

STATE OF NORTH CAROLINA
MECKLENBURG COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
19 CVS 17741

KEITH LEE and YOUNG KWON
(individually and derivatively on behalf
of rFactr, Inc.),

Plaintiffs,

v.

CHRIS MCDOWELL; CHRIS LAU; and
ROBERT DUNN,

Defendants,

and

RFACTR, INC.,

Nominal Defendant.

**ORDER APPROVING PROPOSED
SETTLEMENT AGREEMENT**

CHRIS MCDOWELL,

Third-Party Plaintiff,

v.

RICHARD BRASSER and GREG
GENTNER,

Third-Party
Defendants.

CHRIS LAU and ROBERT DUNN,

Third-Party Plaintiffs,

v.

RICHARD BRASSER and GREG
GENTNER,

Third-Party Defendants.

1. **THIS MATTER** is before the Court on Plaintiffs Keith Lee and Young Kwon (“Plaintiffs”), derivatively on behalf of rFactr, Inc. (“rFactr”), and Defendants Chris McDowell (“McDowell”) and Robert Dunn’s (“Dunn”; together with McDowell, the “Defendants”) Joint Motion for Approval of Proposed Settlement (the “Motion”), (ECF No. 156), filed 20 October 2022 in the above-captioned action. Plaintiffs and Defendants seek through the Motion the Court’s approval of a proposed settlement of Plaintiffs’ remaining derivative claim against Defendants in the above-captioned case under N.C.G.S. § 55-7-45.

2. Having considered the Motion, the briefs in support of and in opposition to the Motion, the arguments of counsel at the hearing on the Motion, and other appropriate matters of record, the Court **APPROVES** the proposed settlement of Plaintiffs’ remaining derivative claim as set forth below.

I.

FACTUAL AND PROCEDURAL BACKGROUND

3. After rFactr failed to respond to Plaintiffs’ timely derivative demand, Plaintiffs filed the Complaint initiating this action on 6 September 2019 against Defendants and Chris Lau (“Lau”), each of whom was an rFactr director at the time

of the acts complained of in the Complaint.¹ Plaintiffs later filed an Amended Complaint on 26 November 2019, asserting individual claims against McDowell and derivative claims against Defendants and Lau for their alleged breaches of fiduciary duty for failing to (i) oversee and monitor rFactr’s finances and operations; (ii) prevent payment of excessive compensation to Third-Party Defendants Richard Brassier (“Brasser”) and Greg Gentner (“Gentner”; together with Brassier, the “Third-Party Defendants”); and (iii) comply with their duty of loyalty in considering the potential sale of rFactr.²

4. On 23 December 2019, McDowell answered Plaintiffs’ Amended Complaint and asserted a crossclaim against rFactr for indemnification pursuant to Article X of rFactr’s bylaws³ (the “Bylaws”).⁴ Dunn and Lau answered the Amended Complaint on 30 December 2019 and also asserted a crossclaim against rFactr for indemnification under Article X of the Bylaws.⁵

5. After the close of discovery, on 17 December 2021, Defendants and Lau filed motions for summary judgment seeking dismissal of Plaintiffs’ claims (the “Summary

¹ (Compl., ECF No. 3.)

² (Verified Am. Compl. 3, ECF No. 10.)

³ (Aff. William J. Farley in Supp. Defs. Chris Lau and Robert Dunn’s Mot. Summ. J. Ex. L. [hereinafter “Bylaws”], ECF No. 114.12.)

⁴ (Chris McDowell’s Answer, Affirmative Defenses, Crossclaim, and Third-Party Compl. 13–14 [hereinafter “McDowell’s Answer”], ECF No. 17.)

⁵ (Chris Lau and Robert Dunn’s Answer Pls.’ Am. Verified Compl., Cross-cl., and Third-Party Compl. 18 [hereinafter “Lau and Dunn’s Answer”], ECF No. 19.)

Judgment Motions”).⁶ The Court entered an order on 26 May 2022 granting in part and denying in part the Summary Judgment Motions (the “Summary Judgment Order”).⁷ In that order, the Court dismissed Plaintiffs’ derivative claims against Lau as well as Plaintiffs’ derivative claims against Defendants for breach of fiduciary duty based on duties of oversight, to monitor, and of loyalty.⁸ Thus, Plaintiffs’ only remaining derivative claim after the entry of the Summary Judgment Order was against Defendants for breach of fiduciary duty based on their failure to prevent the payment of allegedly excessive compensation to the Third-Party Defendants. A jury trial on this remaining derivative claim against Defendants and on Plaintiffs’ remaining individual claims against McDowell is set to commence on 13 February 2023.⁹

6. On 28 September 2022, the parties advised the Court’s law clerk by e-mail that Plaintiffs and Defendants had reached a settlement of Plaintiffs’ remaining claims.

7. On 20 October 2022, the parties filed the Motion and attached thereto as Exhibit A a proposed settlement agreement and mutual release document, executed

⁶ (Def./Third-Party Pl. Chris McDowell’s Mot. Summ. J., ECF No. 109; Chris Lau and Robert Dunn’s Mot. Summ. J., ECF No. 118.)

⁷ (Order and Op. on Def./Third-Party Pl. Chris McDowell’s and Defs./Third-Party Pls. Chris Lau and Robert Dunn’s Mots. Summ. J. [hereinafter “Summary Judgment Order”], ECF No. 141.)

⁸ (Summary Judgment Order 56.)

⁹ (Notice of Jury Trial, ECF No. 151.)

by Plaintiffs and Defendants, for the Court's consideration and approval under N.C.G.S. § 55-7-45.¹⁰ Under the proposed settlement, Dunn and McDowell have agreed to pay Plaintiffs a total of \$100,000 to settle Plaintiffs' remaining derivative claim, and McDowell has agreed to pay Plaintiffs \$32,500 to settle Plaintiffs' individual claims against him.¹¹ The parties have also agreed to the exchange of mutual releases and to release and discharge rFactr from any indemnity claims, including claims for costs and attorneys' fees.¹²

8. rFactr and the Third-Party Defendants (together, the "Objecting Parties") timely filed an opposition to the proposed settlement on 24 October 2022.¹³

9. The Court held a hearing on the Motion on 25 October 2022 (the "Hearing"), at which all parties were represented by counsel. The Motion is now ripe for resolution.

II.

LEGAL STANDARD

10. N.C.G.S. § 55-7-45 provides that "[a] derivative proceeding may not be discontinued or settled without the court's approval." In determining whether to approve the settlement of a derivative action, "the court is to balance (1) any legitimate corporate claims as brought forward in the derivative shareholder suit

¹⁰ (Joint Mot. Approval Proposed Settlement Ex. A [hereinafter "Proposed Settlement Agreement"], ECF No. 156.1.)

¹¹ (Proposed Settlement Agreement 2; Br. Supp. Joint Mot. Approval Proposed Settlement 3.)

¹² (See Proposed Settlement Agreement 2.)

¹³ (Br. Opp'n Proposed Derivative Settlement, ECF No. 158.)

against (2) the corporation's best interests." *Scott v. Sokolov*, 1996 NCBC LEXIS 1, at *6 (N.C. Super. Ct. Dec. 2, 1996) (quoting *Alford v. Shaw*, 327 N.C. 526, 540 (1990)). Factors to consider include "costs to the corporation of litigating the suit (including attorneys' fees, out-of-pocket expenses related to the litigation, time spent by corporate personnel preparing for and participating in litigation, and indemnification) and the benefits to the corporation in continuing the suit," as well as "such ethical, commercial, promotional, public relations and fiscal factors as may be involved in a given situation." *Id.* at *6–7.

11. The statute also provides that notice to shareholders must be given "[i]f the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders." N.C.G.S. § 55-7-45(a). Courts are allowed to exercise their discretion in making this determination. *See Morgan v. Turn-Pro Maint. Servs., LLC*, 2017 NCBC LEXIS 228, at *4 (N.C. Super Ct. Aug. 29, 2017) ("The Court's consideration of the effect of a discontinuance does not 'lend itself to any formula-like approach,' so it is ultimately for 'the court to decide whether the case begun in the Superior Court will continue.'" (quoting *Alford*, 327 N.C. at 540–41)).

III.

ANALYSIS

12. Based on its review of the record and the Motion, the Court concludes that notice of the proposed settlement to shareholders is unnecessary and that it is in the corporation's best interest to approve the proposed settlement.

13. Plaintiffs' counsel asserted at the Hearing that Plaintiffs seek \$200,000 in damages on their remaining derivative claim as well as indemnity under N.C.G.S. § 55-7-46¹⁴ to recover their attorneys' fees and costs incurred in successfully litigating the claim. Plaintiffs' counsel also represented at the Hearing, without objection or challenge, that Plaintiffs' fees and costs already well exceed the \$100,000 Defendants have agreed to pay in settlement of the derivative claim and correctly observed that Plaintiffs' indemnity claim will become significantly greater as their fees and costs increase if this matter proceeds through trial. In addition, Defendants' counsel pointed out at the Hearing that, by the Bylaws' plain terms, Defendants' right to indemnity under the Bylaws will be triggered if Plaintiffs fail on their claims at trial¹⁵ and further that Defendants' fees and costs, like Plaintiffs', already exceed the consideration Defendants have agreed to pay to settle Plaintiffs' remaining derivative claim. Thus, rFactr is very likely to face a substantial indemnity claim greater than the consideration Defendants have agreed to pay in settlement no matter the outcome of this litigation.

14. Based on the foregoing, the Court concludes that Plaintiffs and Defendants have shown by substantial evidence that the proposed settlement will eliminate large indemnity claims against rFactr in amounts far in excess of the amount that Defendants will pay to Plaintiffs to extinguish Plaintiffs' derivative claim. As such,

¹⁴ N.C.G.S. § 55-7-46(1) permits a trial court to “[o]rder the corporation to pay the plaintiff’s reasonable expenses, including attorneys’ fees, incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation[.]”

¹⁵ (See Bylaws, Art. X, Section 1.)

the Court concludes that the proposed settlement is fair to rFactr and that approval of the proposed settlement is in rFactr's best interest.

15. The Court further concludes that here, where rFactr is represented by counsel and the proposed settlement eliminates a liability substantially greater than the consideration paid to Plaintiffs to release that liability, rFactr's shareholders' rights and interests are not substantially affected and notice to them is therefore unnecessary.

16. The Objecting Parties generally support the proposed settlement but contend that equity and fairness demand that rFactr receive \$30,000 of the proposed settlement funds to "cover the cost of defending this case" and to permit "a small amount of recovery for the derivative claims asserted."¹⁶ The Court disagrees.

17. The Objecting Parties effectively ask that the Court permit rFactr to prefer its counsel's claim over those of the company's other creditors—creditors that the parties report hold claims totaling in excess of \$2,000,000. The Court sees no justification for doing so.

18. Indeed, not only should rFactr's creditors of the same class be paid *pro rata* in the event of rFactr's winding up, *see Keener Lumber Co. v. Perry*, 149 N.C. App. 19, 33–34 (2002), but rFactr could have taken measures to mitigate the \$42,000 it reports it has incurred in attorneys' fees in this action had it chosen not to disregard Plaintiffs' derivative demand. For one, rFactr could have investigated Plaintiffs' claims and contemporaneously sought a stay of this proceeding, substantially

¹⁶ (Br. Opp'n Proposed Derivative Settlement 4.)

reducing rFactr's fees and costs. See N.C.G.S. § 55-7-43 ("If the corporation commences an inquiry into the allegations set forth in the demand or complaint, the court may stay a derivative proceeding for a period of time the court deems appropriate."). rFactr could also have chosen to appoint a special litigation committee to determine if the lawsuit was in the company's best interests under N.C.G.S. § 55-7-44(b) or (f). Had such a committee "determin[ed] in good faith after conducting a reasonable inquiry upon which its conclusions are based that the maintenance of the derivative proceeding [was] not in the best interest of the corporation," N.C.G.S. § 55-7-44(a), the Court would have been required to dismiss this action, again resulting in a substantial reduction of rFactr's fees and costs. rFactr chose neither alternative, however, and instead vigorously opposed Plaintiffs' claim, incurring substantial expenses even as it proceeded as a nominal defendant.

19. In these circumstances, the Court does not believe equity or fairness require that rFactr receive any portion of the proposed settlement consideration, particularly taking into account both rFactr's chosen course of conduct and the substantial benefit that rFactr will receive through the release of the significant indemnity claims that Plaintiffs and Defendants now hold.

20. Accordingly, based on the above, the Court concludes that the proposed settlement agreement attached to the Motion as Exhibit A should be approved.

IV.

CONCLUSION

21. **WHEREFORE**, for the reasons set forth above, the Court, in the exercise of its discretion, hereby **GRANTS** the Motion and approves the proposed settlement of Plaintiffs' derivative claim for breach of fiduciary duty based on Defendants' failure to prevent the payment of excessive compensation to Brassler and Gentner as set forth in Exhibit A to the Motion. The case is hereby **STAYED** so that the parties may comply with the conditions of the proposed settlement agreement, including the filing of dismissals as contemplated therein.

SO ORDERED, this the 2nd day of November, 2022.

/s/ Louis A. Bledsoe, III
Louis A. Bledsoe, III
Chief Business Court Judge