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, ROBERT ZUCKERMAN, BRIAN W. TAYLOR and JOHN HANDY,

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 REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS

DATED: August 11, 2010

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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 (together with Horizon Lines, the "Defendants") submit this brief in further support of their motion to dismiss Plaintiff's Verified Shareholder Derivative Complaint (the "Complaint," cited herein as "Compl. ¶ __").[1]

SUMMARY OF THE ARGUMENT

In his Answering Brief (cited herein as "Pl. Ans. Br. at __"), Plaintiff, a shareholder of Horizon Lines who purports to bring this lawsuit on behalf of the Company, concedes that under Delaware law, which governs here, he must plead *specific facts with particularity* that would excuse his failure to make a pre-suit demand on the Horizon Lines Board. Despite acknowledging that he must overcome this heavy pleading burden, Plaintiff's response to Defendants' motion to dismiss for failure to make a demand is premised entirely on his wholly conclusory allegation that all of the directors purportedly "knew" about alleged antitrust violations carried out by three employees in the Company's Puerto Rico tradelane. Plaintiff contends that he was not obligated to make a pre-suit demand on the Board because the directors are incapable of fairly considering such a demand due to their purported direct participation in the alleged antitrust conspiracy. While Plaintiff's Answering Brief repeatedly asserts that the directors had "actual knowledge" of the alleged conspiracy or "knowingly caused" the Company to join the alleged conspiracy, the Complaint contains *no specific factual allegations whatsoever* to support that reckless assertion.

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[1] Undefined capitalized terms are defined in Defendants' Joint Opening Brief In Support Of Their Motion To Dismiss The Amended Complaint (cited herein as "Def. Op. Br. at __").

Instead of pleading particularized facts that could show that the directors had actual knowledge of the antitrust conspiracy, Plaintiff asserts that the directors must have known about the alleged price-fixing because they were aware that Horizon Lines was able to raise prices in the Puerto Rico tradelane during the 2002 to 2007 time period despite "soft" overall market conditions in Puerto Rico. Plaintiff, however, is unable to rebut Defendants' explanation in the Opening Brief – based on the allegations in the Complaint – that such price increases were far from tell-tale signs of price-fixing in light of the concentrated, oligopolistic nature of the Puerto Rico tradelane market. Plaintiff's only response to the dispositive antitrust case law that applies this reasoning at the pleading stage is to argue that antitrust cases in federal court are subject to a heightened pleading standard not applicable to this case. In fact, the opposite is true. The antitrust cases cited by Defendants, including the Supreme Court's seminal decision in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 553-54 (2007), apply a general "notice pleading" standard, while this derivative lawsuit is subject to Delaware's strict particularized pleading requirements that govern motions to dismiss for failure to make a demand.

Plaintiff also largely ignores the decisions of the United States District Court for the District of Delaware that dismissed securities fraud claims against the Company and certain senior officers on the grounds that the securities plaintiffs had not pleaded with sufficient particularity that senior officers of the Company had knowledge of the alleged price fixing. *See City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.*, 686 F. Supp. 2d 404, 423 (D. Del. 2009); *City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.*, C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *58-59 (D. Del. May 18, 2010). (*See also* Def. Op. Br. at 28-30) Plaintiff tries to distinguish *City of Roseville* solely on the basis that it applied a heightened pleading standard, but, as noted above, this motion to dismiss for failure to make a demand in this case is likewise

governed by a strict particularized pleading requirement. In *City of Roseville*, as here, the plaintiff's theory was that because the senior officers knew that the Company was raising rates despite soft market conditions, those officers must have known about the price fixing. Just as Judge Bartle rejected such logic in *City of Roseville*, this Court should reject it here.

Plaintiff next contends that the three directors on the Audit Committee must have known about the alleged price-fixing due to their positions and their responsibility for ensuring compliance with applicable regulations and laws. The Delaware Supreme Court has held that this argument is contrary to "well-settled Delaware law." *Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008).

Because Plaintiff has failed to plead that any, much less a majority, of the directors were unable to fairly consider his demand, he should have made a pre-suit demand on the Board. As he made no such demand, the entire Complaint should be dismissed with prejudice as to all Defendants for failure to make a demand on the Board.

In addition, for essentially the same reasons, defendants Charles G. Raymond, M. Mark Urbania, John V. Keenan, Robert Zuckerman, Brian W. Taylor, and John Handy move to dismiss the claims against them for failure to plead a claim upon which relief can be granted. Plaintiff's wholly conclusory allegations that these officer defendants "knew" of the alleged antitrust conspiracy are insufficient even under a notice pleading standard. Furthermore, Plaintiff has failed to plead a breach of fiduciary duty against the officer defendants because the Complaint does not specify the particular duties or responsibilities of each officer defendant. For all of these reasons, and the reasons set forth further below and in the Opening Brief, Defendants ask the Court to dismiss the Complaint with prejudice.

ARGUMENT

I. DELAWARE LAW REQUIRES PLAINTIFFS TO PLEAD DEMAND FUTILITY BASED ON PARTICULARIZED ALLEGATIONS OF SPECIFIC FACTS.

The parties agree that Delaware law governs the motion to dismiss for failure to make a pre-suit demand on the Board because Horizon Lines is a Delaware corporation. (Def. Op. Br. at 13; Pl. Ans. Br. at 9) The parties also agree that Plaintiff must plead facts supporting his allegations of demand futility *with particularity*. (*See* Pl. Ans. Br. at 10 (acknowledging obligation to plead "particularized allegations"); *id*. at 11 ("'What the pleader must set forth are *particularized* factual statements that are essential to the claim.'") (quoting *Brehm v*. *Eisner*, 746 A.2d 244, 254 (Del. 2000) (emphasis added)).

The parties part ways on which demand futility test applies to Defendants' motion to dismiss for failure to make a demand. Defendants submit that their motion is governed by the one-step demand futility standard announced in *Rales v*. *Blasband*, 634 A.2d 927, 933 (Del. 1993), which requires a plaintiff to plead with particularity facts that would raise a reasonable doubt that a majority of the directors are disinterested and independent with respect to the decision to file a lawsuit. (*See* Def. Op. Br. at 17-18) The *Rales* standard applies where, as here, the derivative claim is premised on the Board's alleged failure to appropriately monitor employees and ensure the company's compliance with legal requirements. (*See id*. at 17 ("[T]he *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.'") (quoting *Wood v*. *Baum*, 953 A.2d 136, 140 (Del. 2008)).

Plaintiff contends that his case does not concern the directors' failure to properly monitor employees, but rather asserts that the directors had actual knowledge of, and directly

participated in, the alleged antitrust conspiracy. (*See* Pl. Ans. Br. at 9-10) Thus, according to Plaintiff, this motion is governed by the two-step demand futility standard announced in *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), that applies to challenges to actual decisions made by a board of directors. (*Id.*) In order to plead demand futility on a claim challenging an actual decision by a board of directors, the complaint must plead particularized facts 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).

As explained below, this dispute regarding the governing standard is actually meaningless because the Complaint fails to satisfy either standard.

II. PLAINTIFF CANNOT SATISFY THE *ARONSON* STANDARD BECAUSE THE COMPLAINT FAILS TO PLEAD WITH PARTICULARITY A KNOWING VIOLATION OF LAW BY THE DIRECTORS.

In the Opening Brief, Defendants explained that the *Rales* standard applies here because the Complaint does not challenge any actual decisions made by the Board, *i.e.*, the Complaint does not allege that the Board passed resolutions or specifically authorized any of the disputed acts of employees. (Def. Op. Br. at 17) Setting aside the wholly conclusory assertion that all of the Individual Defendants "knew" about the alleged antitrust conspiracy, Plaintiff's fiduciary duty claim rests on an alleged failure of oversight – that the Board purportedly should have been able to identify the price-fixing by analyzing the data submitted to the full Board or its Audit Committee. (*See id.* at 17-18) This is a classic "red flags" argument that has always been treated as a *Caremark* duty to monitor claim (and therefore analyzed under the one-step *Rales* standard) by the Delaware courts. (*See* Def. Op. Br. at 18 (citing *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)); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 127 (Del. Ch. 2009)).

In response, Plaintiff contends that this motion is not governed by *Rales* but the two-part *Aronson* standard that applies to actual decisions made by a board. Plaintiff contends that his case is not about a failure to monitor but rather turns entirely on his allegation that the directors had "*actual knowledge* of illegal wrongdoing" and "knowingly caused Horizon to engage" in a price-fixing conspiracy. (*See* Pl. Ans. Br. at 2, 4-7, 9, 11-12 (emphasis added))[2] Plaintiff's attempt to invoke the *Aronson* standard fails because the Complaint falls far short of pleading particularized facts that could establish actual knowledge of the alleged wrongdoing on the part of the directors. There are ***no*** *particularized* allegations whatsoever in the Complaint that support Plaintiff's wholly conclusory assertion that a majority of the directors had "actual knowledge" of the alleged antitrust violations and directly participated in a price-fixing conspiracy.

To be sure, the Complaint contains the following words: "the Individual Defendants breached their fiduciary duties by knowingly causing the Company to engage in an illegal conspiracy." (Compl. ¶ 2) Such conclusory allegations have consistently been rejected by the Delaware courts as insufficient to plead actual knowledge by directors with the

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[2] Plaintiff's contention that the *Aronson* test applies to allegations of "conscious inaction" was recently rejected by the District of Delaware as contrary to Delaware law. *See In re Intel Corp. Derivative Litig.*, 621 F. Supp. 2d 165, 173 (D. Del. 2009). Indeed, even Plaintiff is forced to acknowledge that his claims are based on *Caremark*'s duty to monitor elsewhere in his Answering Brief when he argues that the directors purportedly face a substantial likelihood of liability under *Caremark* and its progeny. (*See* Pl. Ans. Br. at 18) While Defendants continue to believe that *Rales*, not *Aronson*, is the proper standard, it makes no practical difference because Plaintiff's theory that *Aronson* applies depends on well-pled allegations that the directors made a conscious decision to endorse the alleged antitrust conspiracy, and no such well-pled allegations are found in the Complaint.

particularity required to excuse demand. *See e.g.*, *In re Citigroup Inc. S'holders Litig.*, C.A. No. 19827, 2003 Del. Ch. LEXIS 61, at *3-4, 7 (Del. Ch. June 5, 2003) (dismissing complaint on demand grounds based on conclusory allegations that the directors "knew or should have known" about illegal Enron transactions and "either approved of those transactions or are liable for a 'sustained and systematic failure' to supervise the activities of their corporate subordinates"); *Rattner v. Bidzos*, C.A. No. 19700, 2003 Del. Ch. LEXIS 103, at *34 (Del. Ch. Sept. 30, 2003) (holding allegations that "merely posit[], without any particularized facts, that the [directors] knew of inside information, and that they knew of (or directly participated in) the allegedly material misstatements" as insufficiently particularized to excuse demand); *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1271 (Del. Ch. 1995) ("The claim of director culpability in this case is conclusory. The complaint does not include anything specific about the alleged scheme suggesting that the directors must have known of it."). Generalized allegations regarding the directors that do not directly link them to the alleged wrongdoing have been rejected as insufficient by the Delaware courts. *See Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008) (holding complaint failed to plead with particularity that directors had actual or constructive knowledge of wrongdoing where specific facts alleged in the complaint were: "(a) the defendants executed [the company's] annual reports and other publicly filed financial reports; (b) the defendants authorized certain transactions; (c) five of the defendants served on [the company's] Audit Committee; and (d) other 'red flags'"); *Guttman v. Huang*, 823 A.2d 492, 506-07 (Del. Ch. 2003) ("Their conclusory complaint is empty 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.").

Plaintiff's flawed position is further demonstrated by his heavy reliance on an inapposite non-demand case, *IOTEX Communications, Inc. v. Defries*, C.A. No. 15817, 1998 Del. Ch. LEXIS 236 (Del. Ch. Dec. 21, 1998), to support his claim that conclusory assertions of knowledge are sufficient to excuse demand. (*See* Pl. Ans. Br. at 12, 20-21) *IOTEX* was *not* a derivative suit brought by a shareholder who did not make a pre-suit demand, but was a lawsuit authorized by the board of directors to be brought directly in the name of the corporation. *See IOTEX*, 1998 Del. Ch. LEXIS 236, at *9-10 ("IOTEX claims Maag breached his fiduciary duties[] owed in his capacity as an IOTEX director. . . ."). Thus, the director-defendant in *IOTEX* could not have moved to dismiss under the heightened pleading standard of Delaware Court of Chancery Rule 23.1 but instead brought his motion under Delaware's Rule 12(b)(6), which resembles an ordinary motion to dismiss under the same rule in this court and the federal courts. *See id*. at *7.

Moreover, even the lesser pleading standard applied in *IOTEX* would be of no help to Plaintiff here. The court dismissed the complaint in *IOTEX* because the plaintiff alleged knowledge based on "[s]peculative conclusions unsupported by fact." *Id*. at *13. IOTEX alleged that the director "'knew' as a 'fact'" that another person and his companies had no intention of meeting their contractual obligations because the director was associated with that person and was a director of one of his companies. *Id*. at *11. The court rejected the inference that the director's associations with the other person and his corporations meant the director had knowledge of his alleged intent to breach the contract because that assertion was not supported by specific factual allegations. *Id*.

Plaintiff also relies heavily on two federal cases applying Delaware law that excused demand, *In re Pfizer Inc. Shareholder Derivative Litigation*, No. 09-7822 (JSR), 2010 U.S. Dist. LEXIS 69593, at *23-28 (S.D.N.Y. July 13, 2010), and *In re Abbott Laboratories Derivative Shareholders Litigation*, 325 F.3d 795, 806 (7th Cir. 2003), but the specific factual allegations that sustained the complaints in those cases stand in stark contrast to the cursory and conclusory assertions in the Complaint here. In *Abbott*, the court found that the complaint alleged with particularity that the board knew of Abbott's long-running violations of FDA regulations based on specific allegations that: (i) several warning letters from the FDA describing the violations were given to the directors; and (ii) Abbott had failed FDA inspections and those failures were reported to the audit committee. *See Abbott*, 325 F.3d at 805.

In *Pfizer*, the court held that the complaint alleged with particularity that the defendants "knew of a high probability that Pfizer was continuing to purposely promote off-label marketing" in violation of FDA regulations based on: (i) a large number of FDA violation notices and warning letters submitted to the company about the issue; (ii) reports to senior executives about the off-label marketing; (iii) allegations made in lawsuits regarding off-label marketing: and (iv) settlements of lawsuits challenging the off-label marketing. *Pfizer*, 2010 U.S. Dist. LEXIS 69593, at *22. Based on this extensive and specific information that was allegedly submitted to or readily available to the directors, the court found that the complaint adequately pleaded that Pfizer's board had "deliberately decided to let [the legal violations] continue." *Id*.

Here, in contrast, the Complaint does not contain specific factual allegations that could show actual knowledge by the directors as in *Abbott* or *Pfizer*. The Complaint instead merely alleges that a clandestine price-fixing scheme was carried out by three Horizon Lines

employees assigned to the Puerto Rico tradelane and fails to allege that any reports were provided to the Board or the Audit Committee that warned the directors of that illegal conduct. According to the Complaint, the Board received reports regarding the Company's operations, including the financial results from the Puerto Rico tradelane, but the Complaint does not allege that any of those reports contain any mention of price fixing. Rather, Plaintiff alleges the directors should have concluded that price fixing was taking place in the Puerto Rico tradelane based entirely on the facts that Horizon Lines was able to increase prices during a period of "soft" market conditions.

As established in the Opening Brief, Plaintiff's hypothesis that anyone would recognize that rising prices in such circumstances *must have* resulted from price fixing: (i) is not a sound conclusion as a matter of economic theory; (ii) is inconsistent with extensive antitrust case law; and (iii) in the specific context of Horizon Lines, was rejected by the District of Delaware in a securities fraud lawsuit based on the very same allegations made by Plaintiff here. (*See* Def. Op. Br. at 26-29) Plaintiff's Answering Brief fails to rebut these points.

Plaintiff's Answering Brief does not address the obvious flaws in his economic reasoning at all. As explained in the Opening Brief, as a matter of economic theory, the fact that Horizon Lines was able to increase prices in the 2002 to 2007 time period would hardly seem unusual because the Puerto Rico tradelane was an oligopolistic market with significant barriers to entry for new competitors. (Def. Op. Br. at 26-27; s*ee also* Compl. ¶ 81 ("The Puerto Rico Cabotage Market has been a highly concentrated oligopoly with four key players.")) Furthermore, the Complaint itself pleads that this highly concentrated market became even more highly concentrated after 2001, with the "bankruptcy and closing of Navieras de Puerto Rico, a shipping company that was . . . at the time [] the largest provider of shipping services to Puerto

Rico." (Compl. ¶ 84) When the largest competitor leaves an already oligopolistic market, it is hardly surprising that prices thereafter rise. Plaintiff's Answering Brief has no response to these points and instead asserts, *ipse dixit*, that "market conditions were 'soft' with shipping volumes steadily decreasing, which could ***only*** be explained by an antitrust conspiracy." (Pl. Ans. Br. at 12 (emphasis in original)) The conclusion reached by Plaintiff is unsupported and unreasonable.

Indeed, it is well-understood as a matter of antitrust law that rational competitors in a concentrated market can engage in consciously parallel conduct without conspiring to fix prices and that such conduct "'is not in itself unlawful.'" *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 554 (2007) (citation omitted). *Accord Matson Navigation Co. v. Fed. Mar. Comm'n*, 959 F.2d 1039, 1045 (D.C. Cir. 1992) (affirming the Federal Maritime Commission's conclusion that, "instead of engaging in fierce price competition with Matson, Sea-Land . . . was more likely to follow Matson's price leadership and compete primarily on the basis of service"); *DHX, Inc. v. Surface Transp. Bd.*, 501 F.3d 1080, 1092 (9th Cir. 2007) ("All businesses . . . monitor their competitors' pricing to see whether and how they should match or beat the discounts they are offering."). (*See also* Def. Op. Br. at 27-28) Plaintiff's only response to *Twombly* is to argue that it is inapplicable to this motion because it turned on a "heightened pleading burden applicable in such cases." (Pl. Ans. Br. at 12 n.9) In truth, *this case* is subject to a heightened pleading burden (*see* p. 4, *supra*), while *Twombly* was governed by the notice pleading standard of Rule 8(a)(2) of the Federal Rules of Civil Procedure. *Twombly*, 550 U.S. at 555. Thus, unlike here, where Plaintiff must plead facts with particularity, the plaintiff in *Twombly* was not required to plead "detailed factual allegations" but just enough "to raise a right to relief above the speculative

level." *Id*. Thus, the Court should give no credence to Plaintiff's effort to explain away *Twombly* based on the pleading standard.[3]

Finally, and perhaps most significantly, the District of Delaware has issued two decisions rejecting the contention that Horizon Lines' senior officers must have known about the alleged price-fixing conspiracy because they knew that the Company had been increasing its rates in the Puerto Rico tradelane despite soft market conditions. *See City of Roseville Emps*.' *Ret*. *Sys*. *v*. *Horizon Lines, Inc*., 686 F. Supp. 2d 404, 423-24 (D. Del. 2009); *City of Roseville Emps*.' *Ret*. *Sys*. *v*. *Horizon Lines, Inc*., C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *53-54 (D. Del. May 18, 2010). (*See also* Def. Op. Br. at 28-30) Plaintiff tries to distinguish the *City of Roseville* decision on the grounds that the plaintiffs there had to comply with the heightened pleading requirements for securities fraud (*see* Pl. Ans. Br. at 20), but this case is also subject to a heightened pleading burden. *See* p. 4, *supra*.

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[3] Plaintiff's contention that there was a widespread conspiracy as to all three of Horizon Lines' tradelanes (Pl. Ans. Br. at 4, 13, 15, 20) is even weaker than his argument regarding the Puerto Rico tradelane. Plaintiff alleges that Horizon Lines must have violated the antitrust laws in the Alaska and Hawaii/Guam tradelanes because the competitors in those markets raised fuel surcharges in the same amounts and within short time periods of one another. Once again, these allegations suggest conscious parallelism, not an illegal conspiracy. *See In re LTL Shipping Servs*. *Antitrust Litig*., No. 1:08-MD-01895-WSD, 2009 U.S. Dist. LEXIS 14276, at *69-70 (N.D. Ga. Jan. 28, 2009) (dismissing antitrust claim based on alleged lockstep increases in fuel surcharges for failure to plead price fixing). Indeed, a federal court has already dismissed antitrust claims against Horizon Lines based on the same fuel surcharge allegations that Plaintiff raises here. *See In re Hawaiian & Guamanian Cabotage Antitrust Litig*., 647 F. Supp. 2d 1250, 1260 (W.D. Wash. 2009) (dismissing antitrust claims based on alleged lockstep fuel surcharges between the two competitors in the Hawaii/Guam tradelane because that allegation showed nothing more than "the type of parallel conduct generally present in a homogeneous market") Plaintiff also contends that Horizon Lines violated the antitrust laws by entering into a capacity sharing agreement with Matson in the Hawaii/Guam tradelane (Pl. Ans. Br. at 6), but the same allegations were also made and dismissed in the lawsuit in federal court in Washington. *Id*. at 1260, n.5.

Moreover, the reasoning of Judge Bartle in *City of Roseville* applies with particular strength here because Judge Bartle held that the same allegations that Plaintiff recycles here were insufficient to plead with particularity that senior executives with direct reporting relationships to the three Puerto Rico tradelane employees knew of the antitrust conspiracy; *a fortiori*, those same allegations fall far short of pleading with particularity that the outside directors, who do not have an everyday role in the Company, must have known of the alleged wrongdoing. The *City of Roseville* opinion explains:

> At issue here is an illegal price-fixing conspiracy, *which by its very nature is a secret undertaking*. . . . [P]laintiffs here have pleaded no facts showing that Raymond, Keenan, or Urbania [the senior executives] had access to information which would have alerted them to the misleading nature of their statements. The revenues and shipping rates discussed by Raymond, Keenan, and Urbania are bottom-line figures derived from a number of variable components. Absent facts indicating that those defendants were aware of or had available to them information which would have alerted them to the conspiracy, or that the rates and revenues were so distorted by the illegal conduct that they should have been aware of it, the mere fact that Raymond, Keenan, and Urbania made statements about revenues and rates does not imply that they were aware of the price-fixing conspiracy.

686 F. Supp. 2d at 424 (emphasis added; citation omitted). Here, Plaintiff likewise pleads no facts indicating that any member of the Board, much less a majority, was aware of the alleged conspiracy or had sufficient information that would have alerted him to it.

In sum, Plaintiff has failed to allege with particularity that the directors knew of or directly participated in the alleged antitrust conspiracy. As all of the demand futility arguments, including his contention that the *Aronson* standard applies, are based on this inadequately pleaded contention, the Complaint should be dismissed for failure to plead with requisite particularity that demand was excused.

III. THE COMPLAINT DOES NOT PLEAD WITH PARTICULARITY THAT DEMAND WAS EXCUSED UNDER THE *RALES* STANDARD.

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 v. Szulik*, 2006 NCBC 4 ¶ 45 (N.C. Super. Ct. Mar. 13, 2006) (quoting *Rales*, 634 A.2d at 934) (emphasis in original). As explained in the Opening Brief, the Complaint fails to satisfy the *Rales* test because it does not plead a disabling conflict of interest as to any director, much less a majority of the Board. (*See* Def. Op. Br at 19-30) Plaintiff responds that all of the directors have a disabling conflict because they face a "substantial likelihood of liability" on the claims asserted in the Complaint. (Pl. Ans. Br. at 17; *see* Compl. ¶ 125)[4] Yet this conclusory assertion is no answer because Plaintiff has failed to plead sufficiently particularized allegations to show that a majority of the Board faces a substantial likelihood of liability such that demand is excused.

A. Directors Are Protected From Liability By Article VII Of Horizon Lines' Certificate Of Incorporation.

Defendants' Opening Brief explains that the directors are immunized from personal monetary liability by Article VII of Horizon Lines' Certificate of Incorporation for any fiduciary duty claims against them based on negligence or even gross negligence. (*See* Def. Op. Br. at 20-21) In response, Plaintiff acknowledges that any claims based on negligence or gross negligence are barred by the Certificate of Incorporation, but argues that his claims fall outside that exemption because they are based on "***intentional misconduct or knowing violations of the***

[4] Plaintiff's Answering Brief acknowledges that a mere threat of liability is insufficient and that he bears the burden of pleading particularized facts that could show a "substantial likelihood" of liability. (Pl. Ans. Br. at 17)

law." (Pl. Ans. Br. at 21-22) (emphasis in original). As explained above, the Complaint does not plead with particularized facts that the directors knew of the alleged antitrust conspiracy being carried out by the three Puerto Rico tradelane employees. *See* pp. 9-13, *supra*. Further, Plaintiff implicitly concedes that his claims are barred by the Certificate of Incorporation to the extent that they are not based on well-pleaded allegations of intentional and knowing violations of law. (*See* Pl. Ans. Br. at 21-22) As Plaintiff has not adequately pleaded intentional or knowing conduct by the directors, his claim does not threaten a majority of the directors with a substantial likelihood of liability. (*See* Def. Op. Br. at 20-21) Accordingly, Plaintiff has not pleaded demand futility under the *Rales* standard.

B. The Directors Do Not Face A Substantial Likelihood Of Liability On A *Caremark* Claim.

Plaintiff's Answering Brief schizophrenically disclaims any intent to plead a claim based on the duty to monitor or "*Caremark* duty" (*see, e.g.*, Pl. Ans. Br. at 13 ("Defendants attempt to improperly rewrite Plaintiff's breach of fiduciary duty claims against the Individual Defendants as 'failure to exercise oversight' under *Caremark* and its progeny")), while it simultaneously argues that the directors face a substantial likelihood of liability "based upon a failure to supervise and monitor." (*Id*. at 18 (quoting *Caremark*, 698 A.2d at 971)) In any event, as explained in the Opening Brief, the Complaint does not meet the extremely high standards for pleading a breach of the duty to monitor under *Caremark* and its progeny. (Def. Op. Br. at 24-30)

Plaintiff's primary response is to again point to his wholly conclusory assertion that the directors knowingly participated in the alleged antitrust conspiracy. (*See* Pl. Ans. Br. at 18-19) As explained above, those allegations are not well-pled.

Plaintiff also argues that at least the three directors who served on the Audit Committee (a minority of the eight-member Board at the time the Complaint was filed) face a substantial likelihood of liability because that Committee was "tasked with the responsibility of assisting the Board with respect to the oversight of the Company's compliance with legal and regulatory requirements." (*Id*. at 19)[5] This argument that liability for audit committee members can be inferred merely from their position and responsibilities has been squarely rejected by the Delaware Supreme Court. *See Wood v. Baum*, 953 A.2d 136, 142-43 (Del. 2008) (holding that plaintiff's assertion that membership on the audit committee was sufficient to establish audit committee member's knowledge of alleged wrongdoing was "contrary to well-settled Delaware law") (citing *Rattner v Bidzos*, C.A. No. 19700, 2003 Del. Ch. LEXIS 103, at *12-13 (Del. Ch. Sept. 30, 2003). *Accord Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Lundgren*, 579 F. Supp. 2d 520, 534 (S.D.N.Y. 2008) (audit committee members did not face a substantial likelihood of liability where plaintiff "fail[ed] to allege, except in a conclusory manner, any adverse non-public information of which directors on this committee would have become aware").

In *Wood*, the plaintiffs asserted that the members of the audit committee faced a substantial likelihood of liability because the company engaged in numerous violations of federal securities and tax laws. 953 A.2d at 142. The court dismissed the suit because "the plaintiff failed to allege with particularity any facts from which it could be inferred that particular

[5] Plaintiff's focus on the Audit Committee is fruitless because its three members make up less than half of the eight-member Board. *See Desimone v. Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007) ("[A] derivative complaint must plead facts specific to each director, demonstrating that at least half of them could not have exercised disinterested business judgment in responding to a demand.") (citation omitted; emphasis removed).

directors knew or should have been on notice of alleged accounting improprieties." *Id*. at 143; *see also Ferre v*. *McGrath*, No. 06 Civ. 1684 (CM), 2007 U.S. Dist. LEXIS 29490, at *24 (S.D.N.Y. Feb. 16, 2007) (applying Delaware law and holding that plaintiff failed to allege "specific facts showing that the members of the Audit Committee 'had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation'") (citation omitted). The only particularized facts that Plaintiff alleges here are that the members of the Audit Committee attended meetings and had fiduciary obligations to the Company. (Compl. ¶¶ 28-29) These allegations fall far short of the requirements established by the Delaware Supreme Court in *Wood*.[6]

Plaintiff also contends that the directors had actual knowledge of the alleged price-fixing scheme because the tradelanes in which Plaintiff claims the concerted activity was occurring were a core business of the Company. (Pl. Ans. Br. at 13) However, Plaintiff ignores the District of Delaware's rulings that already rejected this argument twice. As the court explained:

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[6] The two cases cited by Plaintiff in which demand was excused on *Caremark* claims are far different than this case because the allegations of director knowledge in those cases were much more specific. In *In re Oxford Health Plans, Inc*. *Securities Litigation*, 192 F.R.D. 111, 115-16 (S.D.N.Y. 2000), the complaint alleged that two of the directors were directly involved in insider trading, there were regulatory and legal actions previously taken against the company and a "public expression adverse to the Directors made by the Attorney General of New York." In *McCall v*. *Scott*, the complaint alleged that the board took no action to stop the wrongdoing in the face of an extensive public federal investigation, a *New York Times* article describing the wrongdoing, allegations brought in a public lawsuit, and an investigation by the audit committee which allowed its members direct access to fabricated billing records. 239 F.3d 808, 820 (6th Cir. 2001). Plaintiff also inexplicably relies on *Ash v*. *McCall*, C.A. No. 17132, 2000 Del. Ch. LEXIS 144, at *54 n.54 (Del. Ch. Sept. 15, 2000), which granted a motion to dismiss for failure to plead demand futility despite a massive accounting fraud that cost the corporation billions of dollars because there were no specific allegations demonstrating that the directors had knowledge of the fraud.

> The importance of the Puerto Rico market to Horizon's business, questions from analysts, and prominence of EBITDA as an evaluation metric do not change our conclusion. While "knowledge of the 'core activities of a business may be imputed to its highest officials in some circumstances,'" such imputation is done "'cautiously'" and only where plaintiffs have pleaded "'particularized allegations showing that defendants had ample reason to know of the falsity of their statements.'" … Because plaintiffs have failed to establish that defendants had "ample reason" to know of the conspiracy, we will not impute scienter, regardless of the importance of the Puerto Rico shipping rates.

City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc., C.A. No. 08-969, 2010 U.S. Dist. LEXIS 48714, at *54 (D. Del. May 18, 2010) (citations omitted); *see also City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.,* 686 F. Supp. 2d 404, 423 (D. Del. 2009) (refusing to impute knowledge to defendants regarding Horizon Lines' core business absent particularized allegations that they had knowledge of the price-fixing conspiracy).

Plaintiff's "core business" argument is just a slight alteration of his discredited contention that the directors must have known about the wrongdoing based on their positions within the Company, which the Delaware Supreme Court has held is contrary to settled Delaware law. *See* p. 16, *supra*. Notably, Plaintiff is unable to cite to any Delaware case that supports his "core business" theory. Moreover, one of the federal cases he cites for the proposition, *In re Forest Laboratories*, found the argument unpersuasive and ***granted*** the motion to dismiss for failure to plead with particularity that the directors had knowledge of the alleged wrongdoing. *In re Forest Labs., Inc. Derivative Litig.*, 450 F. Supp. 2d 379, 390 (S.D.N.Y. 2006) (refusing to infer that directors had knowledge about wrongful conduct relating to core products where the complaint contained mere "conclusory statements that the directors of Forest

'participated in, approved, and or [sic] permitted the wrongs alleged' … without particularized allegations").[7]

IV. THE CLAIMS AGAINST DEFENDANTS RAYMOND, URBANIA, KEENAN, ZUCKERMAN, TAYLOR AND HANDY SHOULD BE DISMISSED FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.[8]

As explained in Defendants' Opening Brief and further below, the Complaint must also be dismissed pursuant to North Carolina Civil Court Rule 12(b)(6) for failure to state a claim. (Def. Op. Br. at 30-33); *Classic Coffee Concepts, Inc. v. Anderson*, 2006 NCBC 21 ¶ 83 (N.C. Super. Ct. Dec. 1, 2006) (holding a complaint should be dismissed if it "fails to allege the substantive elements of some legally cognizable claim, or where it alleges facts which defeat any claim") Because the Complaint contains nothing more than conclusions of law and unreasonable "deductions of facts," it fails to state a claim upon which relief should be granted against Raymond, Urbania, Keenan, Zuckerman, Taylor and Handy. *See 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).

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[7] If the Complaint is dismissed, the Court should deny Plaintiff's request for leave to file an amended complaint. (Pl. Ans. Br. at 22 n.14) Under North Carolina law, the court may refuse to grant leave to amend a complaint where such amendment would be futile and the amendment would cause undue prejudice. *Harrold v. Dowd*, 149 N.C. App. 777, 785-86 (N.C. Ct. App. 2002). Any new complaint would be futile as Plaintiff has shown no new information that would cure the Complaint's pleading deficiencies. Plaintiff has already had the benefit of hundreds of pages of corporate records pursuant to his 8 *Del. C.* § 220 demand for inspection. Further, allowing Plaintiff to amend would unduly prejudice the Company by forcing it to incur substantial costs to defend against another frivolous complaint.

[8] To the extent they are applicable, Raymond and the Officer Defendants incorporate by reference the arguments made in Outside Director Defendants' Opening and Reply Briefs In Support Of Their Motion To Dismiss.

A. The Complaint Does Not State A Non-Exculpated Claim Against Raymond.

Defendants demonstrated in the Opening Brief that Plaintiff's breach of fiduciary duty claims are barred by Article VII of the Certificate of Incorporation, which protects the directors from monetary liability for claims based on allegations that they acted with negligence or gross negligence. (Def. Op. Br. at 20-22, 31) Plaintiff responds that Article VII does not apply to Raymond because he is also an officer of Horizon Lines. (Pl. Ans. Br. at 22 n.13) However, in such circumstances where a defendant wears "two hats," the Complaint must plead around the immunity provided by the certificate of incorporation by specifically identifying the wrongful conduct that the defendant took solely in his capacity as an officer. *See Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1288 (Del. 1994) (holding argument that officer-director was not protected by exculpatory provision "lack[ed] merit because plaintiff has failed to highlight any specific actions Connell undertook as an officer (as distinct from actions as a director) that fall within the two pertinent exceptions [of the provision]"). The Answering Brief does not identify any conduct that Raymond took solely in his capacity as an officer, but rather points to his communications with fellow directors and his attendance at Board meetings. (*See* Pl. Ans. Br. at 22 n.13) None of these allegations falls outside the exculpatory provision that protects Raymond for actions he took as a director of the Company.[9]

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[9] The Complaint's failure to "allege sufficient facts of individual participation in any wrongdoing" is also grounds for dismissal under North Carolina Rule of Civil Procedure 12(b)(6). *Oberlin Capital, L.P. v. Slavin*, 554 S.E.2d 840, 845 (N.C. Ct. App. 2001). Plaintiff cannot state a claim against Raymond, Urbania, Keenan, Zuckerman, Taylor or Handy by pointing to allocutions mentioning nameless "executives" from an unnamed company. (*See* Pl. Ans. Br. at 12-13; Compl. ¶¶ 54-58) The District of Delaware already rejected this argument and found that to infer, from what was said at the sentencing hearings of Serra, Gill and Glova, that any particular defendant was referred to, was utter speculation. *City of Roseville Emps.' Ret. Sys. v. Horizon Lines, Inc.*, 686 F. Supp. 2d 404, 422-23 (D. Del. 2009).

B. The Complaint Does Not State A Claim Against The Officer Defendants.

Plaintiff's claims against non-director defendants Urbania, Keenan, Zuckerman, Taylor and Handy should also be dismissed for failure to state a claim. As explained in the Opening Brief, Plaintiff has not pleaded a breach of fiduciary duty claim against any of the Officer Defendants, because the Complaint contains only a cursory summary of each person's job title without any description of the particular obligations and duties of that job, and no information whatsoever about how each Officer Defendant failed to comply with those duties. (Def. Op. Br. at 31-32; Compl. ¶¶ 7, 18-21) Plaintiff responds that the Complaint mentions each officer's job title (*see* Pl. Opp. To Outside Dirs. Mot. To Dismiss at 12), but the Complaint has no description of the specific duties that belong to those positions or how those specific duties were violated. Instead, the Complaint collectively describes duties of the "officers and directors of the Company" and lumps all sixteen defendants together as the "Individual Defendants." Such generalized pleadings do not state a claim. *Bridgeport Holdings, Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings, Inc.)*, 388 B.R. 548, 573 (Bankr. D. Del. 2008) (dismissing claim for failure to identify each officer defendant's particular duties, much less how he failed to comply with those duties).

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 11th day of August, 2010.

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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 REPLY MEMORANDUM OF LAW IN FURTHER 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:

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