SUPREME COURT

REPUBLIC OF MARSHALL ISLANDS

JOSEPH ROSENQUIST, derivatively on behalf of Nominal Defendant DRYSHIPS, INC., Plaintiff-Appellant, vs. GEORGE ECONOMOU, GEORGE DEMATHAS, CHRYSSOULA KANDYLIDIS (A/K/A CHRYSSOULA KANDYLIDI OR CHRYSOULA KANDYLIDIS), EVANGELOS MITILINAIOS (A/K/A EVANGELOS MYTILINAIOS OR EVANGELOS MYTILINAEOS), ANGELOS PAPOULIAS, AND GEORGE XIRADAKIS, Defendants-Appellees, and DRYSHIPS, INC., Nominal Defendant.	Supreme Court Case No. 2010-002 High Court Civil Action No. 2009-056 OPINION

Before: CADRA, Chief Justice; SEABRIGHT[1] and KURREN[2] Acting Associate Justices.

KURREN, Acting Associate Justice:

INTRODUCTION

This is a shareholder derivative action brought by Plaintiff-Appellant Joseph Rosenquist, derivatively on behalf of Nominal Defendant DryShips, Inc. Plaintiff is a shareholder of DryShips and filed this lawsuit against the following current and former members of its Board of Directors ("Board"): Defendants-Appellees George Economou, Chryssoula Kandylidis (a/k/a Chryssoula Kandylidi or Chrysoula Kandylidis), George Demathas, Evangelos Mitilinaios (a/k/a Evengelos Mytilinaios or Evangelos Mytilinacos), George Xiradakis, and Angelos Papoulias (collectively, "Defendants"). Plaintiff alleges that Defendants breached their fiduciary duty of good faith, committed waste by approving transactions that were not the product of good faith business judgment, and were unjustly enriched at DryShips's expense.

Plaintiff did not make a demand on the DryShips Board before instituting this action against Defendants. In the Amended Complaint, Plaintiff

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[1] Honorable J. Michael Seabright, United States District Judge, District of Hawaii, sitting by designation of the Cabinet.

[2] Honorable Barry M. Kurren, United States Magistrate Judge, District of Hawaii, sitting by designation of the Cabinet.

asserted that any such demand would have been "futile and useless . . . because the Board is incapable of making an independent and disinterested decision to institute and vigorously prosecute this action." Absent a demand on the Board, Defendants moved the High Court of the Republic of the Marshall Islands to dismiss the Amended Complaint. The High Court agreed with Defendants and dismissed the Amended Complaint, concluding that it did "not contain particularized allegations that raise a reasonable doubt that at the time the lawsuit was filed a majority of the directors were disinterested and independent or that the challenged transactions were the product of a valid exercise of business judgment." Although Plaintiff was permitted to move for leave to amend the Amended Complaint, he chose to appeal the High Court's decision to this Court.

As discussed below, the Court AFFIRMS the dismissal of the Amended Complaint.

BACKGROUND

A. Factual Background

Plaintiff is a shareholder of DryShips, which is a corporation incorporated under the laws of the Republic of the Marshall Islands and headquartered in Athens, Greece. Defendant Economou founded DryShips in 2004 as a holding company engaged in the ocean transportation of dry bulk

cargoes worldwide. DryShips's assets are managed by Cardiff Marine, Inc., an entity owned 70% by Economou and 30% by his sister, Defendant Kandylidis. Fabiana Services S.A. is a corporation owned by Economou, which "provides the services of the individuals who serve in the positions of chief executive and chief financial officer of the Company." DryShips's articles of incorporation contain an exculpation clause, which exempts directors from liability for breaches of the duty of care.

Defendant Economou has served as DryShips's chairman of the Board, president, chief executive officer, interim chief financial officer and, at the times DryShips entered into the transactions at issue, he owned between 9.0% and 31.0% of DryShips common stock.

Defendant Kandylidis, Economou's sister, has served as a non-executive director of DryShips since March 5, 2008. Defendant Demathas served as a non-executive director since July 18, 2006 and was a member of the Audit, Compensation, and Nomination Committees at all times relevant. Defendant Xiradakis has served as a non-executive director since 2006 and was a member of the same Committees at all times relevant. Defendant Papoulias served as a non-executive director from April 2005 until December 22, 2008. Defendant Mitilinaios has served as a non-executive director and was a member of the Audit

Committee since December 22, 2008. At the time this action was commenced, the Board consisted of: *Economou*, *Kandylidis*, Demathas, Mitilinaios, and Xiradakis.[4]

In the Amended Complaint, Plaintiff alleges that Economou dominates and controls DryShips through his ownership of the company, his positions within the company, "anti-takeover provisions" of the company's articles and bylaws, and "director appointments and compensation." Plaintiff further alleges that Economou's control of DryShips "resulted in Board approval of transactions that appear to have been designed to benefit Economou, not DryShips." The transactions for which Plaintiff seeks relief in this case are: (1) the Primelead Transaction, (2) the July and October Agreements, and (3) Economou's compensation.

1. The Primelead Transaction

On October 3, 2008, DryShips entered into a share purchase agreement to acquire equity interests of DrillShips Holdings, which was controlled by clients of Cardiff, including Economou, in exchange for 25% of the equity of Primelead Shareholders Inc., which is a DryShips subsidiary ("the Primelead

[4] By the time the Amended Complaint was filed, the Board had two additional members: Harry Kerames and Vassilis Karamitsanis

Divestment"). In connection with this transaction, DryShips "assumed installment payment obligations of $1.1 billion and debt obligations of $261.1 million."

Nine months later on July 9, 2009, after the shipping industry suffered an economic downturn, DryShips "announced that 'it has entered into an agreement to acquire the remaining 25% of the total issued and outstanding capital stock of Primelead'" ("the Primelead Acquisition").[5] The Primelead Acquisition would cause "Primelead [to] become a wholly-owned subsidiary of [DryShips]." The Primelead Acquisition "resulted in [DryShips] paying to Economou a one-time $50.0 million cash payment, and issuing to Economou 33,955,224 shares of DryShips convertible preferred stock." "Economou's 25% equity interest in Primelead that DryShips acquired in the Primelead Acquisition was worth approximately $122 million at the time of the transaction, and the Preferred Stock that Economou received in the Primelead Acquisition was worth approximately $185 million." The Amended Complaint alleges that, in sum, "DryShips paid Economou a total of approximately $235 million ($50 million in cash and $185 million in Preferred Stock) for equity worth only $122 million, an overpayment of approximately $113 million, or 93%."

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[5] Together, the Primelead Divestment and the Primelead Acquisition are referred to as the "Primelead Transaction."

2. The July and October Agreements

On July 3, 2008, DryShips entered into the July Agreement to purchase four Panamax bulk carriers for $400 million from companies beneficially owned by Economou. DryShips paid to the selling entities a cash deposit of $55 million or 13.75% of the purchase price, which is higher than the industry standard of 10%. Defendants Demathas, Kandylidis, Mitilinaios, and Xiradakis approved the July Agreement.

On October 6, 2008, Dryships entered into the October Agreement to purchase nine special-purpose companies that each owned one Capesize bulk carrier. The special purpose companies were each owned by Cardiff or undisclosed clients of Cardiff. DryShips agreed to pay "more than $689 million in newly-authorized DryShips stock, and to assume $216 million in debt and $262 million in remaining shipyard installments to complete construction of some of the dry bulk carriers."

As 2008 progressed, "the health of the shipping industry deteriorated" and "the daily average of charter rates . . . [fell] over 90% from May 2008 through October 2008 and over 70% in October 2008 alone." Consequently, the Board terminated the July and October Agreements.

As to the July Agreement, DryShips paid for an "option to purchase the very same dry bulk carriers on an en bloc basis at a fixed purchase price of $160 million. In exchange for this Option, DryShips paid $26.25 million per vessel, or $105 million." As for the October Agreement, upon termination, "DryShips granted to Economou warrants to purchase Company stock . . . , the intrinsic value of these warrants is approximately $82.5 million." DryShips also "granted to 'clients' of Cardiff . . . $6.5 million shares of Dryships stock worth approximately $68,185,000."

3. Economou's Compensation

On January 21, 2009, Demathas and Xiradakis, as members of the Compensation Committee, approved a $6.98 million bonus payable to Economou for services rendered during 2008. On the same day, the Compensation Committee "also approved an increase in the annual fee to Fabiana" by $597,000, which further increased Economou's annual compensation.

B. Procedural Background

Plaintiff commenced this action on March 2, 2009. On August 12, 2009, Plaintiff filed the Amended Complaint, in which he asserts nine causes of action against Defendants for breach of fiduciary duty (Counts I-III), waste of corporate assets (Counts IV-VI), and unjust enrichment (Counts VII-IX).

Prior to filing this action, Plaintiff did not make a demand upon the Board to initiate litigation. On September 11, 2009, Defendants moved the High Court to dismiss the Amended Complaint for failure to do so. The High Court agreed with Defendants and dismissed the Amended Complaint. Although Plaintiff was allowed to file a motion to amend the Amended Complaint, he chose to appeal the High Court's decision to this Court.

STANDARD OF REVIEW

This Court reviews dismissal of a complaint de novo. Momotaro v. Chief Elec. Off., 2 MILR 237, 241 (2004); Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1048 (Del. 2004). In reviewing complaints on a motion to dismiss, "'[p]laintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences.'" White v. Panic, 783 A.2d 543, 549 (Del. 2001). The Court does not "blindly accept as true all allegations, nor [does it] draw all inferences from them in plaintiffs' favor unless they are reasonable inferences." Id. "[I]nferences that are not objectively reasonable cannot be drawn in the plaintiff's favor." Beam, 845 A.2d at 1048.

DISCUSSION

The parties correctly agree that because DryShips is a Marshall Islands corporation, Marshall Islands law controls. See Kamen v. Kemper Finan. Servs., Inc., 500 U.S. 90, 98-99 (1991). Under Marshall Islands law, a shareholder asserting claims derivatively on behalf of a corporation shall first make a demand on the board of directors to initiate the litigation. 52 MIRC, Part I, § 79(3). Where a shareholder plaintiff fails to make such a demand, he must allege "with particularity" the reasons why that demand would have been futile. Id.; MIRCP 23.1 ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort").

The parties also correctly agree that Marshall Islands law instructs this Court to look to Delaware corporate law. See 52 MIRC, Part I, § 13 (noting the Marshall Islands Business Corporations Act "shall be applied and construed to make the laws of the Republic . . . uniform with the laws of the State of Delaware"). Pursuant to Delaware law, where a plaintiff fails to make a demand on the board of directors to initiate litigation, courts apply the two-part test for demand futility set forth in Aronson v. Lewis, 473 A.2d 805 (Del. 1984),

overruled in part on other grounds by Brehm v. Eisner, 746 A.3d 244 (Del. 2000). Under that test, courts "must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." Aronson, 473 A.2d at 814; In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 120 (Del. Ch. 2009) ("the complaint must plead with particularity facts showing that a demand on the board would have been futile"). "These prongs are in the disjunctive. Therefore, if either prong is satisfied, demand is excused." Brehm, 746 A.2d at 256. Further, as to the first prong of the test, a plaintiff shall "establish[] the lack of independence or disinterestedness of a majority of the directors." Aronson, 473 A.2d at 817 (emphasis added).

In determining whether demand is excused, courts "must accept as true the well pleaded factual allegations in the Complaint." In re Citigroup, 964 A.2d at 120. "The pleadings, however, are held to a higher standard . . . than under the permissive notice pleading standard under Court of Chancery Rule 8(a)." Id. To establish that demand is excused, "the pleadings must comply with 'stringent requirements of factual particularity' and set forth 'particularized factual statements that are essential to the claim.'" Id. at 120-21. "A prolix complaint

larded with conclusory language does not comply with these fundamental pleading mandates." Id. at 121 (ellipses points omitted).

"[F]utility is gauged by the circumstances existing at the commencement of a derivative suit." Aronson, 473 A.2d at 810. At the time this action was filed on March 2, 2009, the Board consisted of five directors: Economou, Kandylidis, Demathas, Mitilinaios, and Xiradakis.[6] The parties agree that allegations relating to Defendant Papoulias are irrelevant to the demand futility analysis because he resigned on December 22, 2008 and was no longer on the Board when this suit was commenced.

A. Whether Plaintiff Alleges Particularized Facts Creating a Reasonable Doubt That the Directors Are Disinterested and Independent

1. Defendants Economou and Kandylidis

As to Economou and Kandylidis, the High Court concluded that Plaintiff sufficiently alleged particularized facts of self-dealing in the Amended Complaint that create reasonable doubt that they were disinterested in the relevant transactions. In this context, "disinterested" "means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial

[6] As noted earlier, by the time the Amended Complaint was filed, the Board had two additional directors: Kerames and Karamitsanis.

benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." Aronson, 473 A.2d at 812.

On appeal, neither party disputes that Economou and Kandylidis are not disinterested. Indeed, the particularized facts alleged in the Amended Complaint assert that Economou stood on both sides of the subject transactions, while Kandylidis stood on both sides of the July and October Agreements and the Primelead Transaction. Further, the Amended Complaint alleges that Kandylidis is the sister of Economou, who is interested in all of the transactions. Accordingly, this Court agrees with the High Court and the parties, and concludes that particularized facts alleged as to Economou and Kandylidis create a reasonable doubt that they are disinterested. See Aronson, 473 A.2d at 812. Consequently, demand is excused as to Economou and Kandylidis under the first prong of Aronson. Brehm, 746 A.2d at 256 ("if either prong [of the Aronson test] is satisfied, demand is excused"). Because demand must be excused for a "majority" of the Board under the first prong, the Court now turns to the other Board members. Aronson, 473 A.2d at 817.

2. Defendants Demathas, Mitilinaios, and Xiradakis

As to Defendants Demathas, Mitilinaios, and Xiradakis, the High Court noted that Plaintiff did not argue that they are "interested" but only that they

are not "independent" from Economou. The court concluded that Plaintiff "failed to rebut the presumption of the business judgment rule that [these Defendants], all of whom are sophisticated business people with years of experience, were independent." On appeal, as before the High Court, Plaintiff argues only that Demathas, Mitilinaios, and Xiradakis lack "independence" and does not argue that they were "interested" in the transactions.

"Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." Aronson, 473 A.2d at 816.

> Such extraneous considerations or influences may exist when the challenged director is controlled by another. To raise a question concerning the independence of a particular board member, a plaintiff asserting the "control of one or more directors must allege particularized facts manifesting 'a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling.' The shorthand shibboleth of 'dominated and controlled directors' is insufficient." This lack of independence can be shown when a plaintiff pleads facts that establish "that the directors are 'beholden' to the controlling person or so under their influence that their discretion would be sterilized."

Orman v. Cullman, 794 A.2d 5, 24 (Del. Ch. 2002) (footnote and brackets omitted). As the Aronson court noted: "While directors may confer, debate, and

resolve their differences through compromise, or by reasonable reliance upon the expertise of their colleagues and other qualified persons, the end result, nonetheless, must be that each director has brought his or her own informed business judgment to bear with specificity upon the corporate merits of the issues without regard for or succumbing to influences which convert an otherwise valid business decision into a faithless act." 473 A.2d at 816.

Plaintiff argues that particularized facts show that a reasonable doubt exists that Demathas, Mitilinaios, and Xiradakis are independent from Economou based on the following: (1) DryShips's organizational structure; (2) historical transactions allegedly designed to benefit Economou, and (3) the compensation received by these Defendants.

a. DryShips's Organizational Structure

Plaintiff contends that "Economou has dominated DryShips since it set sail in 2004" and points to the following facts in the Amended Complaint as support: Economou implemented the articles of corporation and bylaws that relate to the Board, Economou caused DryShips to adopt a "poison pill" plan, and Economou is the "largest shareholder" and was the "only senior officer" until 2009. Plaintiff asserts that these facts show that "Economou has retained for

himself total control over the Company's operations and that "Economou unequivocally controls DryShips."

Even if this Court were to agree with Plaintiff that the foregoing facts establish that Economou has total control over DryShips, Economou's control over the company is distinct from his control over its directors. "A stockholder's control of a corporation does not excuse presuit demand on the board without particularized allegations of relationships between the directors and the controlling stockholder demonstrating that the directors are beholden to the stockholder." Beam, 845 A.2d at 1054; see Aronson, 473 A.2d at 815 ("proof of majority ownership of a company does not strip the directors of the presumption of independence"). Indeed, Plaintiff must allege particularized facts showing that the other directors "would be more willing to risk [their] reputation than risk the relationship with the interested director." Id. Plaintiff's allegations that Economou controls DryShips does not establish that he controls the other directors and, therefore, the Court concludes that demand is not excused on this ground.

b. Historical Transactions

Plaintiff next argues that Economou's control over Defendants is "demonstrated by years of gratuitous self-interested transactions that the Board has either approved or failed to stop." According to Plaintiff, the following

transactions approved by the Board show Economou's control over the other directors: DryShips leases office space from Economou, issued stock to Economou instead of a cash dividend received by all other shareholders, issued stocks to Economou "at the lowest 8-day average closing price" during the third quarter of 2006, purchased shares of Ocean Rig, and paid to Cardiff fees for arranging the Ocean Rig purchase. Plaintiff asserts that these prior transactions "demonstrate a pattern of differential and preferential treatment of Economou by Demathas and Xiradakis" and "demonstrate[] that Demathas and Xiradakis lack independence."

As previously found by Delaware courts, Plaintiff's argument that Defendants' past approval of transactions that benefitted "interested" Economou does not excuse demand futility, for it is circular in reasoning. In In re Tyson Foods Inc. Consolidated Shareholder Litigation, 919 A.2d 563, 588 (Del. Ch. 2007), the factual allegations stated that "the board members . . . have 'demonstrated a consistent and unvaried pattern of deferring to anything the Tyson family wants, and of failing to exercise independent business judgment.'" The Delaware court stated that this argument is "wholly circular" for the following reasons: