFICATE OF SERVICE

I hereby certify that the foregoing **JOINT OPENING MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS HORIZON LINES, INC., CHARLES G. RAYMOND, M. MARK URBANIA, JOHN V. KEENAN, ROBERT ZUCKERMAN, BRIAN W. TAYLOR, AND JOHN HANDY'S MOTION TO DISMISS** was served upon each of the parties in this action by depositing it in the United States mail, postage prepaid, in envelopes addressed as follows:

Gary W. Jackson
Sam McGee
Jackson & McGee, LLP
225 East Worthington Avenue, Suite 200
Charlotte, North Carolina 28203
Attorneys for Plaintiff

James F. Wyatt, III
Robert A. Blake, Jr.
Wyatt & Blake, LLP
435 East Morehead Street
Charlotte, North Carolina 28202
Attorneys for Defendants Norman Y. Mineta, Dan A. Colussy, James G. Cameron, William J. Flynn, Vern Clark, Alex J. Mandl, and Thomas P. Storrs

This the 27th day of May, 2010.

/s/ A. Jordan Sykes
A. Jordan Sykes