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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

NW MEDIA HOLDINGS CORP., NEWSWEEK LLC, NEWSWEEK DIGITAL LLC, NEWSWEEK MAGAZINE LLC, NEWSWEEK PUBLISHING LLC, NW DIGITAL LLC and NW MAGAZINE LLC,

Plaintiffs-Appellants,

—against—

IBT MEDIA INC.,

Defendant-Respondent,

—and—

OLIVET UNIVERSITY, WORLD OLIVET ASSEMBLY, INC., ETIENNE UZAC, DAVID JANG and YOUNSEOK CHOI,

Defendants.

CASE NO. 2023-00535

BRIEF FOR DEFENDANT-RESPONDENT

MICHAEL C. HEFTER
RYAN M. PHILP
MATTHEW A. DUCHARME
MAURA ALLEN
HOGAN LOVELLS US LLP
390 Madison Avenue
New York, New York 10017
(212) 918-3000
michael.hefter@hoganlovells.com
ryan.philp@hoganlovells.com
matthew.ducharme@hoganlovells.com
maura.allen@hoganlovells.com

Attorneys for Defendant-Respondent

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Defendant-Respondent IBT Media Inc. ("IBT") respectfully submits this brief in response to the brief filed by Plaintiffs-Appellants NW Media Holdings Corp., Newsweek LLC, Newsweek Digital LLC, Newsweek Magazine LLC, Newsweek Publishing LLC, NW Digital LLC, and NW Magazine LLC (collectively, "Plaintiffs" or "NW Media"), dated February 21, 2023.

PRELIMINARY STATEMENT

In total disregard of the company's bylaws, NW Media's president and purported 50% owner, Dev Pragad ("Pragad"), initiated this lawsuit against IBT and others despite receiving an express advance written objection from the company's other purported 50% owner and board member, Johnathan Davis ("Davis").[1] Although Plaintiffs do their best to distort the issues, the sole question presented on this appeal is whether Pragad had authority to bring this lawsuit in the name of NW Media—and pay for it using corporate assets—over Davis's explicit opposition, or whether Pragad is required to pursue the claims in a shareholder derivative action. As the IAS Court held, the answer to that question is clear: Under well-settled New York caselaw—including the Court of Appeals decision in *Sterling Industries, Inc. v. Ball Bearing Pen Corp.*, 298 N.Y. 483 (1949)—and long-standing principles of New York corporate governance, Pragad lacked authority and is required to pursue

[1] In a separate appeal, IBT disputes NW Media's ownership of Newsweek. *IBT Media Inc. v. Dev Pragad et al.,* Appeal No. 2023-00650 (1st Dep't). For purposes of this appeal, however, IBT addresses the issues as if NW Media is legitimately the owner of Newsweek, which is consistent with the analysis of the IAS Court on the record before it below.

the claims asserted derivatively.

Plaintiffs make a variety of tortured arguments in an effort to avoid that result, but their arguments are unpersuasive and not credible. They dedicate nearly the first half of their brief to regurgitating irrelevant—and often inflammatory—allegations from their complaint concerning the parties' church affiliation and alleged prior bad acts, while sweeping the most pertinent facts—such as Davis's express written objection to the filing of this lawsuit and NW Media's corporate governance structure—under the rug. Perhaps the most egregious omission of all is Plaintiffs' failure to acknowledge that Pragad, as an NW Media shareholder, is not without a remedy because he is free to assert his claims derivatively—and, in fact, has already done exactly that in another lawsuit against Davis that was not only filed contemporaneously, but also contains identical factual allegations cut-and-pasted from the complaint in this case.

Separating the wheat from the chaff, the facts germane to this appeal are straightforward. NW Media was formed in September 2018 and executed a Membership Interest Purchase Agreement ("MIPA") to purchase IBT's interest in Newsweek at that time.[2] Pragad was IBT's CEO at the time of the transaction and Davis owned 50% of IBT at all relevant times. Following the transaction, Davis and

[2] In IBT's separate appeal, referenced in footnote 1, *supra*, IBT disputes the validity of the Membership Interest Purchase Agreement pursuant to which NW Media purported to purchase IBT's interest in Newsweek, but IBT assumes the validity of that transaction for purposes of this appeal.

Pragad each purport to own 50% of NW Media, and are the sole board members. Pragad also serves as company president. According to NW Media's bylaws, any act of the board requires majority consent, which here, on a two-member board, means the unanimous consent of both Davis and Pragad.

For years, IBT and NW Media continued to function as one company, including by maintaining a shared Google Drive containing both companies' documents, utilizing the same office space and employees, and with NW Media voluntarily paying certain of the companies' shared debts. Years later, however, after Davis objected to Pragad's breaches of fiduciary duty and other misconduct, including unilaterally granting himself a massive compensation increase without board approval, Pragad determined to sue Davis and others in an effort to wrest complete control of NW Media. In furtherance of his vendetta against Davis, on June 24, 2022, Pragad, through counsel at the law firm of Gibson Dunn & Crutcher ("Gibson Dunn"), sent Davis a draft complaint purportedly on behalf of NW Media, asserting claims against Davis, IBT and numerous other defendants that Pragad believed to be aligned with Davis for indemnification, conversion, trespass to chattels and misappropriation of trade secrets. On June 30, 2022, Davis, through counsel, sent multiple letters to NW Media's counsel unequivocally objecting to the filing of the draft complaint. In the letters, Davis expressly stated that Pragad lacked board approval for the filing of the complaint and that New York law precludes a

50% shareholder using corporate assets to sue another 50% shareholder. Davis also requested a special meeting of the board. Pragad refused to call a special board meeting, and instead initiated litigation over Davis's objection.

In an effort to circumvent his lack of corporate authority, Pragad executed a contrivance, by splitting the claims set forth in the draft consolidated complaint into two separate complaints—one purportedly filed directly on behalf of the company against all defendants except Davis (*i.e.,* this lawsuit), and the other filed derivatively by a separate law firm primarily against Davis (*Pragad v. Davis*, Index No. 652334/2022). The allegations in the derivative action are comprised almost entirely of cut-and-paste, mirror image allegations that also appear in this direct action, and assert claims arising out of the same facts and circumstances, all of which were set forth nearly word-for-word in the draft consolidated complaint that Davis had objected to.

IBT moved to dismiss the direct complaint, arguing, *inter alia*, that Pragad lacked corporate authority to file the lawsuit over Davis's objection. The IAS Court agreed, and this appeal followed.

On appeal, Plaintiffs assert three arguments: (1) IBT lacks standing to challenge Plaintiffs authority to sue; (2) Pragad had both presumptive and actual authority to sue on behalf of NW Media; and (3) Davis was an interested director disqualified from voting against the lawsuit. All three of these arguments lack merit

and are squarely inconsistent with the decision of the Court of Appeals in *Sterling Industries*.

First, Plaintiffs' argument that only shareholders, officers, and directors have standing to challenge corporate acts finds absolutely no support in the caselaw. Plaintiffs derive this supposed rule solely from *dicta* in a trial court decision, *A.B.C. Publications, Inc. v. New York Times Co.*, 103 N.Y.S.2d 693 (Sup. Ct. N.Y. Cnty., 1951), that cited nothing to support this statement and has not been cited once by any court in the 70 years since it was decided. If *A.B.C. Publications* can be credited, it stands merely for the proposition that complete strangers to a corporation—like the New York Times in that case—may lack standing to challenge ratified corporate acts. Here, given Davis's overlapping ownership in both companies, IBT cannot seriously be considered a stranger to NW Media. Moreover, it is well-established that a third-party can challenge a corporate act that has been challenged by the corporation itself, as is the case here in light of Davis's express objection.

Second, well-settled law makes clear that the president of a corporation is divested of his alleged presumptive authority to file suit on behalf of the corporation once the board of directors has refused to sanction it. That is precisely what happened here, when Davis expressly objected to the filing of the draft complaint. These restrictions on a president's authority are acutely relevant here given a second line of firmly-established New York caselaw holding that a 50% shareholder

(Pragad) cannot weaponize the company's assets against the other 50% shareholder (Davis). Similarly, Plaintiffs' argument that Davis's and Pragad's written consent authorizing NW Media to buy Newsweek in 2018 somehow overrode the company's governance and well-settled New York law and, thus, gave Pragad express authorization to file this lawsuit, is absurd. By its plain terms, the consent simply authorized NW Media to enter into an agreement with IBT for the purchase of Newsweek. There is no basis for Pragad to argue that this written consent—standard in almost every corporate transaction—gave him carte blanche to initiate litigation on behalf of the company. Indeed, NW Media's contemporaneously-executed bylaws state the opposite, requiring board majority for corporate acts, which means unanimity between Davis and Pragad.

Third, Plaintiffs' argument that Davis is an "interested" director and thus disqualified from opposing this lawsuit was neither properly raised below nor considered by the IAS Court and thus should be deemed forfeited. But even if the Court were to consider it, it also fails on the merits. It is well settled that 50% shareholders of a close corporation are permitted to vote based on their self-interest; indeed, a rule to the contrary would be inimical to the 50/50 structure, which is permissible under New York law even though it may result in deadlock. It is therefore not surprising that Plaintiffs fail to cite a single case where a 50% shareholder who specifically bargained for equal control of a closely-held

corporation was disqualified from voting on the institution of a lawsuit. To the contrary, the law recognizes that a 50% shareholder and board member who wishes to pursue claims over the objection of the other 50% shareholder and board member may bring a derivative action based on demand futility or demand refusal.

BACKGROUND AND PROCEDURAL HISTORY[3]

IBT is a global news organization owned and operated at relevant times by Etienne Uzac ("Uzac") and Davis. Compl. ¶ 31. In August 2013, IBT purchased Newsweek, the iconic American news magazine. *Id*. ¶¶ 31, 48. IBT owned Newsweek until September 13, 2018, when IBT purportedly sold all of its ownership interests in Newsweek to NW Media, a corporation equally-owned and controlled by Pragad, then IBT's CEO, and Davis, a 50% shareholder of IBT, pursuant to a Membership Interest Purchase Agreement. *Id*. ¶¶ 9, 106-108. To effectuate that sale, Pragad and Davis, as the two members of the board of NW Media, signed a Unanimous Written Consent authorizing NW Media to purchase Newsweek from IBT in accordance with the terms of the MIPA. *Id*. ¶ 108.

Pursuant to NW Media's bylaws executed contemporaneously with the MIPA, "the business of the Corporation shall be managed by its Board of Directors." R. 202 Art. III, ¶ 1. Any act of NW Media's board of directors requires a majority

[3] The facts recited here are based on the allegations in Plaintiffs' complaint, which IBT accepts as true for purposes of this appeal and the underlying motion to dismiss.

vote, which, in a two-member board, means unanimity. R. 203 Art. III, ¶ 8(a). Further, the bylaws provide that if the board of directors is unable to act because of deadlock, the matter is referred to the shareholders for a vote. R. 204 Art. III, ¶ 8(d). While the bylaws delineate roles for various officers, the bylaws do not confer the right to commence litigation on the president. R. 205-08 Art. IV.

As alleged in a separate proceeding filed in New York Supreme Court, *IBT Media, Inc. v. Pragad*, Index No. 652277/2022, NW Media and IBT operated as a single company after the purported "spin off" until at least 2021, when Pragad began to take unauthorized steps to seize Newsweek for himself.[4]

In furtherance of his plan to oust Davis and seize complete control over Newsweek, on June 24, 2022, Pragad caused NW Media's counsel, Gibson Dunn, to send a draft complaint to Davis's then-counsel purporting to assert direct, non-derivative claims on behalf of NW Media against Davis, IBT and the other Defendants here. R. 129. The draft complaint asserted substantially the same series of bogus claims that the complaint in this action makes, including a claim for indemnification seeking to recoup the payments that Plaintiffs allegedly had

[4] These unauthorized actions, including paying himself exorbitant compensation, are the subject of another action before the Supreme Court in which Davis seeks, among other things, to prevent Pragad from taking further unauthorized actions and to have him removed as a director. *Davis v. Pragad*, Index No. 652366/2022. The court in that case has already granted a preliminary injunction significantly reducing Pragad's salary, based on a finding that his excessive pay raises lacked board approval. *See* Index No. 652277/2022, NYSCEF Doc. No. 79.

voluntarily made on IBT's behalf during the period when the companies effectively operated as a single entity. *Id.*

The draft complaint prompted Davis's counsel to send two similar letters on June 30, 2022 (the "June 30 Letters")—one to Gibson Dunn[5] and one to NW Media's in-house counsel—stating that Davis, a director and 50% shareholder of NW Media, objected to and did not approve or authorize the filing of the draft complaint in the name of, and at the expense of, NW Media. R. 194-99. The letters expressly stated that neither "NW Media [n]or Newsweek has any authority to bring the claims asserted in the draft complaint." R. 194. And if there were any doubt, the letters further stated that the claims "have not been sanctioned or approved by the Board." *Id.* In the June 30 Letters, Davis also expressed grave skepticism over the allegations in the draft complaint, noting, among other things, that the indemnification claim was premised on amounts paid by NW Media with no agreement to be repaid and based on fictitious board minutes signed by Pragad; that NW Media was seeking damages for IBT's deletion of documents that in fact belonged to IBT; and that the draft complaint accused Davis of sharing confidential information with IBT when in fact that information related to a joint project for IBT

[5] Plaintiffs now claim for the first time that Gibson Dunn did not receive the letter directed to it, Appellants' Brief ("NW Br.") at 12, but this assertion was not raised below and should not be considered now. *See Paulino v. Braun,* 170 A.D.3d 506, 96 N.Y.S.3d 181 (1st Dep't 2019). In any event, even if credited as true, it is inconsequential. There is no dispute that Plaintiffs and Pragad received at least one of the June 30 Letters, and in both letters, Davis vehemently objected to the filing of the draft complaint and requested a special board meeting.

and Newsweek. R. 195. In light of these concerns, Davis expressly objected to the filing of the draft complaint, called for a "Special Meeting [to] be scheduled as soon as practicable," and proposed that an independent investigation be conducted to review the allegations in the draft complaint. R. 199. The June 30 Letters also stated that New York law is clear that "where there are only two stockholders each with a 50% share, an action cannot be maintained in the name of the corporation by one stockholder against another with an equal interest and degree of control over corporate affairs." R. 197-98 (citing *Exec. Leasing Co. v. Leder*, 191 A.D.2d 199 (1st Dep't 1993)).

The board deadlock created by the June 30 Letters left Pragad in a predicament, because he knew that he could no longer file the draft complaint on behalf of NW Media. Thus, he orchestrated a contrivance intended to circumvent the clear limitations dictated by New York corporation law. He directed Gibson Dunn to file the complaint on behalf of NW Media anyway, largely unchanged save the removal of claims against Davis, and directed a new law firm, Friedman Kaplan ("Friedman"), to assert the same claims, almost word for word, against Davis and others in a separate derivative complaint. This blatant claim-splitting implicitly recognized that Pragad lacked authority to sue Davis directly on behalf of NW Media, but it failed to take into account that Pragad also lacked authority to file suit

as to *all* Defendants, including IBT, in light of Davis's express and unequivocal objection to the entirety of the draft complaint.

On September 9, 2022, IBT moved to dismiss Plaintiffs' complaint under CPLR 3211(a)(1), (a)(3), and (a)(7), arguing, *inter alia*, that Pragad had no authority to file this lawsuit on behalf of NW Media in light of Davis's express objection to filing the lawsuit as set out in the June 30 Letters. R. 83-84. After an all-day oral argument on December 15, 2022, Justice Melissa Crane of the New York Supreme Court granted IBT's motion to dismiss based on Pragad's lack of authority on December 29, 2022. R. 8-18. The IAS Court correctly held that "[t]his case fits squarely into *Sterling*." R. 15. Relying on the June 30 Letters, the Court found that Davis "expressed extreme disapprobation to the filing of this lawsuit . . . [and] [t]hus, the board was deadlocked." R. 16. "Accordingly, under *Sterling* and its progeny, as the president of a closely held corporation, Pragad lacked the authority to act unilaterally against Davis' interest." *Id.*

The IAS Court rejected Plaintiffs' argument that the Unanimous Written Consent executed in connection with NW Media's purchase of Newsweek somehow authorized Pragad to bring this lawsuit. The Court held that all the consent "entailed was authorization to enter into and carry out the purchase of Newsweek." R. 17.

The IAS Court also rejected Plaintiffs' standing argument, holding that "it cannot be said that IBT, which is Davis' company, and a party to the contract to sell

Newsweek, is a 'total stranger'" to NW Media. R 18. Thus, in light of Davis's objection to the lawsuit, the IAS Court concluded that "[t]his leaves plaintiff, who is essentially Dev Pragad, recourse through a derivative suit only." *Id.*

ARGUMENT

I. IBT Has Standing To Challenge Plaintiffs' Authority To Sue Because It Is Not A Corporate Outsider And Because It Is Raising An Unratifiable Objection Asserted By 50% Of The NW Media Board

Plaintiffs assert that only a shareholder, officer or director of a corporate plaintiff can challenge the corporation's authority to act, NW Br. at 15, and thus IBT, as a supposed outsider, lacks standing to challenge Plaintiffs' authority to initiate this litigation. Plaintiffs are wrong on both the facts and the law.

To start, the factual premise on which Plaintiffs' argument is based—that IBT is a complete stranger to NW Media—ignores the undisputed fact that Davis owned 50% of both IBT and NW Media at all relevant times. As the IAS Court correctly recognized, "it cannot be said that IBT, which is Davis' company, and a party to the contract to sell Newsweek, is a 'total stranger and third party.'" R. 18.

Plaintiffs also have the law wrong. The generally recognized rule is that a third-party has standing to challenge a plaintiff corporation's authority to bring a lawsuit so long as the corporation itself has also raised an objection. *See 9 Fletcher Cyc. Corp. § 4216* ("Generally, if a corporation does not object to an officer's lack of authority to initiate a lawsuit, a third person may not object."); *see also Hutterville*

v. Sveen, 776 F.3d 547, 555, n.5 (8th Cir. 2015) (citing the rule with approval); *Farmers Union Oil Co. of New England v. Maixner*, 376 N.W.2d 43, 46 (N.D. 1985) (same); *Vill. of Brown Deer v. City of Milwaukee*, 114 N.W.2d 493, 497 (Wis. 1962) (same). And thus even if IBT were a stranger to the corporation, which it is not, it would still have standing here because it is raising an objection asserted by Davis, a 50% owner of NW Media.

Moreover, the Court of Appeals' decision in *Sterling* directly refutes Plaintiffs' flawed reasoning and confirms that IBT has standing both because it cannot be considered a corporate outsider and because it is raising an objection asserted by the company itself (*i.e.,* Davis). In *Sterling*, the corporate plaintiff was formed by two distinct groups who intended to share control of the company equally. Each group owned 50% of the company's stock, and each group was entitled to name two of the four directors to sit on the corporate board. One faction on the board was comprised of Sterling's president, Middleman, and a second individual associated with him, and the other faction was comprised of two directors associated with a separate company, Ball Bearing Pen Corp. ("Pen Co."). In *Sterling*, the company president (Middleman) sought to bring an action on behalf of the corporation against Pen Co. for breach of contract. At a special board meeting, the Middleman faction voted in favor of bringing the lawsuit and the Pen Co. faction voted in opposition, creating a deadlock. Nonetheless, the Sterling president filed a complaint

purportedly on behalf of Sterling against Pen Co. and two individuals, neither of whom were officers or directors of Sterling or held any shares in the company. The defendants moved to dismiss, challenging the president's authority to bring suit on behalf of the corporation in light of the board deadlock.

Significantly, none of the defendants in *Sterling* was an officer, director or shareholder in Sterling Industries. Nevertheless, although the Court of Appeals did not discuss the issue, the Court had no difficulty in reaching the merits of defendants' challenge to Middleman's authority to bring the lawsuit on behalf of the corporation. And, as discussed in greater detail below, the Court ultimately ruled for the defendants, concluding that the president was divested of any authority he had to initiate suit once the board deadlocked.

Plaintiffs' standing argument is thus completely inconsistent with *Sterling.* *Sterling* is particularly instructive here because IBT is similarly situated to Pen Co., and in fact is even more closely tied to NW Media than Pen Co. was to Sterling. Pen Co. did not own shares of Sterling but had representatives who owned common stock and sat on Sterling's board. Here, too, IBT does not own shares of the corporate Plaintiffs, but Davis owns 50% of NW Media and sits on the board. The facts here are even more compelling because in *Sterling*, the objecting board members were merely representatives of Pen Co. Here, Davis has even closer ties to IBT given his role as 50% owner. Accordingly, to the extent it is relevant to the standing analysis,

IBT cannot fairly be considered a complete stranger to the corporation. *Sterling* is also directly on point because Pen Co. was asserting an objection raised by 50% of the board of the plaintiff corporation, just like IBT is doing here by raising an objection asserted by Davis. Accordingly, the Court of Appeals' holding in *Sterling* leaves no doubt that IBT has standing.

In stark contrast to *Sterling*, Plaintiffs' reliance on the trial court's holding in *A.B.C. Publications v. N.Y. Times Co.* is entirely misplaced. In *A.B.C.*, the defendant New York Times—a complete stranger to the plaintiff—challenged the corporate plaintiff's authority to institute the litigation based on an alleged technical defect in the company's compliance with the applicable notice requirements for its board meeting. While the court stated in *dicta*, without citing any authority, that "strangers" to the corporation cannot challenge the validity of corporate acts, the court proceeded to address the merits of defendant's arguments, and ultimately denied defendant's motion based in part on unequivocal evidence that plaintiff's corporate board had ratified the filing of the lawsuit.

Ignoring the actual holding in *A.B.C.*, Plaintiffs try to pass off unsupported *dicta* from the opinion—the court's statement that only a shareholder, officer or director can challenge the validity of corporate acts—as the established rule in New York. It is not. The court's statement is inconsistent with the Court of Appeals decision in *Sterling*, decided two years earlier, and the court cited nothing to support

its assertion. *A.B.C.* also is readily distinguishable from *Sterling* and this case because the corporate act at issue could be—and, in fact, was—ratified, whereas the corporate acts at issue here and in *Sterling* plainly cannot be ratified because corporate insiders' objections deadlocked the boards. *A.B.C.* has never once been cited in any other case in the over 70 years since it was decided. And the only other authority that Plaintiffs cite for this purported standing rule is a secondary source that merely cites back to the *dicta* in *A.B.C.* and provides no other authority. NW Br. at 15 (citing 14A N.Y. Jur. 2d Bus. Relationships § 658).[6]

At best, *A.B.C.* holds that a complete stranger to a corporation cannot challenge the validity of a corporate act that has been ratified by the corporation itself. But even under that framework, IBT clearly has standing. Consistent with the discussion above, IBT is not a complete stranger to the corporation, and it is not challenging the validity of a corporate act that has been ratified by the board; rather, it is challenging a corporate act that was not and cannot be ratified because 50% of the board has objected to it.

[6] Plaintiffs also cite *Rothman & Schneider, Inc. v. Beckerman*, 2 N.Y.2d 493 (1957), but in that case, the court addressed the merits of defendant's argument rather than dismissing it for lack of standing. *See* 2 N.Y.2d at 499. And in any event, the defendant in *Rothman* was merely a former employee of the corporate plaintiff, which is starkly different from the close association that IBT has here with NW Media given Davis's common ownership.

II. Plaintiffs Lack Authority To File This Lawsuit In Light Of Davis's Objection

a. Pragad Lacks Presumptive Authority

The key question presented on this appeal is whether Pragad can rely on his position as president of NW Media to bring a lawsuit on behalf of the corporation over the express written objection of 50% of its board of directors. The Court of Appeals in *Sterling* directly answered this question with an unequivocal and resounding "no." As discussed above, the facts of *Sterling* are remarkably similar to those presented on this appeal. While recognizing that the president had presumptive authority to initiate litigation, the *Sterling* court found that "the parties intended that the corporation should be managed by its board of directors and that the board should take no affirmative action if not sanctioned by a majority." *Id.* at 491. And thus, once the board deadlocked, the president was divested of his authority to bring the lawsuit on behalf of the company.

The facts here warrant the same outcome. The court in *Sterling*, in holding that the president was divested of his authority in the presence of a board deadlock, relied heavily on Sterling's bylaws, which provided that the "affairs and business" of the company shall be managed by the board, and "[t]he act of a majority of the entire Board of Directors shall constitute the act of the Board of Directors." *Id.* at 487-88. NW Media's bylaws contain virtually identical provisions. R. 202-03, Article III, Paragraph 1 ("the business of the Corporation shall be managed by its

Board of Directors"), Article III, Paragraph 8 ("the vote of a majority of the Directors . . . shall be the act of the Board of Directors"); *see also* N.Y. BCL § 701 (a corporation is to be managed by its board of directors).

As the IAS Court correctly noted, "[c]ases following *Sterling* cement the concept that, where the by-laws do not overtly give the president the right to commence litigation, and there is board or shareholder deadlock about the propriety of doing so, the president then lacks the authority to bring an action directly in the name of the corporation." R. 10 (citing *Crane, A.G. v. 206 W. 41st St. Hotel Assocs., L.P.*, 87 A.D.3d 174 (1st Dep't 2011). Accordingly, after Davis expressly objected to the filing of the lawsuit, the board deadlocked and Pragad was stripped of his presumptive authority to bring the lawsuit as president. *See* 14A N.Y. Jur. 2d Bus. Relationships § 576 ("The statutory provision that the business of a corporation must be managed by its board of directors cannot be circumvented. When the board of directors refuses to sanction or permit an action, any actual or implied authority of a corporate officer to take that action is terminated." (citing *Sterling* and *Crane*)). Indeed, as the *Sterling* court recognized, to hold otherwise would be to amend New York statutory law "to read that the corporation shall be managed by its board of

directors, except in the case of deadlock when it shall be managed by any director who happens to be president." *Sterling*, 298 N.Y. at 492.

If Plaintiffs' argument were valid, a corporate president could effectively serve as a tiebreaker to overcome a deadlocked board. But that does not reflect the intent of the parties to share equal control of the plaintiff corporation, or New York law governing the management of close corporations. Plaintiffs are improperly asking this Court to usurp the role of the New York legislature, which has not prescribed a tiebreaking mechanism to resolve a deadlocked board in the seventy-plus years since *Sterling*. As the Court stated in *Sterling*:

> Had the Legislature intended to eliminate the problem of a deadlock it could have done so by the simple expedient of requiring an odd number of directors. Instead, apparently realizing the desire for equal control in some closely held corporations, it has continued to permit the election of a board of directors with an even numbers of directors. The fact that a deadlock may result does not necessarily mean that the present law is inadequate and that it should be remedied by the approval of presidential power where none in fact exists -- thus disregarding fundamental rules of agency law.

Id. at 491.

Like the parties in *Sterling*, when Pragad and Davis formed NW Media, they specifically bargained for equal control, and contemplated the possibility of deadlock, as is permitted under New York law. They could have included a provision in the bylaws to the effect that the president shall serve as a tiebreaker in the event of any board deadlock. But they did not, and it is not the role of the judiciary to impose such a rule where it does not exist either in the company's

formation documents or in New York law. Instead, as the Court recognized in *Sterling*, the appropriate remedy available to the frustrated 50% owner is the filing of a shareholder derivative action. *Id.* at 491-92.

Plaintiffs argue that *Sterling* does not apply here because there was no formal meeting and vote of the NW Media board, NW Br. at 19-21, but that is a distinction without a difference. It is undisputed that prior to the filing of the lawsuit, Davis, through counsel, sent letters to NW Media's counsel emphatically objecting to the filing of the draft complaint. That is plainly sufficient under the holding in *Sterling*, which found it dispositive that the board refused to sanction the lawsuit, and placed no particular significance on the fact that the board's refusal occurred at a special board meeting. Plaintiffs are unable to muster even a single case that supports their argument that an express written objection from a 50% voting member of the board is insufficient to create board deadlock in the absence of a formal vote, much less that a president retains authority to bring a suit in the face of an express objection from 50% of the board.

Instead, Plaintiffs make the giant leap of analogizing this case—where 50% of the board has filed an express written objection to the lawsuit—to cases where the president was allowed to institute litigation where the board had *taken no action at all* prior to the president filing suit. All of these cases are clearly inapposite. For example, in *Paloma Frocks, Inc. v. Shamokin Sportswear Corp.,* 3 N.Y.2d 572

(1958), a case on which Plaintiffs heavily rely, the Court distinguished *Sterling* on the ground that the directors in *Paloma* had not either approved or rejected instituting the suit, whereas "Sterling's president asked his board's permission to bring the suit but there was a tie vote which this court treated as a refusal by the directors of permission." *Id.* at 575.[7] Here, unlike in *Paloma*, it is undisputed that Davis—in no uncertain terms—objected in writing to the filing of the complaint.

All of the other cases cited by Plaintiffs can be distinguished in the same way, because each one involves a situation where the board had not objected to the lawsuit in advance of its filing. *See West View Hills, Inc. v. Lizau Realty Corp*., 6 N.Y.2d 344, 348 (1959) (holding that president was authorized to sue where "board has taken no action"); *Rothman*, 2 N.Y.2d at 496 (holding that president was authorized to sue where 50% shareholder and board member was not consulted in advance and only objected after the filing of the lawsuit). As much as Plaintiffs would like to argue that a formal board meeting is required to deprive the president of his authority to bring suit, the caselaw does not support that claim. At most, the cases cited by Plaintiffs can be read to require that there be "direct" opposition by the board expressed prior to the filing of the complaint in order to divest the president of his

[7] The Court in *Paloma* also distinguished *Sterling* on the basis that the president was merely carrying out an existing agreement to arbitrate, which as discussed further in Section II.b, is also not present here.

authority to bring suit, *Id.* at 497, but that test is easily satisfied here via Davis's direct written objection.

If this Court were to adopt the rule advanced by Plaintiffs—that directors can only divest the presumptive powers of the president at formal board meetings—perverse results would clearly ensue. Such a rule would upend the bedrock principles that a company is to be managed by its board of directors and that a 50% shareholder cannot weaponize corporate assets against another 50% shareholder. One need look no further than the facts of this case to see the sort of gamesmanship that would result. In the June 30 Letters, Davis expressly stated that the draft complaint was not authorized by the board of directors and requested a special meeting of the board. R. 194-95. Rather than comply with Davis's request, Pragad opted instead to race to the courthouse and file the complaint before a formal board meeting could be held. To hold that this maneuver succeeds based on the lack of a formal board vote would create an obvious loophole for corporate presidents to subvert the parties' intent to share control of NW Media equally, and violate the fundamental tenet of New York corporate law that the corporation is to be managed by the board of directors.

Plaintiffs contend that a president may deliberately opt not to call a board meeting for the express purpose of preserving his authority to act, NW Br. at 21, but the cases cited for this proposition are entirely inapposite, because they do not

involve the situation presented here, where a board member specifically requested a special board meeting and expressly objected to the lawsuit. *See Berma Mgmt. Corp. v. 140 W. 42nd St. Realty, Inc*., 21 Misc.2d 571, 572-73 (Sup. Ct. N.Y. Cnty. 1960) (president knew that two of four members opposed lawsuit, but no express objection was filed and no board meeting requested); *Hellman v. Hellman*, 31 Misc.3d 265, 269-70 (Sup. Ct. N.Y. Monroe Cnty. 2010), *aff'd* 79 A.D.3d 1813 (4th Dep't 2010) (president may have known that board member opposed execution of lease, but no board meeting was requested).

Plaintiffs also contend that a president has the authority to act "even in the face of known opposition to the filing of the lawsuit," NW Br. at 20, but this is not a case like *West View Hills*, cited by Plaintiffs for this point, where a president was allowed to file suit even though he must have known that the board would have opposed the lawsuit. Here, Pragad was not left to speculate as to whether Davis *would* oppose the lawsuit; he knew that for sure because Pragad sent him the draft complaint in advance, and then Davis opposed the lawsuit in writing a week before it was filed, thereby divesting Pragad of his presumptive authority to sue pursuant to the plain import of *Sterling*.[8] *See also Crane , A.G. v. 206 W. 41st St. Hotel Assocs.,*

[8] Plaintiffs' assertion that Pragad is the active CEO of Newsweek and Davis is supposedly an absentee director (NW Br. at 24) has no bearing on the *Sterling* analysis. The cases cited by Plaintiffs lend no support to their argument. *Happy Banana, Ltd. v. Tishman Const. Corp. of N.Y.*, 179 A.D.2d 562, 563 (1st Dep't 1992), involved a third-party—not an alleged absentee director—challenging an active officer's authority to bring suit. And in *Rothman & Schneider, Inc. v. Beckerman*, 2 N.Y.2d 493, 498 (1957), a secretary-treasurer was found to have the authority to

L.P., 87 A.D. 3d 174 (1st Dep't 2011) (holding that president lacked presumptive authority to defend foreclosure action when shareholders deadlocked and board could not authorize that action) (citing *Sterling*).

The principles espoused by *Sterling* are particularly weighty here given that Davis's objection arises in the context of a corporation owned equally by two 50/50 shareholders. Under the so-called "50/50 Shareholder Rule," it is well-settled that one 50% shareholder in a close corporation cannot weaponize the assets of the corporation against the other 50% shareholder. *See, e.g., Executive Leasing*, 191 A.D.2d 199 ; *Stone v. Frederick*, 245 A.D.2d 742 (3d Dep't 1997); *see also Giaimo v. EGA Assocs. Inc.,* 68 AD3d 523, 524 (1st Dep't 2009) ("[a]s the president of a closely held corporation, Edward lacked the authority to act unilaterally against Robert's interest"). As the First Department explained in *Executive Leasing*:

> [W]here there are only two stockholders each with a 50% share, an action cannot be maintained in the name of the corporation by one stockholder against another with an equal interest and degree of control over corporate affairs; the proper remedy is a stockholder's derivative action.

191 A.D.2d at 200.

This long-standing New York rule squarely applies here because Pragad is trying to weaponize the company coffers of NW Media against its co-owner Davis by suing IBT, which is 50% owned by Davis, and others, over Davis's express

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bring suit because the president had retired, leaving the entire management of the company to the secretary-treasurer.

objection. Plaintiffs contend that the 50/50 Shareholder Rule places no constraints on a corporate president's authority to bring suit against a corporate "outsider" such as IBT. NW Br. at 19. However, there clearly is no support for the proposition that a 50% shareholder can end-run the 50/50 Shareholder Rule by weaponizing corporate assets against those affiliated or aligned with the other 50% shareholder, while simply omitting the other 50% shareholder from the suit. Permitting such a contrivance would undermine the purpose and intent of the 50/50 Shareholder Rule, and would sanction the sort of claim-splitting gamesmanship attempted by Pragad here. But even if it were true that the 50/50 Shareholder Rule does not prohibit suit against corporate outsiders, the IAS Court correctly found that IBT cannot be considered an outsider given that it is half-owned by Davis R. 18. Thus, although the Court need not reach this issue because Davis's objection divested Pragad of his authority to sue pursuant to the express holding in *Sterling*, the 50/50 Shareholder Rule itself provides an independent basis for the Court to affirm the IAS Court's decision to dismiss the claims against IBT.

b. Pragad Lacks Actual Authority

Plaintiffs' argument that the Unanimous Written Consent vests him with actual authority to sue fails the straight face test. NW Br. at 24-27. The Unanimous Written Consent merely provides that "Johnathan Davis and Dev Pragad, officers of [NW Media], are each authorized to execute the [MIPA], and any and all

instruments, writings and other documents necessary to carry out the transaction contemplated under the [MIPA]." *See* Index No. 652277/2022, NYSCEF Doc. No. 44. By its plain terms, this language merely authorizes NW Media to enter into the MIPA and effectuate the purchase of Newsweek. It by no means authorizes Pragad to unilaterally decide to file suit against IBT pursuant to the MIPA's indemnification provision.[9] In fact, nothing in the language of the written consent remotely constitutes a grant of authority to initiate litigation of any sort. It thus cannot possibly be read to provide Pragad with a blank check to use company funds years later to institute any litigation he pleases, regardless of whether or not Davis directly opposes the action. Nor can this language override the contemporaneously-executed bylaws of NW Media whereby Pragad and Davis agreed that their unanimous consent would be required for board action.

Plaintiffs' reliance on Davis's agreement to the Unanimous Written Consent also is directly contrary to the First Department's most recent decision on this issue—*Crane*, 87 A.D.3d 174. There, "two sophisticated parties" formed the corporation in question and together agreed that one of the parties' affiliates would provide financing. This decision created the obvious risk that, if the corporation was

[9] Even if Plaintiffs' fanciful interpretation of the Unanimous Written Consent to enter into the MIPA were correct, which it clearly is not, Plaintiffs would only be authorized to assert their indemnification claims against IBT, but they still would lack authority to assert the other claims interposed against IBT in NW Media's complaint here, including unjust enrichment and misappropriation of trade secrets, all of which have absolutely nothing to do with the MIPA.

not a success, the party-affiliate might attempt to recoup some of the financing through legal action. *Id.* at 180. The parties nevertheless contracted to require unanimous consent of the shareholders for the corporation to take action, including defending itself from a foreclosure action, and the court found no reason to "relieve them of the consequences of their bargain[,]" which there led to the stark outcome that the corporation was precluded from defending the action. *Id.* A similar, albeit less harsh, result is dictated here. Even though the MIPA raises the obvious risk that NW Media might develop grounds to seek indemnification from IBT, that does not change the fact that Pragad and Davis agreed to bylaws requiring unanimous consent of the board to act, meaning Davis could prohibit NW Media from pursuing those claims, in turn, leaving Pragad to seek a remedy for the company, if he saw fit, through a derivative action.

Relying heavily on the Court of Appeals' decision in *Paloma Frocks*, Plaintiffs also make the strained argument that because the MIPA contains an indemnification provision, that somehow gave Pragad advance authorization to bring this lawsuit. NW Br. at 26. But *Paloma* cannot be stretched so far, and by its express holding, cannot escape the import of *Sterling*. In *Paloma*, the Court of Appeals held that the authorization of a company president to enter into a commercial contract containing a general arbitration clause amounted to authorization to the president to later submit a particular dispute under the contract

to arbitration, without seeking board approval. 3 N.Y.2d at 575. Plaintiffs argue that the arbitration provision in the *Paloma* contract is analogous to the indemnification provision in the MIPA, and thus that Pragad had actual authority to file this lawsuit. They are wrong. As an initial matter, the *Paloma* court specifically declined to determine whether the president's authority was "express or implied." *Id*. Second, unlike the MIPA, the contract in *Paloma* concerned a long-term agreement to provide services over time. In that context, the court found that the filing of an arbitration demand, as contemplated in the agreement itself, was merely a "routine step in the performance of an authorized contract." *Id.* The MIPA is not a long-term commercial contract for services, but rather a sale agreement that was intended to be fully performed on the day it was executed. Thus, the institution of this lawsuit, years after the MIPA was executed, cannot seriously be considered a routine step in the performance of the contract. It also cannot be said that Davis had somehow pre-authorized the filing of the lawsuit by agreeing to the MIPA in light of the contemporaneously executed bylaws making it crystal clear that any act of the NW Media board required Davis's approval.

Putting aside these factual dissimilarities, the *Paloma* court was also addressing a materially different question on appeal. There, the question was whether a president had authority to file an arbitration demand without first seeking board approval. Here, the question is whether a president was divested of his

authority upon sending a draft complaint to a 50% shareholder and board member who then expressly objected to its filing. Tellingly, even though the *Paloma* court was not addressing this question, it still expressly recognized that the president could be *divested* of the authority to sue by direct prohibition by the board. *Id.* at 575-76. Thus, *Paloma* in fact directly supports IBT's argument that Pragad was divested of his authority to sue upon receiving Davis's June 30 Letters. Accordingly, even if Plaintiffs were right that the MIPA somehow pre-authorized the filing of this lawsuit (and they are not), this does nothing to advance their arguments because Plaintiffs would still lack authority to file suit pursuant to *Sterling*, for all the reasons discussed above.

III. Davis Is Not Disqualified From Objecting To This Lawsuit

In a last-ditch effort to save this unauthorized lawsuit, Plaintiffs contend that Davis is an interested director and thus disqualified from participating in any board action that would divest Pragad of his authority to bring this action on behalf of NW Media. There is no merit whatsoever to this argument.

First, as a gating issue, Plaintiffs did not raise this argument in their motion papers in the Supreme Court, and thus this Court should not consider this argument on appeal. *See Paulino,* 170 A.D.3d 506 (refusing to consider argument raised for the first time on appeal). It was not until *after* Plaintiffs' motion to dismiss had been fully submitted and the parties had engaged in a full day of oral argument that

Plaintiffs raised this argument for the first time via an unsolicited post-argument letter submitted without leave of the IAS Court. Given that issues raised for the first time in a reply brief in the court below are not preserved for appeal, *Travelers Indem. Co. v. LLJV Dev. Corp*., 227 A.D.2d 151, 154 (1st Dep't 1996), it follows *a fortiori* that Plaintiffs' argument here raised for the first time in a letter submission filed without leave of court months after the motion was fully submitted should be deemed waived. The IAS Court did not consider this eleventh hour argument in its Decision and Order, and neither should this Court on appeal.

But if the Court nonetheless decides to consider the argument, it should be rejected as utterly meritless. Plaintiffs fail to cite a single case holding that a 50% owner of an equally-controlled corporation was precluded from participating in a vote to initiate litigation, leaving the other 50% owner with unilateral decision-making authority. Indeed, such a finding would flip basic notions of New York corporate governance on its head. For example, black letter law excusing the need for a demand on the corporation before filing derivative litigation if a demand would be futile demonstrates the inherent flaw with Plaintiffs' argument. It is well-settled that the demand requirement for asserting a derivative claim "is excused because of futility when a complaint alleges with particularity that a majority of the board of directors is interested in the challenged transaction." *Marx v. Akers*, 88 N.Y.2d 189, 200 (1996). The doctrine of demand futility is thus premised on the

very notion that an interested director can in fact vote to block the filing of a lawsuit. Indeed, this is in large part why derivative actions exist in the first place, and is precisely why Plaintiffs' proper recourse here was to file this action derivatively.

This fundamental flaw in Plaintiffs' argument is particularly evident here in the 50/50 shareholder context. Close corporations of this type routinely engage in transactions in which some or all of the principals are "interested"—as in many of the cases cited in this brief—but there is no rule that directors with such overlapping interests are unable to participate in the close corporation's governance.

In fact, Pragad has already expressly acknowledged that the opposite is true—that Davis can deadlock the board even if he is considered self-interested. In the separate derivative action that Pragad has filed against Davis on behalf of NW Media, Pragad alleges that the demand requirement is excused because the "bylaws of NW Media Holdings provide that its Board may act only upon the approval of a majority of the directors, *i.e.*, upon the approval of both Pragad and Davis. . . . but Davis has made clear that he does not approve the company's initiation of action against him." *Pragad v. Davis,* Index No. 652334/2022, NYSCEF Doc. No. 2, ¶¶ 138, 139 (citing the June 30 Letters).[10] In other words, Pragad in the *Davis* complaint acknowledges the existence of the board deadlock that he vehemently denies exists

[10] The Court may take judicial notice of court records. *See Matter of Khatibi v. Weill*, 8 A.D.3d 485 (2d Dept. 2004).

here, and seeks to use that fact as the basis for arguing demand futility in the derivative action. Pragad goes on to allege in that case that Davis is "obviously self-interested," just as Pragad himself obviously is self-interested, but even so, admits that Davis still has the "ability to cause a deadlock of NW Media Holdings' Board," such that Pragad may bring his claims derivatively. *Id.* at ¶ 140. Pragad is absolutely right on this point—an interested director maintains blocking powers—which as discussed is precisely why shareholders are allowed to bring derivative actions when a majority of the board is interested. *Marx*, 88 N.Y.2d at 200; *see also Beneville v. York,* 769 A.2d 80, 85, n.9 (Del. Ch. 2000) (in a two-member board, the finding of interestedness on the part of one director will excuse demand on the board because "the key fact remains that the interested director possesses the blocking power to stop the impartial director from acting as he wishes") (applying Delaware law). Accordingly, Pragad's litigation position in this case—that, contrary to Pragad's position in the derivative action, Davis could not deadlock the board because he is self-interested—should be squarely rejected.

Plaintiffs cite just one case directly on point, *Sterling*, and try to distinguish it, but the court in *Sterling* expressly rejected the argument that the two directors affiliated with Pen Co. were disqualified from voting on the proposal to sue Pen Co. *Id.* at 491. As stated in the order by the Special Term in *Sterling*, which was ultimately affirmed by the Court of Appeals, the "dual position of the directors . . .

should lead the courts to scrutinize these transactions with care. . . . [but] [i]t does not, however, alone suffice to render the transactions void." *Sterling Indus., Inc. v. Ball Bearing Pen Corp.*, 75 N.Y.S.2d 475, 478 (Sup. Ct. 1947) (citing *Everett v. Phillips*, 288 N.Y. 227, 237, 43 N.E.2d 18, 22 (1942)). In another case cited by Plaintiffs, *Amfesco Indus., Inc. v. Greenblatt*, the court did *not* hold that a conflicted director was precluded from participating in corporate governance—rather, the court only held that such a director would not be insulated from the protections of the business judgment rule. 172 A.D.2d 261, 264 (1st Dep't 1991).

Ultimately none of the cases cited by Plaintiffs have any bearing on this case because they do not involve a deadlock between 50/50 owners of a closely held corporation over the decision to initiate litigation. For example, Plaintiffs cite to *Park River Owners Corp. v. Bangser Klein Rocca & Blum*, but that case did not involve a 50/50 shareholder dispute. In fact, it provides no guidance as to whether a 50% shareholder may be disqualified from voting on the initiation of litigation because the question posed was whether certain board members could vote to terminate an action that had already been instituted. 269 A.D.2d 313 (1st Dep't 2000). The other cases cited by Plaintiffs have nothing to do with the decision to initiate litigation, but rather concern shareholder actions challenging other corporate acts, such as board members awarding themselves inflated compensation, but these cases only demonstrate IBT's point—that the proper recourse here was for Pragad

to file a derivative action. *See, e.g., Kenneth Cole Prods., Inc. v. Blitzer*, 27 N.Y.3d 268 (2016) (shareholder action challenging merger); *Marx,* 88 N.Y.2d 189 (shareholder derivative action challenging director compensation).

In the end, *Sterling* is the only case directly on point once again. Just like the Pen Co. directors in *Sterling*, there is no basis to find that Davis should be disqualified from determining whether to initiate litigation against IBT. To start, if Davis is an interested director because of his affiliation with IBT, then so too is Pragad. Plaintiffs ignore that Pragad was IBT's former CEO and, as such, was personally responsible for the purported failings NW Media now complains of and for which it seeks damages in the complaint. Plaintiffs also ignore that Pragad was self-interested in the decision to bring claims against IBT because it was part and parcel of Pragad's plan to weaponize NW Media's assets against Davis in an effort to oust him and seize 100% control. Thus, under Plaintiffs' theory, Pragad should also be disqualified, leaving no director able to participate.

And try as they may to argue that Davis was not acting in NW Media's best interest when he objected to the filing of the complaint, there is no basis to draw that conclusion and it is beside the point. The June 30 Letters speak for themselves. In them, Davis expressed obvious and reasonable concerns about the draft complaint, including that the claims for indemnification as to IBT were based on payments made by NW Media pursuant to fictitious board minutes signed by Pragad. R. 195.

In any case, in the event Pragad believes that Davis breached his fiduciary duties by objecting to the claims against IBT, his recourse is to pursue a derivative action, against IBT or Davis (as he already has done) or both.

CONCLUSION

For all the reasons stated above, Plaintiffs lack authority to bring this lawsuit, and the IAS Court's Decision and Order granting IBT's motion to dismiss should therefore be affirmed.

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April 10, 2023

HOGAN LOVELLS US LLP

By: _____

Michael C. Hefter
Ryan M. Philp
Matthew A. Ducharme
Maura C. Allen
Hogan Lovells US LLP
390 Madison Avenue
New York, New York 10017
T. (212) 918-3000
F. (212) 918-3100

Attorneys for Defendant-Respondent IBT Media, Inc.

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