IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
CIVIL ACTION NO.: 3:14-CV-577-RJC-DCK

EDDIE BOLLMEIER, BILL TRACEY and, SIMON PARROTT,

Plaintiffs,

v.

ROBERT FREAR, COURTNEY BORMAN, RONALD NELSON, PAUL DIORIO and PAUL MUSIC,

Defendants.

COURTNEY BORMAN,

Third-Party Plaintiff,

v.

US AIRLINE PILOTS ASSOCIATION,

Third-Party Defendant.

GARY HUMMEL, STEPHEN BRADFORD, ROB STREBLE, STEVE SMYSER, JOHN TAYLOR, JOE STEIN, PETE DUGSTAD, JAY MILKEY and STEPHEN NATHAN

Third-Party Plaintiffs

v.

US AIRLINE PILOTS ASSOCIATION,

Third-Party Defendant.

MEMORANDUM OF LAW IN SUPPORT OF RULE 12(b)(6) MOTIONS TO DISMISS THIRD-PARTY COMPLAINTS [DOCS. 100 & 101]

Plaintiffs Eddie Bollmeier, Bill Tracy, and Simon Parrott (Collectively LMRDA Plaintiffs), in derivative capacity on behalf of US Airline Pilots Association (USAPA), submit this Memorandum of Law in Support of Rule 12(b)(6) Motions to Dismiss the Third-Party Complaint filed by Defendant Courtney Borman's [Doc. 100] and the Third-Party Complaint filed by Defendants Gary Hummel, Stephen Bradford, Rob Streble, Steve Smyser, John Taylor, Joe Stein, Pete Dugstad, Jay Milkey and Stephen Nathan [101].

INTRODUCTION

Defendants, former and current USAPA officers and current and former members of the Board of Pilot Representatives (BPR), filed Third-Party claims seeking contract indemnity from USAPA for the LMRDA § 501(b) claims brought by Plaintiffs, in a derivative capacity on behalf of USAPA. Such claims must fail as matters of law because: (1) LMRDA claims such as this are handled in a manner analogous to shareholder derivative lawsuits; and (2) in such matters, the corporate entity cannot indemnify its officers for liability to the entity. The Court, therefore, should dismiss the Third-Party Complaints [Docs. 100 & 101] with prejudice and without leave to amend.

STANDARD OF DECISION

A motion to dismiss pursuant to Rule 12(b)(6), Federal Rule of Civil Procedure, tests the "legal sufficiency of the complaint" but "does not resolve contests surrounding the facts, the merits of a claim, or the applicability of defenses." *Republican Party of N.C. v. Martin*, 980 F.2d 943, 952 (4th Cir. 1992); *Eastern Shore Markets, Inc. v. J.D. Assoc. Ltd. Partnership*, 213 F.3d 175, 180 (4th Cir. 2000). "Although for the purposes of this motion to dismiss [a court] must take all the factual allegations in the complaint as true, [it is] not bound to accept as true a legal conclusion couched as a factual allegation." *Papasan v. Allain*, 478 U.S. 265, 286 (1986).

To state a valid third-party indemnity claim, Defendants/Third-Party Plaintiffs had to allege facts that, if proven, would show they have a right to such indemnification from USAPA. LMRDA Plaintiffs show that, as a matter of law, they cannot do so.

CURRENT AND FORMER OFFICERS AND BPR MEMBERS SEEK INDEMNIFICATION FROM USAPA FOR DERIVATIVE LMRDA § 501(b) CLAIMS BROUGHT ON BEHALF OF USAPA.

With their Answers to the LMRDA Plaintiffs' Complaint [Doc. 1], Defendants/Third-Party Plaintiffs state Third-Party Claims against USAPA for contract indemnification pursuant to Article VIII, Section 2 of the USAPA Constitution and Bylaws. [Doc. 100 at 7, ¶ 1; Doc. 101 at 8, ¶ 1.] This section of the USAPA Constitution and Bylaws states that USAPA is required to indemnify "to the extent permitted by law," for all liability arising from actions of "members of the Board of Pilot Representatives, National Officers, and committee members, as well as other members authorized by USAPA to act on its behalf." [Doc. 100 at 9, ¶ 10; Doc. 101 at 10, ¶ 19.]

The LMRDA Plaintiffs made the LMRDA § 501(b) claims here in a derivative capacity for breach of § 501(a) duties owed to USAPA. [Doc. 1 at 14, ¶ 40 ("Defendants violated their section 501(a) duties to hold USAPA's money solely for the benefit of its members and to expend such monies only in accordance with USAPA's constitution and bylaws."). Defendants/Third-Party Plaintiffs violated such duties as current or former USAPA officers or members of the USAPA BPR. [Doc. 1 at 2, ¶ 3.]

An LMRDA § 501(b) claim is akin to a shareholder derivative action in that the plaintiff workers seek damages on behalf of the union entity, not for themselves personally. 29 U.S.C. § 501(b); *Phillips v. Osborne*, 403 F. 2d 826, 831 (9th Cir. 1968) ("Section 501(b) makes it clear that relief granted under Section 501 is for the benefit of the real party in interest, the union whose officers are charged with dereliction."). Hence, courts recognize that "Congress … turned to the concept of the shareholders' derivative suit when designing the procedures by which union members could fulfill their 'policing functions'

within their labor organization." *Reed v. United Transp. Union*, 633 F. Supp. 1516, 1527 (W.D. N.C. 1986) (*see also Int'l Union of Operating Eng'rs, Local 150, AFL-CIO v. Ward*, 563 F.3d 276, 279 (7th Cir. 2009) ("Because these member suits serve to benefit the union, they are derivative, much like shareholder derivative suits brought on behalf of corporations."); *O'Hara v. Teamsters Union Local# 856*, 151 F. 3d 1152, 1161 (9th Cir. 1998) ("As both the case law and the statutory language indicate, section 501 suits are similar to shareholder derivative actions, in which a plaintiff brings an action in which 'any relief obtained ... shall benefit the corporation as a whole and not the suing individual directly.'").

Defendants/Third-Party Plaintiffs made Third-Party claims against USAPA seeking indemnity for expenses incurred defending and liability arising from these LMRDA § 501(b) claims. In other words, Defendants/Third-Party Plaintiffs seek to be indemnified by USAPA for the costs incurred defending and the liability arising from claims against them brought in a derivative capacity on behalf of USAPA. In effect, they want USAPA to pay for all the harm they caused to USAPA.

USAPA MAY NOT INDEMNFY THE CLAIMS AT ISSUE

Because Defendants/Third-Party Plaintiffs and their allies control USAPA, the LMRDA Plaintiffs expect that USAPA, through its current General Counsel, will not object to the indemnity claims at issue.[1] The Court must not allow this. It must not allow

[1] The Defendants have raised advice of counsel as an affirmative defense, essentially claiming that USAPA's General Counsel advised them that they could spend USAPA funds on seniority-related matters post decertification without risk. So far that advice has proven wrong, so the Defendants have now initiated a claim for indemnity in their Third-Party Complaint. The LMRDA Plaintiffs' position is that USAPA's General Counsel is now conflicted from responding on behalf of USAPA. If USAPA, through its General Counsel, correctly responds by denying the indemnity claim, then the General Counsel will be exposing itself to yet another bad "advice of counsel" claim. To avoid that, USAPA's General Counsel may be inclined to respond for USAPA admitting that the indemnity claim is well taken when it is not.

USAPA and its General Counsel to agree to pay the litigation expenses incurred defending against these claims and covering any liability the LMRDA Defendants might owe to USAPA on the LMRDA § 501(b) claims. Were it otherwise, USAPA would have no net remedy on these claims because it would be paying back to these officers and agents all the damages and more that it would receive on such claims.

It does not matter that the indemnity provision in the USAPA constitution purports to provide broad indemnification to USAPA officers and its BPR members. Any such indemnification is, as recognized in the USAPA constitution and bylaws, limited "to the extent allowed by law." As explained below, as a matter of law USAPA cannot provide such indemnification. These claims, then, must be dismissed because they fail to state a claim upon which relief can be granted.

First, as noted above, the Court should look to the law of shareholders' derivative suits when addressing a union member's LMRDA § 501(b) lawsuit. *See Reed*, 633 F. Supp. at 1527. In the contexts of both for-profit and not-for-profit corporations,[2] North Carolina law (using identical language) provides that a company officer or agent cannot be indemnified for liability owed to the company:

Then there is the additional issue about whether the Officers or Board of Pilot Representatives are capable of making an unbiased decision for USAPA about "their" indemnity claim. USAPA's entire current leadership (except for current Secretary/Treasurer John Owens) are the ones seeking indemnity protection from USAPA so they are not in a position to commit USAPA to pay themselves for the financial harm they might suffer in this case.

[2] USAPA is a private, not-for-profit entity. North Carolina laws do not address derivative suits in the context of not-for-profit entities, thus our explanation of what the North Carolina law is for corporations. The point is, directors and officers of non-profit organizations should not fare better than their corporation counterparts.

> A corporation shall not indemnify a director under this section:
>
> (1) In connection with a proceeding by or in the right of the corporation in which the director was adjudged liable to the corporation; or
>
> (2) In connection with any other proceeding charging improper personal benefit to the director, whether or not involving action in his official capacity, in which the director was adjudged liable on the basis that personal benefit was improperly received by the director.

N.C.G.S. § 55-8-51(d) & 55A-8-51(d). USAPA's officers and BPR members have positions analogous to corporate directors because they were the final decision makers for disbursement of the funds at issue. Under North Carolina corporate law, therefore, a labor union cannot indemnify its officers and agents for liability incurred to the union, whether such claims are made directly or in a derivative capacity.

Second, the North Carolina Court of Appeals recently recognized in *Malone v. Barnette*, ___ N.C. App. ___, ___, 772 S.E. 2d 256 (2015), that an indemnification provision must not be interpreted so as to be inconsistent with federal law. *Id.* at 261 (recognizing that the indemnification at issue must not be "inconsistent with the requirements of the Federal Motor Carrier Safety Act."). Thus, the indemnification provision in USAPA's constitution must not be interpreted so as to be inconsistent with the LMRDA.

LMRDA § 501(b) expressly provides that a union member may bring a derivative lawsuit on behalf of the union against its officers to recover misspent funds: "[A] member may sue such officer, agent, shop steward, or representative in any district court of the United States or in any State court of competent jurisdiction to recover damages or secure an accounting or other appropriate relief for the benefit of the labor organization." 29 U.S.C. § 501(b). Courts, therefore, should limit indemnification provided by a union to the extent necessary to prevent such indemnification from nullifying the relief available under § 501(b). In other words, the rule in N.C.G.S. § 55-8-51(d) & 55A-8-51(d) should limit indemnification allowable for an LMRDA § 501(b) claim.

Finally, common sense tells us that USAPA cannot indemnify its officers and BPR members for the LMRDA § 501(b) claims here. As explained above, indemnification of a § 501(b) claim would nullify all relief USAPA might obtain on such claims. In effect, it would have the same effect as a provision that directly stated that union officers were permitted to violate the rights under § 501(a) without the risk of any financial harm. Surely, a union—such as USAPA—that it still under the control of the offending officers and representatives (and/or their allies) cannot use provisions in USAPA's Constitution to directly nullify federal law for their own personal benefit. If a union cannot do this directly, it cannot do this by operation of an indemnity provision.

In sum, there are three compelling reasons why the Court should hold that USAPA cannot use its funds to indemnify its officers and BPR members for liability arising from the derivative LMRDA § 501(b) claims at issue. First, such indemnification would be inconsistent with state law that does not allow a corporation to indemnify directors for claims brought by the company against those directors. Second, such indemnification would conflict with the intent of Congress to provide a meaningful remedy for violations of § 501(a). And finally, if the USAPA indemnification provision had such effect it would be tantamount to a provision expressly nullifying § 501(a) rights. For any one of these reasons, the Court should dismiss the Third-Party indemnity claims.

PLAINTIFFS HAVE DERIVATIVE STANDING TO MOVE TO DISMISS THESE CLAIMS

As in shareholder derivative litigation, LMRDA Plaintiffs are nominal parties only to the LMRDA § 501(b) claims. *Phillips*, 403 F. 2d at 831. USAPA is the real party in interest. *Id.* It stands to reason, though, that LMRDA Plaintiffs have standing to defend against such claims because they are appearing on behalf of USAPA to assert the underlying liability claims, which claims are the direct reason why the Defendants/Third-Party Plaintiffs are making these claims for indemnity. Because USAPA is controlled by the Defendants/Third-Party Plaintiffs and their allies, Plaintiffs reasonably believe USAPA

will not assert a proper defense to these indemnity claims any more than it would properly assert the LMRDA § 501(b) claims. It is entirely reasonable, therefore, that Plaintiffs should have derivative standing to make this Rule 12(b)(6) motion to dismiss.

CONCLUSION

The Court should grant Plaintiffs motion under Rule 12(b)(6) to dismiss the Third-Party claims at issue with prejudice and without leave to amend.

Dated this 20th day of January, 2016.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing Memorandum of Law in Support of Rule 12(b)(6) Motions to Dismiss Third-Party Complaints [Docs. 100 & 101] with the Clerk of the court using the CM/ECF system and that notification will be sent via that system to:

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This 20th day of January, 2016.

/s/ *Kelly J. Flood*