STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PROVIDENCE, SC. **SUPERIOR COURT**

(FILED – JUNE 11, 2012)

HERITAGE HEALTHCARE SERVICES, INC., VITO'S EXPRESS, INC., SWIMMING POOL SPECIALIST, INC., J. BROOMFIELD & SONS, INC., STERLING INVESTIGATIVE SERVICES, INC., LEONELLI AND VICARIO, LTD., individually and on behalf of all those similarly situated	:	
vs.	:	**C.A. No. PB 02-7016**
THE BEACON MUTUAL INSURANCE COMPANY, JOSEPH ARTHUR SOLOMON, MICHAEL DENNIS LYNCH, and JOHN DOES 1-100	:	

DECISION

SILVERSTEIN, J. Before the Court is Defendant The Beacon Mutual Insurance Company's (Beacon) Motion for Judgment on the Pleadings, pursuant to Super. R. Civ. P. 12(c). Beacon requests the Court grant judgment in its favor on the grounds that all Counts of the Ninth Amended Complaint (Complaint) are derivative claims that were not brought in accordance with G.L. 1956 § 7-1.2-711(c) and Super. R. Civ. P. 23.1. Plaintiffs[1] object to the Motion, arguing that the claims set forth in the Complaint are not derivative in nature, but rather, are direct claims.

[1] Plaintiffs, pursuant to this Court's Decision on January 19, 2011, consist of the named parties individually and as class representatives (with the exception of Heritage Healthcare Services, Inc.). See Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2011 WL 202299, slip op. at 20-21 (R.I. Super. Jan. 19, 2011) (granting class certification). The named Plaintiffs are Heritage Healthcare Services, Inc., Vito's Express, Inc., Swimming Pool Specialist, Inc., J. Broomfield & Sons, Inc., Sterling Investigative Services, Inc., and Leonelli and Vicario, Ltd.

I

Facts and Travel

The basic facts of this matter have been presented by this Court and the Rhode Island Supreme Court in the past.[2] As such, only the facts set forth in the pleadings that are pertinent to this Motion are presented below.

By Order of this Court dated September 17, 2008, Plaintiffs' Ninth Amended Complaint is the controlling pleading in this litigation. As noted in the Court's Decision, the Ninth Amended Complaint modified considerably the Plaintiffs' claims for relief in this matter. See Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2008 WL 4376187 (R.I. Super. Sept. 4, 2008) (noting Complaint would "represent a shift in legal theories" and "focuses on the allegation that Beacon diverted over $101 million in profits to a small percent of its policyholders in the form of lower insurance rates rather than distributing these premium

[2] This Court has issued the following written decisions in this case and other related matters: Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2004 WL 253547 (R.I. Super. Jan. 21, 2004) (considering 12(b)(6) motion to dismiss the Third Amended Complaint for failure to state a claim); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2005 WL 2101412 (R.I. Super. Aug. 29, 2005) (considering motion to dismiss Count III of Fifth Amended Complaint for lack of subject matter jurisdiction); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2007 WL 1234481 (R.I. Super. Apr. 17, 2007) (considering motion to compel production of Market Conduct report); Heritage Healthcare Servs., Inc. v. Marques, No. PB 06-4420, 2007 WL 2405917 (R.I. Super. Aug. 9, 2007) (considering appeal from the Decision of the Department of Business Regulation (DBR)); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2007 WL 2692031 (R.I. Super. Sept. 6, 2007) (considering temporary restraining order); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2008 WL 4376187 (R.I. Super. Sept. 4, 2008) (considering motion to file Ninth Amended Complaint); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., 2009 WL 3328481 (R.I. Super. Apr. 15, 2009) (considering Defendants' motion for summary judgment on all Counts of the Ninth Amended Complaint); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2011 WL 202299 (R.I. Super. Jan. 19, 2011) (considering class certification); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2011 WL 3153291 (R.I. Super. June 9, 2011) (considering Defendants' motion in limine). The Rhode Island Supreme Court had occasion to discuss this matter through an appeal of the DBR Decision as well. See Heritage Healthcare Servs., Inc. v. Marques, 14 A.3d 932 (R.I. 2011).

savings equally among all policyholders"). The class action Complaint now stands as including counts for Breach of the Implied Covenants of Good Faith and Fair Dealing (Count I), Breach of Fiduciary Duty (Count II), and Unjust Enrichment (Count III).

The crux of Plaintiffs' claims are that Beacon "engaged in a systematic scheme to divert over $101 million to a small percent of its policyholders rather than distributing it equitably to all its policyholders" by charging "consent-to-rate discounts" to select policyholders from 2001 to 2006. See Compl. ¶ 28; see also Pls.' Opp'n to Def.'s Mot. for J. on the Pleadings 4, Mar. 30, 2012. Particularly, the Complaint alleges "favoritism and bias in pricing; inappropriate and lavish spending . . ." as well as the issuance of "'unauthorized' and illegal" consent-to-rate discounts. See id. at ¶¶ 25, 29. Plaintiffs claim Beacon "operated in a corrupt, improper and unlawful manner" and without "customary prudence, appropriate checks and balances, accountability or transparency." See id. at ¶¶ 32-33.

Overall, Plaintiffs claim the actions of Beacon resulted in "distributing significant profits (in the form of lower net premiums) to the Select Policyholders at the expense of all its other policyholders." See id. at ¶ 30. Plaintiffs acknowledge, however, that Beacon paid no annual dividends to all of its policyholders from 2002 to 2004. See id. at ¶ 31; see also Pls.' Opp'n to Def.'s Mot. for J. on the Pleadings 4. The improper distributions alleged by Beacon were apparently made in the form of the consent-to-rate discounts to select policyholders.

Beacon's charter provides it with the authority to issue consent-to-rate discounts to its policyholders. See 2003 R.I. Pub. Law ch. 410 §§ 11(d)(2) ("Notwithstanding any law to the contrary, the fund and any workers' compensation insurance policyholder may mutually consent to modify the rates for that policyholder's workers' compensation insurance policy, provided the fund files notice of the modification with the director of the department of business regulation."),

11(d)(4) ("discretion of the fund to apply discounts and surcharge multipliers of up to three (3) times the premiums that would otherwise be applicable under the rates").[3] Separately and independently, the Board of Directors of Beacon has the authority to declare dividends equitably among its policyholders and may do so when there is an excess of assets over liabilities and minimum surplus requirements. See id. at §§ 6, 10(6); Compl. ¶¶ 19-20.

Plaintiffs' causes of action seek "an accounting, restitution and/or damages, and an injunction prohibiting Defendants from engaging in the unlawful activity . . . in the future." See Compl. ¶¶ 54, 61, 64. However, this Court has recognized in its prior decisions that policyholders of Beacon are not entitled to a dividend until one is declared by the Board, and "[e]ven if the Plaintiffs were successful in establishing that the Defendants had breached their fiduciary duty and implied duties of good faith and fair dealing . . . they would still have no right to compel the payment of dividends." See Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2011 WL 202299, slip op. at 19-20 (R.I. Super. Jan. 19, 2011). First, the Board would have to "convene and consider whether, in light of their fiduciary and implied duties, a dividend should have been declared . . . ." Id. Accordingly, this Court has found that "the actual relief sought by the Plaintiffs is a declaration that the Defendants have breached their fiduciary and implied duties, and an injunction compelling Beacon's board to convene and consider whether, in light of their fiduciary and implied duties, a dividend should have been declared in each or any of the years 2002-2005." Id.

[3] The Court notes that Beacon, admittedly, did not file notice of any modifications between 2001 and 2006. See Mem. of Law in Supp. of Def.'s Mot. for J. on the Pleadings 4 n.2, Feb. 17, 2012. This failure has no effect on the Court's decision on this Motion for Judgment on the Pleadings regarding whether the claims are derivative in nature.

On February 17, 2012, Beacon filed this Motion for Judgment on the Pleadings. Plaintiffs objected on February 28, 2012, and oral arguments were heard before this Court on May 23, 2012.

II

Standard of Review

A Rule 12(c) motion for judgment on the pleadings "is tantamount to a Rule 12(b)(6) motion, and the same test is applicable to both, that is, is it clearly apparent that the plaintiff can prove no set of facts to support the complaint." Collins v. Fairways Condo. Ass'n, 592 A.2d 147, 148 (R.I. 1991). Accordingly, the standard to be applied is "restrictive," and the facts presented in the pleadings are to be construed "in the manner most favorable to the nonmoving party." Haley v. Town of Lincoln, 611 A.2d 845, 847 (R.I. 1992). "The factual allegations contained in the nonmovant's pleadings are admitted as true for the purposes of the motion," and proper inferences are to be "drawn in favor of the nonmovant." Id. To prevail on a motion for judgment on the pleadings, the defendant must "demonstrate to a certainty that the plaintiff will not be entitled to relief under any set of facts that might be proved at trial." Id.

The Superior Court Rules of Civil Procedure provide for judgment on the pleadings "[a]fter the pleadings are closed but within such time as not to delay trial." Super. R. Civ. P. 12(c). While many defenses may be waived, "the defense of failure to state a claim upon which relief can be granted . . . may also be made by a later pleading . . . or by motion for judgment on the pleadings or at the trial on the merits." Super. R. Civ. P. 12(h).

III

Discussion

Beacon argues that based on the pleadings, Plaintiffs' claims are derivative in nature and should be dismissed for failing to comply with the requirements for filing a derivative claim, as set forth in § 7-1.2-711(c) and Super. R. Civ. P. 23.1. Plaintiffs counter that the claims were properly brought directly and need not comply with the derivative claim demand and pleading requirements.

A

Derivative or Direct

This Court has held that whether a suit is derivative in nature is a question for the court. See Marsh v. Billington Farms, LLC, No. 04-3123, 2006 WL 2555911, at *9 (R.I. Super. Aug. 31, 2006) (Silverstein, J.) (citing Dowling v. Narragansett Capital Corp., 735 F. Supp. 1105, 1113 (D.R.I. 1990)); Dunn v. Shannon, No. 99-2533, 2005 WL 1125315, at *4 (R.I. Super. May 11, 2005) (Silverstein, J.). To determine whether a claim is derivative or direct, the Court applies the Tooley test, set forth by the Delaware Supreme Court. See Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031 (Del. 2004); Marsh, 2006 WL 2555911 at *9 (applying Tooley test); cf. Lawton v. Nyman, 327 F.3d 30, 50 (1st Cir. 2003) (stating general Rhode Island law on derivative versus direct claims prior to Tooley decision).[4] Although this case concerns a

[4] The First Circuit, prior to Tooley, summarized Rhode Island law as follows:

> "The usual rule is that an action grounded in an injury to a corporation must be brought as a derivative suit. If, however, the injury is a result of a violation of a duty owed directly to shareholders, they may sue on their own behalf. Where the action complained of creates not only a cause of action in favor of the corporation but also creates a cause of action in favor of the stockholder, *as an individual*, for violation of a duty owing directly

mutual insurance company, policyholders in a mutual insurance company are equivalent to stockholders in a corporation. See Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2005 WL 2101412, at *5 (R.I. Super. Aug. 29, 2005) ("policy holders have an ownership interest in the corporation akin to that of a shareholder"); Heritage Healthcare Servs., Inc. v. Beacon Mut. Ins. Co., No. PB 02-7016, 2004 WL 253547, at *4-5 (R.I. Super. Jan. 21, 2004); 3 Steven Plitt et al., Couch on Insurance 3d § 39:15 (2011). The proper remedy for claims that are derivative in nature but did not comply with the requirements for bringing a derivative action is dismissal. See Giuliano v. Pastina, 793 A.2d 1035, 1037 (R.I. 2002) (affirming dismissal of direct claims that were "in reality a derivative action that had not been filed in accordance with Rule 23.1"); Dunn, 2005 WL 1125315 at *7; see also Krupinski v. Deyesso, No. PB 07-3484, 2012 WL 1360869, slip op. at 5-6 (R.I. Super. Apr. 12, 2012) (Silverstein, J.) (noting prior dismissal of counts that were derivative in nature but brought directly for failure to comply with requirements for derivative actions).

Under the basic Tooley standard, "a court should look to the nature of the wrong and to whom the relief should go." Tooley, 845 A.2d at 1039. Therefore, the test turns solely on two parts: "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or any other remedy (the corporation or the stockholders, individually)?" Id. at 1032.

> to him, the stockholder may bring suit as an individual. In order to pursue a derivative suit, plaintiffs must allege that all other avenues of redress are foreclosed, including redress by the board of directors." Lawton, 327 F.3d at 50 (citations omitted) (emphasis in original).

The federal court determined the claims in Lawton to be derivative in nature under Rhode Island law and affirmed dismissal of the plaintiff's direct claims concerning the issuance of stock options to some employees. Id. Notably, the Lawton statement of the law is similar to the subsequent Tooley test applied by this Court.

For the claim to be direct, it must be "independent of any alleged injury to the corporation." Id. at 1039; see Dunn, 2005 WL 1125315 at * 6 (determining cause of action derivative in nature where plaintiff "has not demonstrated that he has suffered a wrong involving his contractual rights as a shareholder that exists independently of the corporation's right"). Thus, the plaintiff "must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation." Tooley, 845 A.2d at 1039; see Lawton, 327 F.3d at 50 (pre-Tooley, requiring cause of action in favor of plaintiff as an individual for violation of duty owing directly to him in order for claim to be direct); 2 American Law Institute, Principles of Corporate Governance § 7.01 (explaining "[a]n action in which the holder can prevail only by showing an injury or breach of duty to the corporation should be treated as a derivative action," and "[a]n action in which the holder can prevail without showing an injury or breach of duty to the corporation should be treated as a direct action that may be maintained by the holder in an individual capacity"); see also Giuliano, 793 A.2d at 1037 (determining claim derivative in nature when "alleged wrongdoing did not cause any present injury or damage to the plaintiff," but only damaged corporation); Dowling, 735 F. Supp. at 1113 ("Where the injury is personalized to a shareholder and flows from a violation of rights inherent in the ownership of stock, suit may be brought by the shareholders. On the other hand, where the injury is to the corporation and only affects the shareholders incidentally, the action is derivative.").

Courts afford little weight to the labels the plaintiff assigns to its claims and instead "look to the nature of the wrong alleged, taking into account all of the facts alleged in the complaint, and determine for itself whether a direct [or derivative] claim exists." Protas v. Cavanagh, No. 6555-VCG, 2012 WL 1580969, at *5 (Del. Ch. May 4, 2012) (quoting Hartsel v. Vanguard

Group, Inc., No. 5394-VCP, 2011 WL 2421003, at *16 (Del. Ch. June 15, 2011)) (explaining and applying Tooley test); see In re Syncor Int'l Corp. Shareholders Litig., 857 A.2d 994, 997 (Del. Ch. 2004) ("a claim is not direct simply because it is pleaded that way" (citations omitted)). Claims of breach of fiduciary duty are "classically derivative," and thus may be derivative in nature under the Tooley standard. See Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC, 922 A.2d 1169, 1178-81 (Del. Ch. 2006) (applying Tooley test, noting that breaches of fiduciary duty are "classically derivative," and determining them to be derivative in nature under the test); see also Gatz v. Ponsoldt, No. 174-N, 2004 WL 3029868, at *7 (Del. Ch. Nov. 5, 2004) (stating breach of fiduciary duty and dilution claims are "traditionally understood as derivative"); Orlinsky v. Patraka, 971 So.2d 796, 801-02 (Fla. Dist. Ct. App. 2008) (stating under Florida law that claim concerning "disguised distribution" should have been brought as derivative action for breach of fiduciary duty). Similarly, "[c]orporate waste is a "classic" derivative harm . . . because it diminishes the value of the corporation as a whole and entitles the corporation to recover damages." Penn Mont Secs.v. Frucher, 502 F. Supp. 2d 443, 463 (E.D. Penn. 2007) (citing Winston v. Mandor, 710 A.2d 835, 845 (Del. Ch. 1997) and Kramer v. W. Pac. Indus., 546 A.2d 348, 353 (Del. 1988)) (applying Tooley test to claims of corporate waste, determining derivative injury, and dismissing claims).

In a Southern District of New York case where a corporate board of directors sold assets of the corporation and did not distribute the proceeds ratably to all stockholders but instead distributed cash proceeds to some third parties—resulting in a reduction of the amount to be paid to the plaintiff stockholder—the court determined that the claims really alleged a diminution of value of stock because of the mismanagement. See Burghart v. Landau, 821 F. Supp. 173, 177 (S.D.N.Y. 1993) (applying Delaware law). Accordingly, the court held it was "precisely the type

of claim that . . . is derivative in nature and may not be the subject of a suit by an individual stockholder seeking recovery for his personal loss." Id.; see also Fidelity & Cas. Co. of N.Y. v. Metro. Life Ins. Co., 248 N.Y.S.2d 559, 572 (N.Y. Sup. Ct. 1963) (stating in context of inequitable dividends from mutual insurance company that contesting such business operations and charging waste or mismanagement "must be litigated in an appropriate derivative action," but holding in favor of defendants on the merits).

Likewise, in another case applying Delaware law, a federal court determined allegations that a mutual fund (Fund) was mismanaged by making improper payments "fail[ed] to allege any injury independent of the alleged injury to the Funds." In re Goldman Sachs Mut. Funds Fee Litig., No. 04 Civ. 2567(NRB), 2006 WL 126772, at *5-6 (S.D.N.Y. Jan. 17, 2006) (applying Tooley standard requiring direct injury independent of injury to corporation). The plaintiffs in Goldman Sachs argued that although in a traditional corporation an increase in expenses would not necessarily impact the shareholders' stock, in a mutual fund, any increase in the Fund's expenses automatically affected the shareholders' price because the shareholders own the assets of the Fund. See id. at *6. The court ruled, however, that such an injury was "not independent of any injury suffered by the Funds," and the plaintiffs were only injured secondarily in proportion to their pro rata investment in the Fund. See id.; see also Reget v. Paige, 626 N.W.2d 302, 308-10 (Wis. Ct. App. 2001) (ruling under Wisconsin law that individual claims for breach of fiduciary duty would have to show injury personal to plaintiff rather than primarily to corporation, and therefore dismissing claims for nonpayment of dividends and corporate waste through overcompensation of employees as derivative in nature). The Goldman Sachs plaintiffs also argued that the Fund owed them duties directly, but because the "plaintiffs [could not] allege any injury independent from that suffered by the Funds," the Court dismissed the direct counts

under the Tooley test of "who suffered the harm alleged and who would receive the benefit of a recovery." Goldman Sachs, 2006 WL 126772 at *7.

Considering solely who suffered the harm and who would receive the benefit, this Court is convinced that, here, Plaintiffs' claims are derivative in nature. First, Beacon suffered the alleged harm, and second, Beacon would receive the benefit of any recovery. See Tooley, 845 A.2d at 1039 (setting forth two-part test to determine whether suit is derivative in nature); Marsh, 2006 WL 2555911 at *4 (applying Tooley test).

The alleged harm set forth in the pleading relates to a "systematic scheme to divert over $101 million to a small percent of its policyholders" by granting consent-to-rate discounts to select policyholders. (Compl. ¶ 28.) Plaintiffs further allege in the Complaint that Beacon engaged in "favoritism and bias in pricing; inappropriate and lavish spending . . ." and "operated in a corrupt, improper and unlawful manner." See generally Compl. ¶¶ 25-33. In essence, the Complaint claims that Beacon made illegal distributions from the corporate coffers in the form of the consent-to-rate discounts. Plaintiffs brought claims for breach of fiduciary duty, breach of good faith and fair dealing, and unjust enrichment. Plaintiffs seek "an accounting, restitution and/or damages, and an injunction prohibiting Defendants from engaging in the unlawful activity . . . in the future. See Compl. ¶¶ 54, 61, 64.

The contested expenditures of Beacon in the form of consent-to-rate discounts primarily injures the corporation, not the Plaintiffs. See Dunn, 2005 WL 1125315 at *4 ("where the injury is to the corporation and only affects the shareholders incidentally, the action is derivative" (quoting Dowling, 735 F. Supp. 2d at 1113)). Diversion of funds from a corporation or mutual insurance company has been determined by other courts to give rise to derivative causes of action, such as claims for breach of fiduciary duty or corporate waste. See Burghart, 821 F.

Supp. at 177 (ruling claim derivative in nature when board sold assets to some third parties rather than distributing proceeds ratably to shareholders); Goldman Sachs, 2006 WL 126772 at *5-7 (holding mutual fund's improper fee payments gave rise to derivative claim despite duties owed directly from Fund to plaintiffs and the affect on plaintiffs' assets in the Fund); Fidelity & Cas. Co., 248 N.Y.S.2d at 572 (noting that contesting business operations allegedly causing inequitable dividends must be litigated as derivative action). In the end, the consent-to-rate discounts made by Beacon diverted assets from the corporation, not from the Plaintiffs. Although those assets may have been later disbursed to the Plaintiffs through a dividend, Plaintiffs had no injury independent from that suffered by Beacon, if any injury was suffered. Tooley, 845 A.2d at 1039 (requiring harm suffered by plaintiff independent of that suffered by the corporation); Goldman Sachs, 2006 WL 126772 at *6-7.

The Plaintiffs here argue, among other things, that claims must be direct when the harm suffered by each shareholder or policyholder is not proportionate, and the claims are derivative only when the harm indirectly affects each owner equally in proportion to its ownership interest. See Pls.' Opp'n to Def.'s Mot. for J. on the Pleadings 2, 8 (citing Gatz, 2004 WL 3029868 at *8). Contrary to Plaintiffs' contention, the Delaware court in Gatz found multiple claims to be derivative and found only one which directly affected the liquidation status of a class of stock to be properly brought as a direct claim. See Gatz, 2004 WL 3029868 at *7-10. The count of the complaint in Gatz that survived as a direct claim related directly to entitling one class of stock to preferential liquidation status over the class of shares owned by the plaintiffs by way of an inside transaction. See id. at *7-8.[5] Applying the Tooley test to those facts, the court determined that

[5] Furthermore, the Delaware Chancery Court later ruled all of the plaintiffs' re-pled claims "clearly derivative under Tooley" and dismissed the amended complaint. See Gatz v. Ponsoldt, 2006 WL 1510467, at *1 (Del. Ch. May 26, 2006) (dismissing all claims as derivative); Gatz v.

the corporation suffered no harm because its overall value remained the same; meanwhile, the "book transaction" harmed the liquidation position of the plaintiffs, who would benefit directly by an unwinding of the transaction. See id.

This Court believes that singular finding in the Gatz lower court relied upon by Plaintiffs to be easily distinguishable. Stepping back for a moment, it is apparent that in many derivative claims, such as for self-dealing or usurpation of corporation opportunities, shareholders are not all harmed equally in proportion to their ownership interests, but the claims are correctly derivative in nature. This Court has in fact found that usurpation of corporate opportunities to the benefit of one shareholder over another "gives rise to a derivative claim." See Dunn, 2005 WL 1125315 at *5-6 (determining the diversion of assets and usurpation of corporate opportunities resulted in injury to the corporation). Accordingly, it is not necessary, as Plaintiffs contend, that all policyholders be injured equally or proportionally for the claim to be derivative in nature.

Under the second prong of the Tooley test, Beacon would receive the benefit of any remedy in this case. See Tooley 845 A.2d at 1032 (describing second prong of whether corporation or stockholders individually would receive recovery). Plaintiffs argue that the remedy here would be to the Plaintiffs and not Beacon because Beacon would be ordered to make an equitable distribution to the policyholders. See Pls.' Opp'n to Def.'s Mot. for J. on the Pleadings 11 (citing Kimberly-Clark Corp. v. Factory Mut. Ins. Co., 566 F.3d 541, 544 (5th Cir.

Ponsoldt, No. 174-N, 2005 WL 2709640, at *1-2 (Del. Ch. Oct. 14, 2005) (permitting plaintiffs to re-file complaint). However, the Delaware Supreme Court later found that the one "Recapitalization" claim could be brought directly because of its "expropriation of economic value and voting power" from the shareholders. Gatz v. Ponsoldt, 925 A.2d 1265, 1277-81 (Del. 2007) (relying on Gentille v. Rossette, 906 A.2d 91, 99-100 (Del. 2006) (noting one "transactional paradigm" that may be both derivative and direct when over-issuance of stock harms both the corporation and the individual shareholders' rights)).

2009)). Plaintiffs cite Kimberly-Clark for the proposition that a policyholder is entitled to receive its share of the distribution of excess surplus directly from a mutual insurance company. However, the court in Kimberly-Clark relied on the fact that the board of that mutual insurance company had declared distribution of a surplus. See 566 F.3d at 548-49, 551-52 ("policyholders who contribute to a surplus are equitably 'entitled' to a share of any announced surplus distribution . . ." (emphasis added)). The court explained:

> "a corporate board has the discretion to manage the 'timing, amount, and method' of a surplus distribution but once a distribution's timing, amount and method is declared, the distribution funds no longer constitute the company's property; instead, the funds become the joint asset held by the members who are policyholders at the distribution's operative date." Id. at 549.

Therefore, only once a surplus distribution is announced or declared are the policyholders entitled to participate in the distribution. See id. at 551. The board in Kimberly-Clark attempted to deny distributions to the plaintiff and any other policyholders who did not renew within a certain timeframe. Id. at 543. The court ruled specifically that a distribution, once announced, could not then be conditioned on renewal of the policy. See id. at 551-52.

Here, however, the Court has already stated that "[e]ven if the Plaintiffs were successful in establishing that the Defendants breached their fiduciary duty and implied duties of good faith and fair dealing . . . they would still have no right to compel the payment of dividends." Heritage Healthcare Servs., 2011 WL 202299, slip op. at 19-20. There is no declared dividend here, and as such, no direct right of the Plaintiffs to an equitable distribution. See Compl. ¶ 31 (acknowledging that no dividends were distributed to all policyholders from 2002 to 2004); Kimberly-Clark, 566 F.3d at 548-52 (providing policyholder entitled to equitable distribution of dividend only after board declares dividend); see also 3 Steven Plitt et al., Couch on Insurance 3d § 39:40, n.5 (2011) (providing mutual insurance policyholder entitled to participate in annual

surplus but has no right to any particular amount of dividends); 5 Steven Plitt et al., Couch on Insurance 3d § 80:51 (2005) (explaining in discretion of board or officers to determine how much of surplus to distribute to policyholders). In contrast to there being a declared dividend in which Plaintiffs would be entitled to share, Plaintiffs' Complaint alleges the improper distributions were "in the form of lower net premiums." (Compl. ¶ 30.)

Because no dividend has been declared by the Board and the Board would have to declare a dividend for the policyholders to be entitled to one, any remedy flows directly to Beacon, not the Plaintiffs. See 2003 R.I. Pub. Law ch. 410 § 10(6) (presenting Board power to declare dividends). It is clear to the Court that Beacon's Board is and was under no obligation to distribute dividends to its policyholders. Even if Beacon had not issued any consent-to-rate discounts and, as a result, retained an excess of assets over liabilities and surplus requirements, the Board would not be required to issue a dividend. See 2003 R.I. Pub. Law ch. 410 § 10(6) (providing Board "may" declare dividends); Downey v. Carcieri, 996 A.2d 1144, 1151 (R.I. 2010) ("axiomatic principle of statutory construction that the use of the term 'may' denotes a permissive, rather than an imperative, condition"). The remedy here would require the Board to reconvene and determine whether to declare a dividend in favor of the Plaintiffs; therefore, Plaintiffs' eventual recovery would not be independent of the injury to the corporation and would first require recovery by Beacon. See Heritage Healthcare Servs., 2011 WL 202299, slip op. at 19-20 (finding actual remedy would include "injunction compelling Beacon's board to convene and consider whether . . . a dividend should have been declared"); Tooley, 845 A.2d at 1039 (requiring direct claim be independent of injury to corporation and that plaintiff demonstrate he/she could prevail without first showing injury to the corporation); Goldman Sachs, 2006 WL 126772 at *5-7 (denying direct claim where plaintiff could not allege injury independent from

that suffered by the Fund); Dunn, 2005 WL 1125315 at *6 (requiring plaintiff show "wrong . . . that exists independently of the corporation's right"). Plaintiffs' recovery here is dependent on Beacon.

Therefore, under the Tooley test as applied by this Court to Rhode Island law, Plaintiffs' claims are derivative in nature. The alleged breach of fiduciary duties, breach of good faith and fair dealing, and unjust enrichment harmed Beacon primarily and the policyholders only incidentally. See Dunn, 2005 WL 1125315 at *4-5. Beacon would receive the benefit of any recovery in this matter, and Plaintiffs would benefit only incidentally if Beacon were to declare dividends. See Heritage Healthcare Servs., 2011 WL 202299, slip op. at 19-20.

B

Requirements for Derivative Action

Because the Court has determined that Plaintiffs' claims are derivative in nature, it is necessary that the lawsuit complied with the requirements of § 7-1.2-711(c) and Super. R. Civ. P. 23.1. Section 7-1.2-711(c) sets forth the requirement of a demand prior to initiation of a derivative action, providing, in pertinent part:

> "No shareholder may commence a derivative proceeding until:
>
> (1) A written demand had been made upon the corporation to take suitable action; and
>
> (2) Ninety (90) days have expired from the date the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the ninety (90) day period."

Further, the Superior Court Rules of Civil Procedure provide pleading requirements for derivative actions by shareholders, stating, in pertinent part:

> "In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having

> failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interest of the shareholders or members similarly situated in enforcing the right of the corporation or association." Super. R. Civ. P. 23.1.

Considering both requirements for the filing of a derivative action, it is evident that a derivative lawsuit may not commence until a written demand has been made upon the corporation, time has passed or the demand has been rejected by the corporation, and a verified complaint is filed, that complaint alleging with particularity the efforts to obtain the action from the directors of the corporation. See § 7-1.2-711(c); Super. R. Civ. P. 23.1.

Here, Plaintiffs' Complaint makes no averment regarding a demand on the Board or the futility of making such a demand. Even judged in the light most favorable to the Plaintiffs, there is no debate that the pleading does not comply with the requirements for bringing a derivative action. See § 7-1.2-711(c); Super. R. Civ. P. 23.1; Haley, 611 A.2d at 847 (providing standard for judgment on the pleadings). The proper remedy for failure to comply with those requirements is dismissal. See Giuliano, 793 A.2d at 1037 (affirming dismissal of direct claims that were derivative in nature and failed to comply with Rule 23.1); Dunn, 2005 WL 1125315 at *7. Accordingly, the Court dismisses all Counts of Plaintiffs' Complaint.

IV

Conclusion

After due consideration, the Court grants Beacon's Motion for Judgment on the Pleadings and dismisses Plaintiffs' Complaint. Plaintiffs' claims were derivative in nature and failed to comply with the requirements for filing a derivative action. Prevailing counsel shall present an Order consistent herewith which shall be settled after due notice to counsel of record.