UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

In re MEDCISION, LLC, Debtor,	Case No. 20-cv-06028-RS
MEDCISION, LLC, Plaintiff/Appellant, v. BLAIR W. STEWART, PAT NOWAK, RODNEY TURNER, AND HEINER DREISMANN, Defendants/Appellees.	Bankr. Case No. 17-31272 HLB Bankr. Adv. Pro. No. 19-03059 HLB **ORDER AFFIRMING JUDGMENT IN BANKRUPTCY ADVERSARY PROCEEDING**

I. INTRODUCTION

In the bankruptcy adversary proceeding that gave rise to this appeal, debtor MedCision, LLC, sued its former officers and outside directors, alleging they had breached their fiduciary duties to the company in various respects. The bankruptcy court denied a motion to dismiss the first amended complaint as to the CEO and the CFO, and they are not parties to the appeal. As to the outside directors, however, the court elected to treat the motion as one for summary judgment, and granted it. In essence, the court concluded the pleaded facts did not show a breach of the duty of loyalty, and any claim for breach of the duty of care was foreclosed by an exculpatory provision in MedCision's operating agreement.

On appeal, MedCision contends the court erred in converting the motion to dismiss into

one for summary judgment and/or gave insufficient notice before doing do, should not have considered the exculpatory provision, and reached the wrong conclusion as to whether the complaint presented viable claims against the outside directors. Because these contentions all fail, the decision of the bankruptcy court will be affirmed.

II. BACKGROUND

The operative first amended complaint alleged that MedCision, formerly known as BioCision, LLC, was founded in 2008 as a Delaware limited liability company to develop medical products and devices. The appellees herein, Blair W. Stewart, Paul Nowak (misnamed as Pat), Rodney Turner, and Heiner Dreismann were independent members of the board of directors. There is no allegation that any of these outside directors was ever an officer or employee of MedCision.

Dr. Rolf Ehrhardt was a founding member and manager of MedCision, as well as the Chief Executive Officer and Chairman of the Board. Ron DiNocco was MedCision's Chief Financial Officer. As noted, the motion to dismiss was denied as to Ehrhardt and DiNocco and they are not parties to this appeal.

MedCision had perennial financial struggles. It sold assets to Brooks Automation, Inc; it borrowed money from BroadOak Capital Partners, LLC; it sought a large investment from a German company; it sought potential acquirors; and it ultimately laid off employees. MedCision exhausted its funds by the end of 2017.

The complaint alleges BroadOak presented a financing proposal that was rejected by the board at the direction of Ehrhardt and DiNocco. It also asserts the board improperly approved compensation, severance, and other payments for Ehrhardt and DiNocco. Nothing in the complaint, however, suggests any outside director ever obtained any illicit payment or had a personal financial interest in the challenged transactions. MedCision filed for Chapter 7 bankruptcy in December of 2017, which subsequently was converted into a proceeding under Chapter 11 bankruptcy.

BroadOak eventually purchased MedCision's remaining assets. The gravamen of the adversary proceeding is that but for defendants' various acts of malfeasance during the final months prior to bankruptcy, there would have been more value returned to its members.

It is undisputed that The Limited Liability Company Operating Agreement of BioCision, LLC, Amended and Restated as of March 12, 2014 was MedCision's governing operating agreement at all relevant times. Section 11.11 of that agreement provides no "Member, Director or Manager shall have personal liability to the Company" for any "breach of such Member's, Director's or Manager's fiduciary duty (if any) or for any act or omission performed or omitted by such Person in good faith on behalf of the Company."

III. STANDARD OF REVIEW

The bankruptcy court's ruling on summary judgment is reviewed *de novo*. *In re Fernandez*, 227 B.R. 174, 180 (B.A.P. 9th Cir. 1998). Summary judgment is appropriate where "the movant shows there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); Fed. R. Bankr. P. 7056. In reviewing a grant of summary judgment, the evidence is viewed, "in the light most favorable to the party against whom the . . . court ruled." *Allen v. A.H. Robins Co., Inc*., 752 F.2d 1365, 1368 (9th Cir. 1985).

A court's decision to convert a motion to dismiss to a motion for summary judgment *sua sponte* is reviewed for abuse of discretion. *Salveson v. W. States Bankcard Ass'n*, 731 F.2d 1423, 1430 (9th Cir. 1984). A decision to take judicial notice is also reviewed for abuse of discretion. *Madeja v. Olympic Packers*, LLC, 310 F.3d 628, 639 (9th Cir. 2002).

The decision of the bankruptcy court may be affirmed for any reason supported by the record and a court of review generally must "ignore harmless error." *In re Mbunda*, 484 B.R. at 355 (2012)(citing Fed. R. Civ. P. 61; Fed. R. Bankr. P. 9005; 28 U.S.C. § 2111).

IV. DISCUSSION

A. The summary judgment ruling

As noted, MedCision complains the motion to dismiss should not have been treated as one for summary judgment. Its initial argument, however, is that if the matter is viewed through the summary judgment lens, the motion should have been denied because defendants failed to present evidence—other than the exculpatory provision in the operating agreement—to support their arguments.

MedCision insists defendants were obligated to "produce evidence that Plaintiff would be unable to carry its ultimate burden at trial." That is not a defendant's burden on summary judgment. Rather, a defendant "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the pleadings and admissions on file, together with the affidavits, if any, which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, (1986) (citations and internal quotation marks omitted). In the language of Rule 56, summary judgment is proper "if the pleadings and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c).

Here, of course, defendants had not framed their motion as one for summary judgment, but when the court elected to treat it as such, it satisfied that initial burden. The motion explained why defendants contended they would be entitled to judgment as a matter of law even if MedCision proved all of the factual allegations (as opposed to conclusory assertions) in the complaint. Defendants had presented the one piece of evidence beyond the face of the complaint on which their motion relied—the exculpatory provision in the operating agreement—through a request for judicial notice and/or an argument that it could be considered as sufficiently implicated by the complaint and not subject to dispute. Although MedCision objected to taking judicial notice of the document, or otherwise considering it in the context of a motion to dismiss, it certainly could be

considered in the summary judgment context,[1] and MedCision never questioned its authenticity or that it remained in effect during the relevant times. Accordingly, MedCision's contention that summary judgment was improper on the basis that the outside directors failed to meet their evidentiary burden is without merit.

B. Converting the motion to dismiss

MedCision's challenge to the conversion of the motion to dismiss into one for summary judgment has three prongs. First, MedCision contends conversion was improper because the motion to dismiss did not rely on matters beyond what may properly be considered on such motions. MedCision points out that defendants had requested consideration of the exculpatory clause through a request for judicial notice. *See Lee v. City of Los Angeles*, 250 F.3d 668, 689 (9th Cir. 2001)("A court may take judicial notice of 'matters of public record' without converting a motion to dismiss into a motion for summary judgment.")

MedCision also notes the court found the complaint "invoke[d] the Operating Agreement to a degree sufficient to justify its consideration in connection with the Motion." Relying on *United States ex rel. Lee v. Corinthian Colls*., 655 F.3d 984, 999 (9th Cir. 2011), MedCision argues, "[t]his further demonstrates that this is not a matter outside the pleadings since it is a document relied on in the FAC."

While it is certainly true that the court would have had no occasion to convert the motion if the operating agreement were properly the subject of judicial notice, MedCision is ignoring the fact that it strenuously argued to the bankruptcy court, and continues to insist on appeal, that judicial notice would *not* have been permissible. Similarly, notwithstanding the court's observation that the complaint effectively invoked the operating agreement and MedCision's curious concession that it thereby was "not outside the pleadings," there was at least some

[1] Indeed, that appears to be exactly why the court elected to treat the motion as one for summary judgment.

uncertainty as to whether the exculpatory provision could properly be considered in the context of a motion to dismiss. The court's decision to avoid that uncertainty by treating the matter as summary judgment may have been "erring on the side of caution," but it was not error.

MedCision next contends it was entitled to greater notice once the court decided to convert the motion. Rule 12(d) of the Federal Rules of Civil Procedure provides that when a motion to dismiss is converted, "[a]ll parties must be given a reasonable opportunity to present all the material that is pertinent to the motion." While many circumstances can be envisioned where a party would need more than the two days' notice afforded to MedCision, additional time would have served no purpose here. MedCision was already aware that the court had been asked to consider the exculpatory provision and had been provided authority in support of the propriety of doing so. While MedCision may have believed those authorities were insufficient, it knew the court might very well disagree and take the exculpatory provision into account. MedCision therefore had already briefed its position as to why it believed it should prevail even if the court were to evaluate the exculpatory provision through judicial notice or otherwise.[2]

MedCision cannot reasonably contend that it needed more time to respond to the motion or that there was additional or different material to present under the summary judgment framework that had not been implicated at the time it was still only a motion to dismiss. Accordingly, the court did not err in providing only a short notice period.

Finally, MedCision argues it should have been given the opportunity to conduct discovery in light of the court's election to treat the motion as one for summary judgment. Again, however, further discovery simply was not implicated by the conversion in these circumstances. MedCision does not contest the existence or authenticity of the exculpation provision—only its legal effect. MedCision did not identify to the bankruptcy court, and has not identified on appeal, any potential discovery that would have been pertinent.

[2] Furthermore, on appeal MedCision has now conceded it would have been proper for the court to consider the operating agreement as a matter not outside the pleadings.

3. The sufficiency of the claims

The court's ruling on the first amended complaint came in the context of its prior ruling on the initial complaint. The court observed that its first order had given MedCision "clear instructions as to how it could ensure that its FAC would survive a motion to dismiss." The court "unfortunately" concluded that, "even with the benefit of these clear directives, the FAC does not pass muster. With respect to the Outside Directors, it contains nothing more than boilerplate, conclusory allegations . . . ."

On appeal, MedCision has failed to show that characterization of the complaint to be unfounded. Particularly with respect to allegations directed at the duty of loyalty, the complaint even as amended is devoid of facts plausibly suggesting the outside directors were not independent or had a financial interest in any of the challenged transactions. The court did not err in concluding that the first amended complaint fails to support any claim against the outside directors for a breach of the duty of loyalty.[3]

As the court noted, MedCision's allegations as to breach of the duty of care are slightly stronger, in that they suggest the outside directors permitted or ratified various transactions without undertaking a reasonable effort to inform themselves of the necessary facts or without appropriate deliberation. As the court correctly held, however, even those allegations "fall flat" in light of the exculpatory provision. When confronted with provisions like the one here, courts routinely find they entirely shield directors from liability for alleged breaches of the duty of care. *See*, *e.g.*, *Arnold v. Soc. For Sav. Bankcorp, Inc*., 650 A.2d 1270, 1290 (Del. 1994) (exculpation clause in certificate of incorporation shielded directors from liability); *In re Paypal Holdings, Inc. Shareholder Derivative Litigation*, 2018 WL 466527, *3 (N.D. Cal. Jan. 18, 2018) ("a serious threat of liability may only be found to exist if the plaintiffs plead a non-exculpated claim, which

[3] The duty of good faith, which MedCision also invokes, is not free-standing. Instead, bad faith is an element of a breach of the duty of loyalty. See *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

requires plaintiffs to allege particularized facts showing that the directors engaged in disloyal, fraudulent, illegal or bad faith conduct and acted with scienter. Negligent or even reckless conduct is insufficient").

Finally, while MedCision objected to any consideration of the exculpation provision and argues it would not bar claims for breach of the duty of loyalty, it tacitly concedes it precludes claims based on the duty of care. Thus, the court correctly concluded there were no viable claims against the outside directors.[4]

V. CONCLUSION

The decision and judgment of the bankruptcy court as to the outside directors is affirmed.

IT IS SO ORDERED.

Dated: August 5, 2021

RICHARD SEEBORG
Chief United States District Judge

[4] The final error MedCision asserts the court committed was failing to deny the request for judicial notice. The court, however, never expressly granted the request, and plainly was entitled to consider the operating agreement as evidence in the context of summary judgment. No error appears.