VIRGINIA:

IN THE CIRCUIT COURT FOR THE COUNTY OF FAIRFAX

JOHN DeGROOTE SERVICES, LLC, et al., Plaintiffs, v. F. EDWIN HARBACH, et al., Defendants.	Civil Action No. 2011-10612

BRIEF IN SUPPORT OF
DEFENDANT F. EDWIN HARBACH'S DEMURRER AND PLEA IN BAR

TABLE OF CONTENTS

I. INTRODUCTION 1

A. Facts Alleged in the Complaint 2

B. Relevant Bankruptcy Proceedings 7

II. STANDARD OF REVIEW 9

III. PLAINTIFF LACKS STANDING TO ASSERT THE *REVLON* CLAIMS IN COUNTS I, II AND IV OF THE COMPLAINT. 10

IV. PLAINTIFF'S DISGUISED DEEPENING INSOLVENCY CLAIMS MUST BE DISMISSED BECAUSE DELAWARE LAW REJECTS THAT THEORY. 14

V. PLAINTIFF FAILS TO PLEAD FACTS SUFFICIENT TO SUPPORT A CLAIM THAT HARBACH BREACHED HIS FIDUCIARY DUTIES. 17

VI. CONCLUSION 19

I. INTRODUCTION

Plaintiff brings this action seeking to hold F. Edwin Harbach responsible for the demise of BearingPoint, a deeply troubled consulting firm that went bankrupt in 2009, fourteen months after Harbach became its Chief Executive Officer. With the benefit of perfect hindsight, Plaintiff second-guesses Harbach's business judgment to try to fix BearingPoint's problems; he asserts that Harbach should instead have somehow sold the company, in whole or in part, to a credulous buyer in the midst of the financial crisis of 2008. Plaintiff asks the Court to infer that Harbach's failure to perform this feat must have been due to some self-interested motive, despite Plaintiff's own allegations that make clear that Harbach had nothing to gain and everything to lose if BearingPoint failed.

Plaintiff—who stands in BearingPoint's shoes[1]—asserts in Counts I, II and IV of the Complaint that Harbach breached his fiduciary duties to BearingPoint.[2] These claims fail as a matter of governing law. First, to the extent the claims allege that Harbach failed to sell BearingPoint for the best available price—a so-called "*Revlon* claim" under Delaware law[3]—they fail for lack of standing. Only shareholders of BearingPoint—not BearingPoint itself—can enforce such claims. Second, to the extent the claims allege that Harbach erred in attempting to

---

[1] The Complaint defines Plaintiffs John DeGroote Services LLC and John DeGroote (together "Plaintiff") as "the Trustee" of a liquidating trust which is authorized to prosecute claims belonging to BearingPoint for the benefit of its creditors. Compl. ¶ 6.

[2] Count I addresses Harbach in his role as a Director; Count II in his role as a member of the BearingPoint board's Finance Committee; and Count IV in his role as CEO. To the extent that Counts I and II are directed to other Defendants' alleged failures to oversee Harbach, *see* Compl. ¶¶ 310(e), 318(e), they do not state a claim against Harbach. Count III is not asserted against Harbach.

[3] Delaware law governs Plaintiff's claims because BearingPoint was a Delaware corporation. *See Stockbridge v. Gemini Air Cargo, Inc.*, 269 Va. 609, 609 (2005).

make BearingPoint profitable and thus only worsened the eventual reckoning, they are claims for "deepening insolvency" that are not valid under Delaware law.

Third, to any extent that the claims survive these arguments, they fail to state a claim because they are based on allegations that are self-contradictory and contrary to the very documents Plaintiff claims to rely on.[4] Many parties lost when BearingPoint went bankrupt, but one of the biggest losers was Ed Harbach, who lost his job, his substantial equity in BearingPoint, and his hopes for turning the company around. Harbach had absolutely every incentive to do what was in the best interests of BearingPoint, and absolutely no incentive to cause BearingPoint to fail. As a matter of law, none of the facts pleaded by Plaintiff give rise to any inference of disloyalty on his part.

BACKGROUND

A. Facts Alleged in the Complaint[5]

BearingPoint was a large international management and technology consulting firm. Compl. ¶¶ 1, 19. When Harbach joined BearingPoint in early 2007 as President and Chief Operating Officer, he joined a company in crisis. *Id.* ¶¶ 45, 48. BearingPoint had grown rapidly in the early 2000s and was facing the consequences of its hasty expansion. The company's growth had come through debt financed acquisitions. *Id.* ¶¶ 42, 45. The resulting debt burden

[4] Harbach adopts and incorporates the arguments set forth in the Brief in Support of Former Outside Director Defendants' Plea in Bar and Demurrer filed by the outside director Defendants Albert L. Lord, Roderick C. McGeary, J. Terry Strange, Douglas C. Allred, Betsy J. Bernard, Spencer Fleischer, Jill Kanin-Lovers, and Edward Munson (collectively, "Outside Director Defendants") on November 21, 2011 ("Outside Director Demurrer") where applicable.

[5] The Complaint takes substantial liberties with the facts. Although this Demurrer generally assumes the truth of Plaintiff's allegations, Harbach is simultaneously filing a motion craving oyer to permit the Court to consider the entirety of the documents giving rise to Plaintiff's claims, which directly rebut the claims, as well as a document relied on in misleading fashion in the Complaint.

amounted to nearly $700 million. *Id.* ¶¶ 43–44. BearingPoint reported net losses in both 2006 and 2007. *Id.* ¶ 26. The company also was beset by legal problems, including securities fraud lawsuits and SEC investigations. *Id.* ¶¶ 37–38, 48.

Despite the problems facing BearingPoint, Harbach accepted an "equity-heavy compensation package" to participate in "the upside potential of BearingPoint's equity." *Id.* ¶¶ 49–50. This form of compensation would reward him if he were able to revitalize the company, and it aligned his interests with those of the shareholders of BearingPoint.

According to the Complaint, throughout the first three quarters of 2007, BearingPoint engaged in the strategy that Plaintiff now faults Harbach for failing to pursue: the company "actively explored and engaged in . . . a strategy to sell individual business units" to address the company's liquidity crisis. *Id.* ¶ 68. BearingPoint was unable to consummate any such sales.

Tensions then developed between the BearingPoint board and its then-CEO, Harry You, who supported selling at least one of BearingPoint's business units. *Id.* ¶¶ 79, 99. Harbach did not support the sale of individual business units, believing that such sales would erode the long-term equity of BearingPoint.[6] *Id.* ¶ 77. Instead, Harbach believed that BearingPoint should keep the company together and "attempt . . . an operational turnaround." *Id.* ¶¶ 80, 82. He presented his strategy at a board meeting on November 30, 2007. *Id.* ¶ 87.

The board made a business judgment to accept Harbach's proposed strategy, determining that the company should "focus on enhancing BearingPoint's operations and business

---

[6] For example, Plaintiff contends that Harbach "ultimately prevented" the sale of BearingPoint's Europe, Middle East, and Africa ("EMEA") business unit. *Id.* ¶ 78. Plaintiff quotes BearingPoint's general counsel as saying that "'the . . . main reason' that the EMEA deal could not be consummated 'was [that] Ed Harbach was not supportive.'" *Id.* But the word that Plaintiff conveniently omits and replaces with an ellipsis in this quote is "<u>other</u>." The document in question makes clear that the principal reason the transaction did not occur was that "there was a significant valuation gap between the two sides" and the offer "was not considered sufficient value for the asset." Ex. 1 at 5–6.

performance" and abandon the plan to break up BearingPoint. *Id.* ¶¶ 106, 110, 112–114. It dismissed Harry You, appointed Harbach as CEO, and elected him a director. *Id.* ¶ 101. The board also decided not to undertake active measures to sell BearingPoint but rather to "passively wait for an interested buyer." *Id.* ¶¶ 113, 143. In his new role, Harbach again accepted an equity-heavy compensation package, *id.* ¶ 103, which would reward him (like all shareholders) if he improved BearingPoint's fortunes.

The Complaint alleges that in 2008, the inevitability of a sale became clear, *id.* ¶ 140, and Harbach seized control of the sales process, *id.* ¶¶ 105, 118, "deflect[ing] . . . numerous expressions of interest by potential purchasers . . . because they did not fit his personal plans or suit his personal interest in preserving and enhancing his equity interests in BearingPoint." *Id.* ¶ 144. It also alleges that Harbach favored a purchase by a financial buyer—one that was not engaged in the same business as BearingPoint—over a strategic buyer, because the former offered him a better chance to "negotiate an even greater amount of equity as part of his employment arrangements with the buyer," *id.* ¶ 58, whereas the latter would likely result in the end of his employment. *Id.* ¶ 59. Despite his complete access to deposition transcripts and other discovery in the bankruptcy proceedings and to BearingPoint's own documents,[7] however, Plaintiff does not cite any supporting document or any piece of testimony for these allegations.

Moreover, elsewhere in the Complaint, Plaintiff acknowledges that the company formed a Special Committee of three Directors other than Harbach to oversee the sales process, *id.* ¶ 229; engaged Greenhill and Company, Inc., an investment bank, to advise the company with regard to various possible methods of selling the company, *id.* ¶ 116; and hired a managing director specifically to coordinate the sales process. *Id.* ¶ 117. Also, the Complaint makes clear

[7] Harbach requested access to these materials to permit a level playing field on this motion, but the Plaintiff refused to produce them.

that BearingPoint's board sought advice on its fiduciary duties from the New York law firm of Davis, Polk & Wardwell, which assured the Directors that they had "demonstrated both their duties of care and good faith, and that the creation of the Special Committee to review and monitor the transaction process is designed to address any real or perceived conflicts of interest arising in any transaction." *Id.* ¶ 265. Davis Polk also advised the board that its actions "reflect that the Board members are taking appropriate steps to be fully informed and to fulfill their duty to obtain the highest value for the Company." *Id.*

Plaintiff's allegations regarding Harbach's motives are contradicted by the very contracts that Plaintiff claims created Harbach's conflict of interest.[8] Harbach's employment agreement indicates that, in the event that he lost his job after a change in control of BearingPoint, all of his stock awards would instantly vest instead of vesting over a span of four years as they would if his employment continued.[9] Harbach also stood to benefit from a sizeable severance package—equal to the sum of his salary and annual bonus, *see* Ex. 2, §§ 2(h), 3(a)–(b) (Dec 31, 2007 Special Termination Agreement)—in the event that he was terminated without cause after a change in control. If the termination came before a change in control—as Plaintiff (illogically and speculatively) alleges was likely, Compl. ¶ 103—the package doubled to <u>two times</u> salary and bonus. *See* Ex. 3, at 4 (Dec. 31, 2007 Employment Letter).

---

[8] The Court may consider these agreements in evaluating Harbach's demurrer for the reasons stated in his Motion Craving Oyer. *See Ward's Equip., Inc. v. New Holland N. Am., Inc.*, 254 Va. 379, 383 (1997) (finding that trial court properly considered terms of contract on demurrer where plaintiff "has ignored the contract's language in asserting claims that the contract refutes.").

[9] The relevant agreement provided that, if "the Company terminates the Executive's employment within two years after a Change in Control . . . all stock option grants, awards of restricted stock or restricted stock units, and all other forms of stock awards previously granted to the Executive shall vest immediately (as if his employment were not terminated) and be nonforfeitable." *See* Ex. 2 , ¶¶ 3(a)(i), 3(h) (Dec. 31, 2007 Special Termination Agreement).

The Complaint alleges that Harbach eventually "funneled" all of the potential transactions down to a single one—a sale of BearingPoint to Cerberus Capital Management L.P. ("Cerberus")—because it offered him the greatest personal benefit. Compl. ¶ 5. Yet the Complaint goes on to allege that Harbach did numerous things that made a transaction with Cerberus less likely. For example, Harbach supposedly unduly restricted the involvement of others in discussions with Cerberus, which "eroded and delayed negotiations" and contributed to their breakdown, *id.* ¶¶ 236–238, 240, and otherwise imperiled the Cerberus transaction, "ignor[ing] his own warnings" that BearingPoint would not survive bankruptcy. *Id.* ¶ 266. Harbach also did wrong, Plaintiff alleges, by overstating BearingPoint's financial prospects to potential buyers, including Cerberus, which presumably would make the buyers more interested rather than less interested. *Id.* ¶¶ 199, 283, 339. Apparently, Plaintiff faults Harbach for being too zealous in attempting to bring about a beneficial transaction.[10]

Plaintiff also alleges that Harbach negotiated his own and other managers' post-transaction compensation too assiduously, causing Cerberus to "chok[e]" on his demands. *Id.* ¶ 272. But the Complaint does not allege, because it cannot, that Harbach's negotiating posture was the reason Cerberus declined to consummate the transaction.[11] Rather, it alleges only that "negotiations with Cerberus ceased." *Id.* ¶ 280.

[10] Tellingly, Plaintiff alleges that Harbach also provided overstated financial information to CGI, one of the strategic buyers that Harbach allegedly wished to deflect. *Id.* ¶ 283. The Complaint's own allegations showing that Harbach acted in the same manner as to a financial buyer and a strategic buyer undercut the vague allegation that he preferred one to the other.

[11] Harbach negotiated not only his own prospective equity stake but that of all of BearingPoint's approximately 650 managing directors and core senior management. *Id.* ¶ 256. Although the Complaint labels Harbach's position as "overreaching," *id.* ¶ 271, its own allegations are that Cerberus's initial offer (eight percent of enterprise value for management) was only half of what it later offered, *id.* ¶¶ 255, 269, and that Cerberus demanded that the top officers invest $20 million of their own money in the new enterprise. *Id.* ¶ 263.

Ultimately, in the wake of the financial crisis in the fall of 2008, Cerberus backed away from purchasing BearingPoint. Five months later, after additional efforts to find a buyer failed, BearingPoint entered bankruptcy. Plaintiff alleges that "[a]ll Defendants knew the worst possible option for BearingPoint was bankruptcy," *id.* ¶ 65, but fails to mention that bankruptcy also was the worst possible option for Harbach. Under Articles 5.3 and 10.3 of the Bankruptcy Plan, all of his equity in BearingPoint was cancelled.

B. Relevant Bankruptcy Proceedings

Harbach remained CEO of BearingPoint through August 2009 and led it through the first stages of bankruptcy, including the sale of its Public Services and Commercial Services Industry Groups. During that year, he worked closely with Plaintiff, John DeGroote, who was named Chief Legal Officer and Executive Vice President of BearingPoint on December 31, 2008—almost two months before BearingPoint declared bankruptcy. DeGroote, a BearingPoint attorney since 2000, was intimately involved in the bankruptcy process and took positions on behalf of the company during that process that directly contradict those he asserts in this litigation.[12]

---

[12] DeGroote's involvement in BearingPoint's affairs can be traced through public records on the docket of the United States Bankruptcy Court for the Southern District of New York. This Court may take judicial notice of these public documents. *See, e.g., Station #2, LLC v. Lynch*, 75 Va. Cir. 179, 191 (Norfolk City, 2008) (noting that court "may take judicial notice of matters of public record" without granting oyer of such documents in deciding demurrer); *Resk v. Roanoke Cnty, Va.*, 73 Va. Cir. 272 (Roanoke Cnty., 2007) (taking judicial notice of zoning ordinances in deciding demurrer, thereby rendering motion for oyer of such documents moot); *Titan Am., LLC v. Riverton Inv. Corp.*, 264 Va. 292, 305 (2002) (affirming trial court's judicial notice of "records of . . . underlying actions, a procedure long recognized as appropriate by our jurisprudence" and citing *Fleming v. Anderson*, 187 Va. 788, 794–95 (1948)). Here, Plaintiff's ability to bring these claims on behalf of BearingPoint stems directly from the company's bankruptcy proceedings. Compl. ¶ 6 (citing Bankruptcy Court proceedings and Bankruptcy Plan and noting that Plan "conferred on the Trustee authority to prosecute on behalf of the Liquidating Trust 'any and call Causes of Action'"). Therefore, judicial notice of BearingPoint's bankruptcy proceedings and filings is proper.

For instance, DeGroote submitted a declaration in support of the company's petition for bankruptcy in which he emphasized the extensive efforts the company had made to arrange a sale. Ex. 4 (Decl. of John DeGroote Pursuant to Local Bankr. Rule 1007-2). DeGroote stated that "[t]he proposals that BearingPoint received in connection with those efforts either provided insufficient value, appeared impractical, or were unlikely to be consummated in time to address [the company's liquidity problems]." *Id.* ¶ 45 (emphasis added).

In October 2009, DeGroote, who had been elevated to President of the company, filed an amended bankruptcy plan under Chapter 11, which he signed on behalf of BearingPoint. Ex. 5 (Debtors' Am. Joint Plan Under Chapter 11 of the Bankr. Code, Dated Oct. 5, 2009). The plan included "limited releases" for former directors and officers, including Harbach. *Id.* § 10.8. In particular, DeGroote sought to release each of these individuals "from any and all Claims or causes of action whatsoever in connection with, related to, or arising out of the Debtors' restructuring or reorganization efforts on or after January 18, 2008 . . . ." *Id.* § 10.8(a) (emphasis added). In other words, DeGroote requested that Harbach and others be released from any future liability surrounding their efforts to sell BearingPoint in 2008 and 2009. In arguing for the releases, BearingPoint's counsel stated in a brief filed in support of the Bankruptcy Plan "the Debtors do not believe that any Claims or causes of action exist against the parties to whom they are granting a release," and that this conclusion was "based on the findings that resulted from the full investigation into the actions of [BearingPoint's] officers and directors . . . ." Ex. 6 ¶ 3 (Mem. of Law in Supp. of the Limited Releases Provided For In the Debtors' Second Am. Joint Plan Under Chapter 11 of the Bankr. Code, Dated Nov. 2, 2009) (emphasis added). DeGroote

made no effort to challenge or otherwise change these assertions made to the Court on his behalf, and he maintained that position until after he became Liquidating Trustee.[13]

II. STANDARD OF REVIEW

A demurrer "tests the legal sufficiency of a pleading." *Kitchen v. City of Newport News*, 275 Va. 378, 385–86 (2008). Generally, a demurrer "admits the truth of all well-pleaded material facts," but it "does not admit the correctness of the pleader's conclusions of law." *Fox v. Custis*, 236 Va. 69, 69 (1988). In addition, "[w]hen . . . the circuit court grants a demurrant's motion craving oyer, the circuit court in ruling on the demurrer may properly consider the facts alleged as amplified by any written documents added to the record as a result of the motion." *Dodge v. Trs. of Randolph-Macon Woman's Coll.*, 276 Va. 1, 5 (2008). Moreover, the Court "may ignore a party's factual allegations contradicted by the terms of authentic, unambiguous documents that properly are a part of the pleadings." *Id.* (quotation marks omitted). The Court also may also take judicial notice of facts contained in public records on a demurrer.[14]

A plea in bar is a form of pleading "which alleges a single state of facts or circumstances (usually not disclosed or disclosed only in part by the record) which, if proven, constitutes an absolute defense to the claim." *Nelms v. Nelms*, 236 Va. 281, 289 (1988).

---

[13] Notably, DeGroote has a financial interest in the outcome of this lawsuit. *See* Ex. 7 at 5–6 (Order Pursuant to Section 363(b) of the Bankruptcy Code Authorizing the Debtors To Implement a Key Employee Incentive Plan) (naming DeGroote as recipient of Key Employee Incentive Plan payments, including portion of "actual recoveries to prepetition creditors," including "5% of Recoveries over $350 million").

[14] *See* note 12, *supra*.

ARGUMENT

III. PLAINTIFF LACKS STANDING TO ASSERT THE *REVLON* CLAIMS IN COUNTS I, II AND IV OF THE COMPLAINT.

In Count I, Count II, and at least parts of Count IV of the Complaint, Plaintiff asserts claims for breach of fiduciary duty against Harbach based on allegations that Harbach and the Outside Director Defendants are responsible for BearingPoint not being sold for the best price available. Plaintiff, however, has no standing to bring that claim. Only shareholders of BearingPoint—who would have received the benefit of any sale of BearingPoint's equity—could maintain such a claim.

Under the Bankruptcy Plan, the Liquidating Trust stands in the shoes of BearingPoint as a corporation, not in the shoes of BearingPoint's shareholders. The Plan provides that Plaintiff has the power to "investigate, prosecute, settle and/or abandon rights, Causes of Action or litigation of the Liquidating Trust." Ex. 8 § 5.7(g)(iii) (Debtors' Modified Second Am. Joint Plan Under Chapter 11 of the Bankr. Code, Dated Dec. 17, 2009). The relevant Causes of Action are "any and all Claims, Avoidance Actions, and rights of the Debtors." *Id.* § 1.17. The Debtors are not the shareholders, but rather BearingPoint, Inc. and its subsidiaries. *See id.* §§ 1.11, 1.35. Thus, Plaintiff holds BearingPoint's rights to sue.

The relevant fiduciary duties in this case are owed, however, to BearingPoint's shareholders and not BearingPoint itself. Under Delaware law, although directors normally owe their fiduciary obligations to both the corporation and its shareholders, when the sale of the company is at issue, the nature of those duties shifts: "[t]he directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). Negotiating the sale of the company does not involve the

company's ongoing operations, but rather "put[s] the board in a position in which it [is] required to function like an agent selling articles of personal property, the shares of the corporation's stock, which belong[] to its principals, the corporation's stockholders." Clark W. Furlow, *Reflections on the* Revlon *Doctrine*, 11 U. Pa. J. Bus. L. 519, 529–31 (2009).

This duty to obtain the highest reasonable price is often called a "*Revlon* duty" for the case that recognized it. Counts I and II of the Complaint invoke the language of *Revlon* and its progeny ("duty to seek the best available price") and clearly are intended to state a claim for breach of *Revlon* duties; Count IV does not use that language but similarly claims that Harbach frustrated the sale of BearingPoint as a whole. *See, e.g.*, Compl. ¶¶ 334, 336, 339–340.[15]

"A stockholder who directly attacks the fairness or validity of a merger alleges an injury to stockholders, not the corporation . . . ." *Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1245 (Del. 1999);[16] *see also, e.g.*, *N.J. Carpenters Pension Fund v. Infogroup, Inc.*, No. CIV.A. 5334-VCN, 2011 WL 4825888, at *12 (Del. Ch. Sept. 30, 2011) (stating, in a case involving an allegedly invalid merger, that "the alleged wrong here was suffered by the shareholders, whose company was sold in an allegedly tainted transaction"). Because it is the shareholders who are injured by such a fundamentally unfair transaction and are owed the legal duty at issue, it is the shareholders—not the corporation—who have a cause of action. *See Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1035–36 & n.9 (Del. 2004) (citing *Parnes* and noting that, to distinguish between shareholder claims and corporate claims, "the focus should be on the

---

[15] Harbach does not concede that *Revlon* duties apply in this case, but Plaintiff's allegations clearly seek to invoke those duties, and Harbach accepts the Complaint's allegations for purposes of this demurrer only.

[16] In *Revlon* itself, suit was brought by the potential acquiror who was shut out by the defensive measures employed by the board of Revlon, but it was clear that the fiduciary duties at stake were those owed to Revlon's shareholders.

person or entity to whom the relevant duty is owed"); *see also N.J. Carpenters*, 2011 WL 4825888, at *11 (finding that plaintiffs' claim was direct action on behalf of shareholders rather than derivative action on behalf of corporation).

In *Parnes*, the Delaware Supreme Court considered a claim very similar to Plaintiff's here. There, the plaintiff, a stockholder of Bally, claimed that Bally's directors breached their fiduciary duties by entering into a merger agreement that was the product of unfair dealing and that resulted in an unfair price. 722 A.2d at 1244. The plaintiff alleged that Bally's CEO controlled the merger negotiations and demanded that potential acquirers pay him substantial sums in exchange for his support of any proposed acquisition. *Id.* at 1245. The plaintiff alleged that the Bally CEO breached his duty of loyalty by demanding side compensation, *id.* at 1246, just as Plaintiff claims that Harbach breached his duty of loyalty by allegedly ruling out strategic buyers and demanding additional equity for himself from Cerberus. The Court in *Parnes* found that the complaint touched the fundamentals of the transaction, alleging, in particular, that "the other Bally directors breached their fiduciary duties of loyalty by acquiescing in Goldberg's self-interested negotiations and by approving a merger at an unfair price." *Id.* As a result, the Delaware Supreme Court ruled that the claim was a direct claim on behalf of shareholders, not a derivative claim that could be brought on behalf of Bally's. *See id.* at 1245.[17]

That Plaintiff has no standing to assert a *Revlon* claim is highlighted by the fact that any recovery obtained by Plaintiff in this case will flow to BearingPoint's creditors, yet those creditors would not have been entitled to receive any amount tendered by Cerberus (or anyone

[17] Although it is true that not all claims touching on a merger are direct claims on behalf of shareholders, *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348 (Del. 1988), it is clear that claims going to the fundamental fairness of a transaction <u>are</u> direct shareholder claims. *See Golaine v. Edwards*, No. CIV.A. 15404, 1999 WL 1271882, at *6 (Del. Ch. Dec. 21, 1999).

else) for BearingPoint's stock, which they did not own.[18] Any such consideration would have been paid to BearingPoint's shareholders, in exchange for the relinquishment of those shareholders' ownership interest. Only those shareholders can sue to enforce *Revlon* duties owed solely to them.

That the Plaintiff alleges that BearingPoint's equity was worth nothing, Compl. ¶ 232, does not change the conclusion. In *North American Catholic Educations Programming Foundation, Inc. v. Gheewalla*, the Delaware Supreme Court held that directors do not owe fiduciary duties to creditors, even if the corporation is insolvent or in the zone of insolvency. 930 A.2d 92, 99–102 (Del. 2007).[19] Thus, even when the residual stakeholders are the creditors, the focus remains on whether the company was harmed directly. If not, there is no claim.

As the Trustee's own counsel in the bankruptcy court has written:

> Suppose the board decides to reject a sale and continue operating the corporation in the vicinity of insolvency. The strategy fails, and the company's enterprise value declines. But does that strategic choice harm the *company*, or does it harm the creditors that are [the] residual stakeholders, and that are protected, as *Gheewalla* teaches, only by contract rights? The question raises metaphysical difficulties . . . . And if there is an open question whether the corporation is affected by the board's actions, it is hard for anyone . . . to argue that those actions breached a fiduciary duty to the corporation.

Sabin Willett, Gheewalla *and the Director's Dilemma*, 64 Bus. L. 1087, 1099–1100 (2009) (footnote omitted). Willett's analysis is correct, and it applies in this case if BearingPoint was

---

[18] Indeed, it was one of the specific holdings of *Revlon* that the directors in that case breached their duties by considering the interests of certain noteholders rather than focusing solely on the shareholders' interest in obtaining the best price for their shares. 506 A.2d at 184.

[19] When a corporation is insolvent, its creditors, as the residual stakeholders of the corporation, are entitled to sue derivatively to enforce duties owed by the directors to the corporation, but are not owed any direct fiduciary duties by the directors. *Gheewalla*, 930 A.2d at 101–03. That power does not extend to enforcing duties owed solely to shareholders under *Revlon*.

insolvent and its equity was wiped out. In that scenario, the creditors, as the residual stakeholders in BearingPoint, are entitled to receive the benefits of any recovery (obtained through a Trustee action or by proceeding derivatively) that BearingPoint could have obtained itself. But BearingPoint would have no right to bring a *Revlon* claim. While a decline in BearingPoint's enterprise value might have harmed creditors, it did not harm the company *per se*. As a result, Plaintiff's *Revlon* claims must be dismissed for lack of standing.

IV. PLAINTIFF'S DISGUISED DEEPENING INSOLVENCY CLAIMS MUST BE DISMISSED BECAUSE DELAWARE LAW REJECTS THAT THEORY.

In addition to its *Revlon* claims, the Complaint also charges that Harbach wrongly attempted to make BearingPoint a profitable business rather than acquiesce at an earlier time in the view that the company was doomed and should be sold or broken up. But even if hindsight were to suggest that an earlier sale or breakup might have been advantageous to BearingPoint's creditors, Harbach had no duty to favor that approach over an attempt to return the company to profitability. Although Plaintiff studiously avoids the now-discredited term "deepening insolvency," that is precisely the theory that the Complaint advances—that delaying the inevitable day of reckoning worsened BearingPoint's financial position and resulted in a smaller eventual recovery for the company's creditors.[20] Because that theory is invalid as a matter of law, Plaintiff's claims must be dismissed to the extent they are based on it.[21]

---

[20] That Plaintiff has carefully avoided calling his claim a "deepening insolvency" claim does not change the conclusion. "[S]imply calling a discredited deepening insolvency claim cause of action by some other name does not make it a claim that passes muster." *Official Comm. of Unsecured Creditors v. Tennenbaum Capital Partners, LLC*, 353 B.R. 820, 842 (Bankr. D. Del. 2006).

[21] Although Count IV most clearly incorporates this theory, *see, e.g*, Compl. ¶ 336, Counts I and II of the Complaint also appear to include it by alleging that the Defendants failed "timely" to take certain steps both "before and during their efforts to sell BearingPoint." *Id.* ¶¶ 310, 318 (emphasis added).

As described above, the Complaint faults Harbach for attempting to advance the interests of the company's equity "even to the detriment of the Company's enterprise value." Compl. ¶ 64. Plaintiff attempts to disparage Harbach's determination to "make profitability [the company's] first priority" and to "push forward with operational improvements geared towards turning the Company around." *Id.* ¶ 134. The Complaint criticizes Harbach for focusing on the "long-term equity upside" rather than immediately "maximiz[ing] the value of the Company" by selling it or breaking it up. *Id.* ¶ 141; *see also id.* ¶ 232 ("while BearingPoint had no equity value, its substantial enterprise value was in grave danger of erosion"). Plaintiff acknowledges that Harbach became CEO on a "'run the business' platform," *id.* ¶ 218, but he derides that business strategy as "fanciful," *id.* ¶ 170, and based on "overly-optimistic business forecasts." *Id.* ¶ 181. Ultimately, Plaintiff alleges that BearingPoint should have given up any hope of a turnaround more than a year before its bankruptcy and liquidation. *Id.* ¶ 293.

These allegations invoke the theory of deepening insolvency, which the Delaware courts rejected in *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*, as "inconsistent with the principles shaping our state's corporate law." 906 A.2d 168, 204–06 (Del. Ch. 2006), *aff'd sub nom.*, *Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007). As the Delaware courts have explained, claims of deepening insolvency rest on a fundamental legal misconception that the managers of a troubled corporation are obligated to sell it or break it up rather than to attempt to turn it into a profitable business. To the contrary:

> Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bills to cease operations and to liquidate. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm. . . . If the board of an insolvent corporation, acting with due diligence and good faith, pursues a business strategy that it believes will increase the corporation's value . . . it does not become a guarantor of that strategy's success. . . . Rather, in such

> a scenario the directors are protected by the business judgment rule.

Trenwick, 906 A.2d at 204–05 (footnote omitted).

Harbach's duty was to exercise his business judgment to turn BearingPoint around, which was in the best interests of shareholders, even if that risked deepening the company's insolvency. On this point, the scholarship of the Trustee's bankruptcy counsel, Sabin Willett, once again is illuminating. Willett has written of the dilemma facing directors of troubled companies: the problem is that "two oft-cited principles—that a board should strive to maximize enterprise value, and that it should protect the shareholders—sometimes are in conflict." Willett, *supra*, 1087. That is precisely the dilemma faced by the Defendants here, as described in the Complaint; the BearingPoint board, including Harbach, was faced with the problem of trying to meet its obligations to further the long-term interests of shareholders by turning around the business while at the same time complying with whatever duty they had to maximize the short-term value of BearingPoint.

Fortunately, as explained by Willett, Delaware law provides a solution to the dilemma: "where a business strategy may generate a return for equity holders, the board must favor that strategy and reject alternatives, even if in the board's business judgment the strategy is unlikely to succeed, and alternatives, on a risk-adjusted basis, would maximize the enterprise value." *Id.* (emphases added). This conclusion flows from the principle that the directors' duty is to "exercis[e] their business judgment in the best interests of the corporation for the benefit of its shareholder owners." *Gheewalla*, 930 A.2d at 101 (emphasis added).

As applied here, that principle required exactly the course that Plaintiff now faults Harbach for following—erring on the side of attempting to turn around the company for the benefit of the equity holders. That is true even if the turnaround strategy was unlikely to

succeed, such that a later critic could label it "fanciful" with the benefit of hindsight, and even if the strategy resulted in the deepening of the company's insolvency, to the detriment of its creditors. Such decisions of business strategy[22] are protected from judicial second-guessing under the business judgment rule unless a plaintiff can meet his burden of overcoming that protection, which Plaintiff does not do here, *see* Part IV *infra*.

V. PLAINTIFF FAILS TO PLEAD FACTS SUFFICIENT TO SUPPORT A CLAIM THAT HARBACH BREACHED HIS FIDUCIARY DUTIES.

For the reasons set forth in the Plea in Bar and Demurrer filed by the Former Outside Directors, and which are equally applicable to Harbach, Plaintiff fails to state a claim for breach of the duty of care. To the extent Plaintiff attempts to state a claim for breach of the duty of loyalty, he fails to do so. Because Plaintiff's conclusory and self-contradictory allegations do not support a reasonable inference of disloyalty, Harbach is entitled to dismissal. *See Malpiede v. Townson*, 780 A.2d 1075, 1083–84 (Del. 2001).

Plaintiff bases his duty of loyalty claim on Harbach's role in the process by which BearingPoint attempted to sell itself. But "[t]here is nothing inherently wrong with an interested chief executive officer negotiating a merger transaction."[23] *In re Ply Gem Indus., Inc. S'holders Litig.*, No. CIV.A. 15778-NC, 2001 WL 755133, at *10 (Del. Ch. June 26, 2001). Thus, Plaintiff's complaint can survive only if the Court infers a disloyal motive for Harbach's actions.

---

[22] Indeed, the wisdom of that strategy was still being debated by interested stakeholders during the bankruptcy proceedings. Some of the creditors argued strenuously that the best course for BearingPoint was to continue to run the profitable public services business rather than sell it off. *See* Ex. 9 at 23 (Tr. of April 1, 2009 Hearing) (arguing for reorganization of BearingPoint around Public Services Business Unit).

[23] Plaintiff's claim that Harbach dominated the sales process is contradicted by Plaintiff's allegations that BearingPoint hired numerous professional to assist it in the sales process and its board was advised by Davis, Polk & Wardwell that it was complying with its fiduciary duties. Compl. ¶¶ 116–117, 265.

But the Court need not draw inference that are "strained, forced, or contrary to reason," *see Cnty. of Washington v. City of Bristol*, 63 Va. Cir. 450 (Washington Cnty., 2003), and the facts pleaded by Plaintiff do not support—indeed, contradict—any disloyal motive. Plaintiff's own allegations make clear that Harbach had everything to lose and nothing to gain from BearingPoint's bankruptcy.

Although Plaintiff alleges that Harbach was conflicted merely because he was compensated largely in equity, Compl. ¶¶ 50, 103, this allegation is flatly insufficient as a matter of law. Indeed, "Delaware law is clear that substantial stockholdings in a company by directors create powerful incentives to get the best deal in the sale of that company." *McGowan v. Ferro*, 859 A.2d 1012, 1030 (Del. Ch. 2004), *aff'd*, 873 A.2d 1099 (Del. 2005). "A director who is also a shareholder of his corporation is more likely to have interests that are aligned with other shareholders . . . as it is in his best interest, as a shareholder, to negotiate a transaction that will result in the largest return for all shareholders." *Orman v. Cullman*, 794 A.2d 5, 27 n.56 (Del. Ch. Ct. 2002). Indeed, the fact that Harbach was compensated largely in equity goes to the heart of the Complaint's illogic: Someone with a large equity stake would not be motivated to risk putting the company into bankruptcy.

Plaintiff also asks the Court to infer that Harbach labored under a material conflict of interest because selling to a strategic buyer may have resulted in the loss of Harbach's board and management positions. Compl. ¶¶ 59, 61–62. Again, many of the facts Plaintiff relies on to support this inference simply make no sense. For example, why would someone motivated to deter a strategic buyer such as CGI "<u>overstate</u>[] the health of BearingPoint's financial condition" to that buyer? Compl. ¶ 283 (emphasis added). And why would an executive who favored financial buyers over strategic buyers give the same allegedly overstated financial

picture to both? *Id.* ¶¶ 199, 283, 340. Plaintiff's theory also is contradicted by the governing legal documents. Contrary to the allegation that Harbach stood to lose value from the sale to a strategic buyer, his employment agreement expressly provided that, in the event that he lost his job after a change in control of BearingPoint, all of Harbach's stock awards would vest instantly. He also stood to benefit from his significant severance package and, if he was terminated before a change of control, as Plaintiff alleges was likely, that severance package would be doubled. Ex. 3, §§ 2(h), 3(a)–(b).

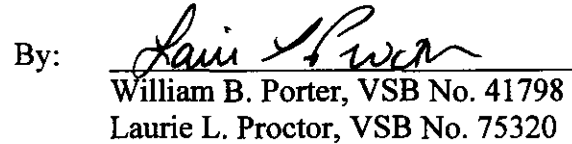
Plaintiff also asks the Court to infer a material conflict because Harbach negotiated management's post-transaction equity and compensation arrangements with Cerberus, a potential buyer. Compl. ¶ 248. Again, however, Plaintiff seeks an inference that is at odds with the facts he pleads. If Harbach in fact had hand-picked the Cerberus transaction as the one most beneficial to him, he would not have taken steps to imperil it. Plaintiff's allegation that Harbach "ignored his own warnings" about the risk of bankruptcy, *id.* ¶ 266, is simply nonsense. Moreover, critically, the Plaintiff does not—and cannot—allege that the negotiations over post-transaction compensation were what caused the Cerberus transaction to fail. Absent an allegation either that Harbach's conduct proximately caused a loss to BearingPoint, or resulted in a gain to Harbach (which the collapse of the Cerberus transaction clearly did not), there is no basis for liability to be imposed. *See Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 444–45 (Del. 1996) (directors who breached duty of loyalty by usurping corporate opportunity could not be liable for transactional damages if their conduct did not proximately cause transaction to fail, but could be liable to disgorge benefits obtained).

VI. CONCLUSION

For the foregoing reasons, the Complaint should be dismissed in its entirety.

Respectfully submitted, this 21st Day of November, 2011,

BLANKINGSHIP & KEITH, P. C.
4020 University Drive, Suite 300
Fairfax, Virginia 22030
(703) 691-1235 (telephone)
(703) 691-3913 (facsimile)

By: 
William B. Porter, VSB No. 41798
Laurie L. Proctor, VSB No. 75320

-and-

Robert A. Van Kirk
George A. Borden
Ana Reyes
Lauren K. Collogan
Michael V. Pinkel
Greg Hillson
WILLIAMS & CONNOLLY LLP
725 Twelfth Street, N.W.
Washington, DC 20005
(202) 434-5163 (telephone)
Pro hac vice admission to be requested

Counsel for Defendant F. Edwin Harbach

CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of November 2011, a true copy of the foregoing was emailed and mailed, first class, postage prepaid to:

Counsel for Plaintiff John DeGroote Services, LLC and John DeGroote:

Andrew J. Terrell, Esq.
WHITEFORD, TAYLOR & PRESTON, L.L.P.
3190 Fairview Park Drive, Ste. 300
Falls Church, Virginia 22042
(703) 280-9260 (telephone)
(703) 280-9139 (facsimile)

Kevin G. Hroblak, Esq.
William F. Ryan, Jr.
WHITEFORD, TAYLOR & PRESTON, L.L.P.
Seven Saint Paul Street, Ste. 1800
Baltimore, Maryland 21202
(410) 347-9405 (telephone)
(410) 223-4305 (facsimile)

Lewis T. LeClair, Esq.
Robert M. Manley, Esq.
MCKOOL SMITH, P.C.
300 Crescent Court, Ste. 1500
Dallas, Texas 75201
(214) 978-4000 (telephone)
(214) 978-4044 (facsimile)

Counsel for Defendants Albert L. Lord, Roderick C. McGeary, J. Terry Strange, Douglas C. Allred, Betsy J. Bernard, Spencer C. Fleischer, Jill Kanin-Lovers and, Edward Munson:

Sean F. Murphy, Esq.
MCGUIREWOODS LLP
1750 Tysons Boulevard, Suite 1800
Tysons Corner, Virginia 22102-4215
(703) 712-5000 (telephone)
(703) 712-5050 (facsimile)

Paul C. Curnin, Esq.
William T. Russell, Jr. , Esq.
Paul C. Gluckow, Esq.
Craig S. Waldman, Esq.
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017-3954
(212) 455-2000 (telephone)
(212) 455-2502 (facsimile)

Counsel