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UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEVADA

IN RE GLOBAL CASH ACCESS HOLDINGS, INC. DERIVATIVE LITIGATION This Document Relates to: ALL ACTIONS.	Lead Case No. 2:07-cv-01659-JCM-PAL GLOBAL CASH ACCESS' MOTION TO DISMISS AMENDED COMPLAINT FOR FAILURE TO COMPLY WITH RULE 23.1 ORAL ARGUMENT REQUESTED

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Nominal defendant Global Cash Access Holdings, Inc. ("GCA"), moves for dismissal of the amended complaint in this action pursuant to Rule 23.1 for failure to make a pre-suit demand on GCA's board of directors. GCA respectfully requests a hearing on this motion.

INTRODUCTION

Rule 23.1 says that a company's directors, and not its shareholders, get to decide whether a company should bring a lawsuit. Rule 23.1 implements this policy by prohibiting a shareholder from bringing a derivative suit, in the name of the corporation, unless the plaintiff satisfies three pre-suit procedural requirements.

First, Rule 23.1 obligates a plaintiff, before suing, to seek "to obtain the desired action from the directors or comparable authority." Plaintiffs made no such effort here.

Second, if a plaintiff doesn't make a demand, Rule 23.1 requires that he plead "with particularity" his reasons for not doing so. The allegations must include specific facts showing that a majority of the company's directors was incapable of making an independent and disinterested decision regarding the plaintiff's grievance. Plaintiffs' complaint contains no such allegations.

Nor could it. GCA has six directors, and five of them are both disinterested and independent. One — Mr. Olson — is a new director and is not even named as a defendant. The other four — Messrs. Enlow, Judge, Kilburn, and Fitzgerald — are completely independent of GCA and are not alleged to face any substantial likelihood of liability for the matters described in plaintiffs' complaint.

And third, Rule 23.1 requires that a plaintiff must be "a shareholder . . . at the time of the transaction complained of " and that "the complaint must be verified." The two plaintiffs here — Mr. Steuve and Ms. Mollenkopf — do not meet this requirement.

Plaintiffs have had almost a year to get it right. The current complaint is their third try, and it doesn't properly plead compliance with Rule 23.1. The action should be dismissed with prejudice.

BACKGROUND

This case is about commissions, and, in particular, GCA's internal controls over its commissions payments.

GCA provides gaming patrons access to instant cash from inside casinos through automated cash machines, credit card cash advances, point-of-sale debit card transactions, check verification and warranty services, and money transfers. Am. Compl. ¶ 2 (Docket No. 62). GCA pays commissions to the more than 1,000 gaming establishments where it does business in exchange for the right to operate on their premises. *Id*. ¶ 3. The commissions, and the service fees on which they are based, differ based on the type of transaction, and also differ from casino to casino. *Id*. ¶ 63. Commissions are GCA's largest single expense. *Id*. ¶ 67.

In early 2006, GCA's auditor, Deloitte & Touche, determined that GCA's internal financial controls were (in some ways) deficient. GCA promptly disclosed this information in its registration statement filed on May 11, 2006. *Id.* ¶ 7. GCA warned its investors: "We cannot assure you that we will be able to remedy these control deficiencies or that we or our independent auditors will not discover additional control deficiencies or significant deficiencies or material weaknesses in our internal control over financial reporting in the future." Tkachenko Decl. Ex. A at 19.[1] GCA subsequently reminded investors of its internal control weaknesses in SEC filings made in May, August, and November 2006. *See* Am. Compl. ¶ 88; Tkachenko Decl. Ex. D at 55; Ex. E at 57.[2]

GCA advised its investors that it was taking steps to remedy its internal control deficiencies. It described "a significant redesign and upgrade of our financial reporting software,

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[1] "Tkachenko Decl. Ex." refers to exhibits attached to the Declaration of Olga A. Tkachenko In Support Of Defendants' Motions To Dismiss. The facts here are based on the allegations in the complaint and other matters of public record, of which this Court may take judicial notice on a motion to dismiss. *See* Request for Judicial Notice In Support Of Defendants' Motions To Dismiss.

[2] In May 2006, GCA also warned that the company was a "party to and threatened with various legal disputes arising from the ordinary course of general business activities." Tkachenko Decl. Ex. A at 64. Consistent with this announcement, GCA later announced in August 2006 that it had settled for $200,000 three lawsuits over commissions allegedly owed "following the expiration of our agreements." Am. Compl. ¶ 89; Tkachenko Decl. Ex. D at 10. These claims concerned duties beyond the terms of the contract, not any miscalculation of the amounts due.

systems and procedures," which was "undertaken to strengthen our internal control over financial reporting." Tkachenko Decl. Ex. E at 57. GCA noted, however, that its efforts had not proceeded without delay, and that it had experienced unusual turnover in its financial staff. *Id.* GCA warned:

> The combination of the delays in implementing our new financial reporting system and the staffing shortages in finance and accounting have significantly increased the risk that we may identify a material weakness in our internal control over financial reporting. Even if we do not identify any such weaknesses, the risk that our independent auditors may identify such a weakness has also increased.

Id.

By early 2007, GCA had identified several areas in which its controls had material weaknesses. Again, GCA promptly disclosed these weaknesses to investors. Am. Compl. ¶ 90. One of the material weaknesses related directly to the calculation of commissions. *Id.* GCA told investors:

> **Inadequate controls related to commissions:** We did not have appropriate internal control design related to how we calculate the amount of commissions we pay our customers. Specifically, 1) internal controls over commission set-up did not include a comparison of commission rates to contractual terms and 2) there was an ineffective process to determine the appropriate commission type and amount. In addition, some of the databases and applications used to maintain transaction records and perform certain commission computations were maintained by a third party, and appropriate controls to monitor and approve changes and to limit access were not in place.

Id. (emphasis omitted).

GCA's audit committee responded to the material weaknesses with an aggressive improvement program. This included a plan to increase both the number of people and the experience and training of its finance and accounting staff, as well as improvements in the financial close process. Tkachenko Decl. Ex. B at 102. "During 2007, we plan to redesign the system of controls governing our commission calculation systems," including changes to contracts, the use of new databases and applications, and periodic audits. *Id.* GCA updated its investors, in every SEC filing, on its progress. *See, e.g., id.* Ex. F at 43.

The Whistleblower and Internal Investigation

Then GCA got hit by a whistleblower. An unnamed individual sent a letter to Deloitte & Touche containing several allegations, including an allegation about improper calculations of commissions. Am. Compl. ¶ 112. Deloitte notified GCA, and the company's audit committee launched an internal investigation, hiring Skadden Arps and KPMG to advise it. *Id.* ¶ 16; Tkachenko Decl. Ex. C at 80. GCA also announced publicly that it would delay releasing its financial statements while the investigation was underway. Am. Compl. ¶ 110. GCA's stock price dropped from $9.00 to $3.71 per share based on the uncertainty created by this announcement. *Id.* ¶ 111.

The audit committee completed its investigation at the end of December 2007, and the committee's findings were described in GCA's January 2008 quarterly SEC filing. *Id.* ¶¶ 118-119. The audit committee found "no evidence of fraud or intentional misconduct to substantiate any of the allegations" made by the whistleblower. *Id.* ¶ 120. Following the investigation, GCA announced additional measures to improve its internal controls. Tkachenko Decl. Ex. C at 104-106.

As a result of inquiries made during the internal investigation, GCA reviewed its contracts and identified a potential issue with the "interpretation of contract clauses relating to the calculation of commissions payable to certain of the Company's customers." Am. Compl. ¶ 119. GCA noted that certain clauses in its commissions agreements were subject to varying interpretations. "While the Company does believe that commissions have been computed and paid in accordance with our business understanding with the relevant customers, we believe that it is probable that there will be disputes between us and the relevant customers regarding the amounts we actually paid." Am. Compl. ¶ 119; Tkachenko Decl. Ex. G at 13.

The company decided to take a reserve against this possibility, and it concluded "it is probable we will incur $2.6 million of additional expense to settle commission disputes." Am. Compl. ¶ 119. Of this reserve, $1.9 million related to transactions that occurred in 2005 and 2006. *Id.* GCA later increased the reserve to $2.9 million. *Id.* ¶ 121. Importantly, GCA never was required to restate its prior financial statements. Tkachenko Decl. Ex. G at 13.

The Present Litigation

Plaintiffs filed their first lawsuit in December 2007 – before the audit committee's investigation was even completed – and they did so without making any demand for action upon GCA's board of directors. They filed an amended complaint on May 5, 2008. Defendants filed two motions to dismiss on June 19, 2008. Plaintiffs never opposed. Rather, they filed a second amended complaint on September 26, 2008.

The second amended complaint alleges claims against many of the former and current officers and directors of GCA, and two early investors of the company. As amended, plaintiffs' complaint alleges breaches of fiduciary duty, unjust enrichment, waste of corporate assets, and insider trading.

GCA's Board of Directors

GCA's board has six directors. Five of these directors are both disinterested and independent. Only one — Scott Betts, GCA's new chief executive officer — should be treated as not independent of the other defendants.

One of GCA's directors — Patrick Olson — joined the board on May 7, 2008, long after the events described in the amended complaint. He is not a defendant in this lawsuit. Nor is there is any suggestion that he is either interested or not independent.

The other four directors — Fred Enlow, Geoff Judge, Miles Kilburn and Charles Fitzgerald — are prominent businessmen who meet the independence standards imposed by the New York Stock Exchange.[3] They have had long and distinguished careers at companies such as MBNA America Bank, Concord EFS, Inc., American Express, and Summit Partners. None of them has ever been employed by GCA. Three of these directors — Messrs. Judge, Kilburn and Enlow — serve on GCA's audit committee. Mr. Kilburn joined the audit committee in 2005. Am. Compl. ¶ 37. Mr. Judge joined the committee in September 2006. *Id.* ¶ 36. And Mr. Enlow

[3] Under NYSE rules, GCA may certify directors as independent only if the board of directors affirmatively determines they have "no material relationship with the listed company." NYSE Rule 303A.02(a), available at: *www.nyse.com/pdf/finalcorpgovrules.pdf. See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 814 (Del. Ch. 2005).

joined the audit committee on August 31, 2007 — just in time to participate in the audit committee's internal investigation. *Id*. ¶ 39.

The sixth director — Scott Betts — is GCA's new chief executive officer. *Id*. ¶ 32. He began working at GCA on October 31, 2007 — just nine days before the whistleblower's accusations were brought to the company's attention. *Id*. Because he is new to the company, Mr. Betts is not personally exposed to liability for any commission issues. But he cannot be said to be independent of the other directors, who hired him and who determine his compensation.

ARGUMENT

Based on the legal requirements described in the next few paragraphs, plaintiffs' complaint can only survive this motion to dismiss if it demonstrates by specific allegations that at least three of GCA's directors face a substantial likelihood of liability or are not independent. If not — if at least four directors are disinterested and independent — the complaint cannot satisfy Rule 23.1 and must be dismissed.

Because one of GCA's directors, Mr. Olson, is not a defendant, he must be counted as being both disinterested and independent.[4] And Mr. Betts must be considered to be not independent of the other directors. That leaves four. This motion, accordingly, focuses on plaintiffs' allegations regarding these four directors — Mr. Enlow, Mr. Judge, Mr. Kilburn, and Mr. Fitzgerald.

Three of these remaining directors (Mr. Enlow, Mr. Judge and Mr. Kilburn) are all treated in essentially the same way in the amended complaint, primarily because all three serve on GCA's audit committee. Thus, following an explanation of the law of governing the demand requirement, this motion turns to an evaluation of the allegations regarding Mr. Enlow, Mr. Judge and Mr. Kilburn, and demonstrates that the complaint does not plead specific facts undermining their independence and disinterestedness under Delaware law.

[4] Under Delaware law, a plaintiff concedes that an unnamed defendant is independent and disinterested. *See Highland Legacy, Ltd. v. Singer*, No. Civ. A. 1566-N, 2006 WL 741939, at *4 (Del. Ch. Mar. 17, 2006); *Said v. Toback*, Case No. 05-C-1981, 2007 U.S. Dist. LEXIS 51136, at *9 (N.D. Ill. Jul. 10, 2007).

But first, the law regarding demand futility. Rule 23.1 embodies the fundamental idea that a company's directors, and not its shareholders, should control litigation brought in the company's name. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 101 (1991). Only rarely can a shareholder overcome this "powerful presumption" in favor of a company's directors. *Beam v. Stewart*, 845 A.2d 1040, 1048-49 (2004).

Rule 23.1 implements this policy by imposing restrictions on a shareholder's ability to sue on a company's behalf. A shareholder bringing a derivative action must either make efforts to "obtain the desired action from the directors" or plead, with particularity, "the reasons for . . . not making the effort." Fed. R. Civ. P. 23.1.

Rule 23.1 thus imposes a heightened pleading standard with regard to demand futility. Rule 23.1 requires plaintiffs to "plead with particularity the reasons why such demand would have been futile." *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 989 (9th Cir. 1999). This standard is similar to Rule 9(b)'s "particularity" pleading standard for fraud claims. *In re BankAmerica Sec. Litig.*, 636 F. Supp. 419, 421 (C.D. Cal. 1986).

While Rule 23.1 sets forth the pleading standard, Delaware law governs the substantive requirements of demand futility.[5] To plead demand futility under Delaware law, a shareholder plaintiff must show "that the board that would be addressing the demand" could not "impartially consider its merits without being influenced by improper considerations." *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993). This must be done by means of "particularized factual allegations . . . creat[ing] a reasonable doubt" that a majority of the directors was both disinterested and independent. *Id.* General allegations of purported wrongdoing will not suffice; rather, "facts specific to each director" must be pleaded. *Desimone v. Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007); *see also Postorivo v. AG Paintball Holdings, Inc.*, Nos. 2991, 3111, 2008 WL 553205, at *6 (Del. Ch. Feb. 29, 2008) (dismissing complaint that "alleges nothing close to the fact-intensive, director by director analysis required").

[5] Because GCA is a Delaware corporation, Delaware law applies. Am. Compl. ¶ 28; *Kamen*, 500 U.S. at 108-09; *Horwitz v. Sw. Forest Indus., Inc.*, 604 F. Supp. 1130, 1134 (D. Nev. 1985) ("[t]he powers of corporate directors [are] determined by state law").

A director is "interested," under Delaware law, if he has a personal stake in the outcome of the litigation. *Beam*, 845 A.2d at 1049. Plaintiffs can plead "interestedness" in two ways. First, they may plead specific facts showing that "the directors face a 'substantial likelihood' of personal liability, [so that] their ability to consider a demand impartially is compromised." *Rattner v. Bidzos*, No. Civ. A. 19700, 2003 WL 22284323, at *12 (Del. Ch. Oct. 7, 2003) (*quoting Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003)). "[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). Second, plaintiffs may allege specific facts showing that a director received a material "personal financial benefit . . . not equally shared by the stockholders." *Rales*, 634 A.2d at 936. The benefit must be significant enough "as to have made it improbable that the director could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest." *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002) (citation omitted).

A director is independent, under Delaware law, if he is able to base his decision "on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Aronson*, 473 A.2d at 816. To show a lack of independence, plaintiffs must "allege particularized facts showing either that the board is dominated by an officer or director who is the proponent of the challenged transaction, or that the board is so under his influence that its discretion is 'sterilize[d].'" *In re Verisign, Inc. Deriv. Litig.*, 531 F. Supp. 2d 1173, 1195 (N.D. Cal. 2007) (*citing Rales*, 634 A.2d at 936).

Because the amended complaint was filed on September 26, 2008, plaintiffs' allegations must demonstrate that demand was futile as to the board in place as of that date. *Braddock v. Zimmerman*, 906 A.2d 776, 785 (Del. 2006); *see also In re Am. Italian Pasta Co. Sec. Litig.*, No. 05-0725-CV-W-ODS 2006 WL 1715168, at *9 (W.D. Mo. June 19, 2006) (applying Delaware law to find that demand futility analysis should "focus on the board's composition at the time the Amended Complaint was filed"). Thus, the amended complaint must demonstrate by specific allegations that three of the current directors face a substantial likelihood of liability.

I. MESSRS. ENLOW, JUDGE, AND KILBURN ARE DISINTERESTED AND INDEPENDENT.

Because Mr. Olson is necessarily disinterested and independent, the present motion largely turns on whether the three current members of the audit committee, Messrs Enlow, Judge and Kilburn, are disinterested and independent. If they are, the complaint must be dismissed. There is no allegation that they are not independent. Thus, the question turns on whether the complaint states with particularity facts that raise a substantial likelihood that each will be liable.

Plaintiffs make essentially the same allegations about all three directors. Plaintiffs allege that the three directors serve on the audit committee, that they (along with prior directors) "failed to take action to direct GCA to timely and sufficiently correct its defective internal controls despite the fact that they have known about these deficiencies since at least March 2006 (if not sooner)." Am. Compl. ¶ 140. The complaint alleges that the secondary offering in May 2006 and the prior litigation (disclosed in August 2006) should have provided notice to the directors that the existing controls needed to be remedied. *Id*. ¶¶ 140 & 143. On this basis, the complaint alleges that "[the] defendants' failure to effectively act amounts to bad faith because it was a conscious and intentional disregard of their fiduciary duties." *Id*. ¶ 140.

These allegations are not backed by specific allegations sufficient to create a substantial likelihood that each of Mr. Enlow, Mr. Judge and Mr. Kilburn faces a substantial likelihood of liability for breach of fiduciary duty. First, the allegations fail to satisfy the very high legal bar that applies in Delaware to claims that directors failed to act to the company's detriment. Second, the allegations fail to distinguish between each director's circumstances individually and ignore the steps that the audit committee did take to address GCA's internal control deficiencies. Plaintiffs' remaining allegations about these gentlemen are too general and elusive to create a substantial likelihood of liability.

A. Plaintiffs Face A Very High Burden To State A Claim Based On Failures To Act.

Under Delaware law, a claim that a director "failed to take action" in "bad faith" is governed by the standard set out in *In re Caremark Int'l Inc. Deriv. Litig*., 698 A.2d 959, 971

(Del. Ch. 1996): "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." The court in *Caremark* stated this standard "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Id*. at 967.

Thus, in order to "state a viable *Caremark* claim, and to predicate a substantial likelihood of director liability on it, a plaintiff must plead the existence of facts suggesting that the board knew that internal controls were inadequate, that the inadequacies could leave room for illegal or materially harmful behavior, and that the board chose to do nothing about the control deficiencies that it knew existed." *Desimone*, 924 A.2d at 940. *See also Guttman*, 823 A.2d at 506 (*Caremark* requires "a showing that the directors were conscious of the fact they were not doing their jobs"). Only complete inaction after explicit notice will suffice to create a risk of liability for breach of fiduciary duty.

B. Plaintiffs Improperly Fail To Distinguish Between Each Individual Defendant.

To succeed in avoiding demand, Delaware law requires that plaintiffs plead specific facts as to each individual director. *Desimone*, 924 A.2d at 943. Plaintiffs fail to do so. Rather they make the same allegations about the three directors as a whole and lump them together with two other former directors (Mr. Harris and Mr. Kortschak), who previously served on the audit committee. *See* Am. Compl. ¶¶ 140 & 143. However, Mr. Harris's and Mr. Kortschak's conduct is irrelevant for purposes of plaintiffs' obligations under Rule 23.1. Only the conduct of Messrs. Enlow, Judge and Kilburn counts. *See Braddock*, 906 A.2d at 786. The distinction is not a technicality. Each director joined the board and audit committee in different periods, and each must be judged solely based on his own knowledge and actions.

Fred Enlow has compelling arguments against any claim of liability, arising solely from his brief service on the audit committee. Mr. Enlow did not join the board until October 2006 and

did not join the audit committee until August 2007. Am. Compl. ¶ 39. Thus, the only actions alleged in the complaint in which Mr. Enlow was a participant is the internal investigation that began in November 2007, essentially two months after he joined the committee. *Id*. ¶ 16. This investigation, which was run by the audit committee with the assistance of Skadden Arps and KPMG, is the very opposite of conscious disregard and inaction. *Id*. ¶¶ 16, 110-112; Tkachenko Decl. Ex. C at 80. The complaint acknowledges that the company spent $4.3 million to complete this work, which resulted in recommendations for improvements in GCA's controls and a new charge to the financial statements. Am. Compl. ¶ 120. These actions "appear to be precisely the types of transaction an independent board exercising valid business judgment should take when made aware of a serious problem." *Perkins ex rel. Bradley Pharm., Inc. v. Daniel*, No. 06 cv 01518, 2007 WL 4322596, at *4 (D.N.J. Dec. 6, 2007) (quoting *Kanter v. Barella*, 489 F. 3d 170, 181 (3rd Cir. 2007)). Certainly, no one can claim that Mr. Enlow (nor Mr. Judge or Mr. Kilburn who served with him on the committee during the investigation) "chose to do nothing" in response to the information they were provided in November 2007. *See Desimone,* 924 A.2d at 940. Plaintiffs do not establish a substantial likelihood of liability as to Mr. Enlow.

Similarly, Geoff Judge joined the board and the audit committee in September 2006. Am. Compl. ¶ 36. Within five months after he joined, the audit committee had identified and disclosed the material weaknesses described in its Form 10-K in March 2007. *Id*. ¶ 90. At that time and over the following quarters, Mr. Judge and Mr. Kilburn oversaw an effort by the company to remedy the deficiencies that had been identified by hiring new personnel and adopting new technology and new procedures. Tkachenko Decl. Ex. F at 43. Of course, Mr. Judge also participated in the company's internal investigation, starting in November 2007. Further, Mr. Judge was not a director during any of the events from March to August 2006 on which plaintiffs rely to allege that the members of the audit committee are not disinterested. Am. Compl. ¶¶ 140 & 143 (referring to the secondary offering and the 2006 litigation over commissions). Thus, the complaint fails to allege with particularity facts that suggest that Mr. Judge faces a substantial likelihood of liability.

Finally, plaintiffs' allegations regarding Miles Kilburn do not meet Delaware's high standard. Mr. Kilburn participated in the identification of the company's material weaknesses as of December 31, 2006. *Id.* ¶ 90. He helped oversee the remedial measures that the company adopted both before and thereafter. He participated in the internal investigation. *Id.* ¶¶ 16 & 110-112. These actions by themselves suffice to show that plaintiffs cannot state a claim against Mr. Kilburn under the *Caremark* standard.

Plaintiffs' other allegations do not undercut this conclusion. Paragraphs 140 & 143 allege that the audit committee ignored "red flags" regarding the deficiencies in the company's controls. "Red flags" are the right issue; however, the complaint only identifies one "red flag." It seeks to imply that the $200,000 litigation settlement, disclosed in August 2006, resulted from miscalculations arising from internal control deficiencies. *Id.* ¶ 143. This is inaccurate. As the company described, the subject matter of the lawsuits was whether commissions were owed "following the expiration of our agreements" with the customers. *Id.* ¶ 9; Tkachenko Decl. Ex. D at 10. The complaint provides no facts that link these circumstances to any alleged deficiency in internal controls. Unrelated litigation is not a red flag that justifies the conclusions plaintiffs seek to draw. *See In re Recoton Corp. Sec. Litig.*, 358 F. Supp. 2d 1130, 1147 (M.D. Fla. 2005) (company's guilty plea to falsifying customs documents did not constitute a red flag because it was unrelated to the alleged fraud).

Plaintiffs' only other allegation is a claim that the audit committee had a duty to evaluate the controls in connection with the secondary offering. Am. Compl. ¶ 140. Whether or not that is true, alleging a duty is not equivalent to alleging inaction in response to that duty. *Kenney v. Koenig*, 426 F. Supp. 2d 1175, 1182-83 (D. Colo. 2006) (quoting from company's press releases and audit committee's charter cannot substitute for alleging "*specific failures* of the independent outside director defendants or the Audit Committee of which they were members") (emphasis in original). The latter is what *Caremark* requires. The complaint does not approach this standard in view of all of Mr. Kilburn's actions.

When the claims against Messrs. Enlow, Judge and Kilburn are evaluated in light of their individual conduct, it is apparent that they did not consciously disregard known problems at the

company. Nothing less is sufficient to create the substantial likelihood of liability that is needed to render demand futile under Rule 23.1.

C. Plaintiffs' Remaining General Allegations Do Not Suffice.

Unable to address each director's conduct individually, the thrust of plaintiffs' allegations appears to be that the audit committee's actions did not prevent the company from incurring $2.9 million in charges in 2008. *See, e.g.,* Am. Compl. ¶ 121. Thus, they allege generally that the directors failed to take action that was "timely and sufficient." *Id*. ¶ 140. Alternatively, they allege generally that the directors made "no *true* effort to remedy the Company's defective controls." *Id*. ¶ 143 (emphasis added). These allegations fail to satisfy *Caremark* or Rule 23.1.

First, these are not allegations of complete inaction. They are a form of after-the-fact second guessing that fails to meet the strict *Caremark* standard, which requires a conscious choice not to do the job. *See Desimone*, 924 A.2d at 940; *see also Guttman*, 823 A.2d at 506. Thus, in *Salsitz v. Nasser*, 208 F.R.D. 589 (E.D. Mich. 2002), for example, the court held demand was not futile notwithstanding Ford Motor Company's well-publicized problems with tires on its Explorer sports utility vehicles. Plaintiff alleged Ford's directors had failed to act responsibly to remedy the problem. In dismissing the case, the Court reasoned:

> Plaintiff's claim amounts to no more than a disagreement, with the benefit of hindsight, concerning the timing and scope of remedial actions taken by Ford in response to the tire problems. Without evidence of bad faith on part of the individual defendants, of which none has been presented, the Company's actions fall well within the parameters of the business judgment rule.

Id. at 598. *See also In re Fannie Mae Deriv. Litig.*, 503 F. Supp. 2d 9, 22 (D.D.C. 2007) (plaintiffs' allegations showed board responded to information regarding accounting issues and inadequate internal accounting controls; demand not futile); *In re Sonus Networks, Inc.*, 499 F.3d 47, 70 (1st Cir. 2007) (internal review's findings of material weaknesses "are actually evidence of directorial supervision, rather than evidence of failure to supervise").[6]

[6] GCA's directors also do not face a substantial likelihood of personal liability for inadequate internal controls because GCA has adopted a so-called "exculpatory" charter provision. Tkachenko Decl., Ex. I. This provision, permitted by Delaware Corporations Code section 102(b)(7), authorizes a company to immunize its directors against any claim for damages

(Footnote continues on next page.)

Moreover, the allegation fails to recognize the distinction between mistakes in prior accounting due to internal control deficiencies and the calculation of a reserve that is set aside to deal with future customer disputes over ambiguous contract language. Following the internal investigation, GCA set aside a reserve to resolve customer disputes. Am. Compl. ¶ 119. It did not restate prior financial statements due to accounting errors. Tkachenko Decl. Ex. G at 13. This distinction itself undermines plaintiffs' attempt to link the audit committee's prior conduct to the resulting charge in 2008.

The remainder of the amended complaint's allegations applies generally either to the whole board or to any member of the audit committee. All fail to meet the requisite standard as a matter of law.

For example, plaintiffs allege that Messrs. Kilburn, Judge and Enlow, as audit committee members, were "responsible and involved in overseeing and directly participating in the dissemination of GCA's public statements and its internal control deficiencies." Am. Compl. ¶ 143. Repetition of the directors' duties does not supply specifics as to what any individual failed to do and therefore will not demonstrate how any director failed in his fiduciary duties. *See Kenney*, 426 F. Supp. 2d at 1182-83. What the complaint is missing is specific allegations of conscious disregard and complete inaction. *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1271 (Del. Ch. 1995) (plaintiffs must allege with particularity "what additional measures the directors should have taken").

Of course, *Caremark* applies to the conduct of the whole board as well. Nonetheless, plaintiffs fail to identify anything known to these three directors outside of their work on the audit

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(Footnote continued from previous page.)

arising from a breach of the duty of care. *Guttman*, 823 A.2d at 501. "[I]n the event that the charter insulates the directors from liability for breaches of the duty of care, 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." *Id.* (emphasis in original); *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001) ("if a shareholder complaint unambiguously asserts only a due care claim, the complaint is dismissable once the corporation's Section 102(b)(7) provision is properly invoked") (emphasis omitted). As a result, GCA's directors cannot face a "substantial likelihood of [personal] liability" for any breach of their duty of due care. They can only face liability for a breach of the duty of loyalty. *Aronson*, 473 A.2d at 815.

committee that should have generated greater concern. *See* Am. Compl. ¶¶ 140-146. Moreover, these directors' actions on the audit committee suffice to demonstrate their diligence as directors generally. Thus, the amended complaint's general allegations regarding the directors as a whole fail to demonstrate a substantial likelihood of liability for Messrs. Enlow, Judge and Kilburn.

Having evaluated the allegations against Messrs. Enlow, Kilburn and Judge and recognizing the lack of allegations against Mr. Olson, the Court need not go any further. At least four members of the board are disinterested and independent. Thus, the complaint must be dismissed under Rule 23.1. For sake of completeness, we address the allegations against the remaining outside director, Charles J. Fitzgerald.

II. MR. FITZGERALD IS DISINTERESTED AND INDEPENDENT.

A. Mr. Fitzgerald Is Not Personally Interested Due To Stock Sales.

Plaintiffs contend that Mr. Fitzgerald received an improper personal benefit and faces a substantial likelihood of personal liability, because he and Summit Partners sold GCA stock in the Secondary Offering in May 2006 and in February 2007. Am. Compl. ¶¶ 141-142.[7]

Mr. Fitzgerald received no personal benefit because the stock that was sold in May 2006 and February 2007 was not his. Mr. Fitzgerald is a managing director of Summit Partners L.P., a venture capital firm that was one of the early investors in GCA. Summit Partners, not Mr. Fitzgerald, sold GCA stock both in the Secondary Offering in May 2006 and on the market in February 2007. Tkachenko Decl. Ex. H, at H21-H23 and H36-H38. Mr. Fitzgerald "disclaim[ed] beneficial ownership" of the stock but was required to disclose the sales on his personal Form 4 filings with the SEC due to his role at Summit Partners. *See id.*; *In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109 SBA, 2001 U.S. Dist. LEXIS 16252, at *44-46 (N.D. Cal. Aug. 27, 2001) (directors not interested where they disclaimed beneficial ownership and plaintiffs did not allege specific facts showing directors personally benefited from sales); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 420-21 and n.19 (5th Cir. 2001) (director not interested because of stock sales

[7] Plaintiffs make the same allegation regarding Mr. Kortschak. Because Mr. Kortschak was not a director when the amended complaint was filed, allegations as to him are irrelevant.

by affiliated investment fund where director disclaimed beneficial ownership). Thus, the sales are not properly attributed to Mr. Fitzgerald for purposes of the plaintiffs' claims.

Even if they were, Mr. Fitzgerald would not face a substantial likelihood of personal liability because plaintiffs do not plead specific facts showing how he was in possession of material non-public information at the time Summit Partners sold the shares. *Guttman*, 823 A.2d at 505 (plaintiffs must plead defendants were in possession of material non-public information). It is not sufficient for the complaint to plead only what was disclosed later. There must be specific allegations to show that the material information was known at the time of the sale. Moreover, with respect to Summit Partners' sales in the secondary offering, the existence of deficiencies in the company's controls was not concealed – it was disclosed in the May 2006 registration statement. Am. Compl. ¶ 7. Trading following the release of information is not a breach of fiduciary duty. *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 934 (Del. Ch. 2004) (insider trading can be established only where defendant possesses material *non-public* information).

The amended complaint's allegations regarding stock sales show neither that Mr. Fitzgerald faces a substantial likelihood of liability nor the existence of an improper personal benefit.

B. Mr. Fitzgerald Is Independent.

Plaintiffs allege that Mr. Fitzgerald has a substantial business relationship with another defendant (Mr. Kortschak) that renders him incapable of independently considering a demand with respect to that defendant. Am. Compl. ¶ 146. But a business relationship by itself does not establish lack of independence. *In re Oracle Sec. Litig.*, 852 F. Supp. 1437, 1442 (N.D. Cal. 1994) ("[b]usiness dealings seldom take place between complete strangers and it would be a strained and artificial rule which required a director to be unacquainted or uninvolved with fellow directors in order to be regarded as independent"). Rather, the issue, under Delaware law, is whether the relationship between Mr. Fitzgerald and Mr. Kortschak is "significant enough" so as to make Mr. Fitzgerald "beholden to" Mr. Kortschak – that is, unable to act objectively without being "influenced" by the relationship. *See Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002).

Plaintiffs plead no facts showing that the relationship between Mr. Fitzgerald and Mr. Kortschak rises to that level. *See Crescent/Mach I Partners, L.P. v. Turner*, 846 A.2d 963, 980-981 (Del. Ch. 2000) (fifteen-year professional and personal relationship between a chief executive officer and director did not raise reasonable doubt about the director's independence).

III. PLAINTIFFS LACK STANDING AND HAVE NOT PROPERLY VERIFIED THE AMENDED COMPLAINT PURSUANT TO RULE 23.1.

A. Plaintiff Stueve Lacks Standing Under Rule 23.1.

Rule 23.1 requires a derivative plaintiff to allege he "was a shareholder or member at the time of the transaction complained of." Fed. R. Civ. Proc. 23.1. This means the plaintiff must allege "continuous ownership" of company's stock during the period of alleged wrongdoing and throughout the duration of the suit. *See Lewis v. Chiles*, 719 F.2d 1044, 1047 (9th Cir. 1983). The complaint "must indicate when plaintiffs bought stock" and "must state that they have owned stock continuously since the date of the filing of the lawsuit." *In re Sagent Tech., Inc. Deriv. Litig.*, 278 F. Supp. 2d 1079, 1096 (N.D. Cal. 2003); *see In re Verisign*, 531 F. Supp. 2d at 1202 ("plaintiffs must unambiguously indicate in any amended complaint the dates they purchased . . . stock, and whether they have continuously owned . . . stock from the time of purchase up to the present").

This standing requirement cannot be met with vague and conclusory allegations. It is not enough for a plaintiff to allege he is "an owner and holder of GCA common stock." Am. Compl. ¶ 26. Nor can a plaintiff satisfy Rule 23.1 by alleging only that he was an "owner[] of the stock of GCA during times relevant to the Individual Defendants' wrongful course of conduct." *Id.* ¶ 138.

Yet that is all plaintiff Stueve alleges. *See In re Computer Scis. Corp. Deriv. Litig.*, No. CV 06-05288, 2007 WL 1321715, at *15 (C.D. Cal. Mar. 26, 2007) (no standing where complaint alleged plaintiff "'is, and was [a shareholder] during the relevant period' or 'is and was [a shareholder] at all times relevant to'" the alleged wrongdoing); *Verisign*, 531 F. Supp. 2d at 1202 (no standing where complaint alleged plaintiffs "have owned . . . stock during the Relevant Period" and "continue to own the Company's common stock"). Mr. Stueve lacks standing to sue.

B. Plaintiff Mollenkopf's Verification Does Not Satisfy Rule 23.1.

Ms. Mollenkopf provides an allegation that she owned stock in 2006 and that she owns stock now. Nonetheless, she fails to satisfy Rule 23.1's requirement of a shareholder verification.

Rule 23.1 requires that a derivative complaint be verified by the plaintiffs who file it. The purpose of the verification is to ensure that a derivative action has a basis in fact and is not brought solely for the purpose of harassment or to force a quick settlement. *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 370-71 (1966). Failure to verify an original or an amended complaint permits dismissal. *Yarosh v. Salkind*, No. Civ. A. 04-1816, 2005 WL 1459719, at *3 (D.N.J. June 21, 2005). Plaintiff has the burden to establish the correctness of her verification. *See Rogosin v. Steadman*, 71 F.R.D. 514, 519 (S.D.N.Y. 1976) (dismissing the complaint for improper verification).

Plaintiff Mollenkopf's verification states she is "familiar with" and "authorized the filing of" a "First Consolidated Derivative Complaint." The verification is dated September 17, 2008. So what complaint did Ms. Mollenkopf verify? The present complaint is titled "Verified Amended Consolidated Shareholder Derivative Complaint." Moreover, it was filed on September 26, 2008, more than a week after Ms. Mollenkopf signed her verification. The September 26 amended complaint differs in substance from a September 19, 2008 version of the complaint that plaintiffs attached to their motion to amend. Ms. Mollenkopf's verification is untimely and incomplete, which provides an independent basis to dismiss.

IV. PLAINTIFFS' AMENDED COMPLAINT SHOULD BE DISMISSED WITH PREJUDICE.

This is the third complaint filed by plaintiffs in this case. Plaintiffs have had almost a year to gather the facts necessary to properly plead their complaint. They have not done so despite three attempts. This number of chances is sufficient. *See In re VISX, Inc. Sec. Litig.*, Nos. C-00-0649, C-00-0815 2001 WL 210481, at *11 (N.D. Cal. Feb. 27, 2001) (dismissing after two unsuccessful attempts); *Desaigoudar v. Meyercord*, 223 F.3d 1020, 1026 (9th Cir. 2000) (failing to state a claim after three attempts "subjected the complaint to the distinct possibility of dismissal with prejudice"). The amended complaint should be dismissed with prejudice.

CONCLUSION

Because the five independent directors are both independent and disinterested and because plaintiffs lack standing and did not provide a proper verification, GCA respectfully requests that plaintiffs' amended complaint be dismissed with prejudice pursuant to Rule 23.1.

Dated: November 6, 2008

DARRYL P. RAINS
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By: /s/ Darryl P. Rains
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CERTIFICATE OF SERVICE

I hereby certify a true and exact copy of Global Cash Access Holdings, Inc.'s Motion To Dismiss Amended Complaint For Failure to Comply With Rule 23.1 has been served on all filing users through the Court's electronic filing system on this 6th day of November 2008.

/s/ James J. Pisanelli
James J. Pisanelli