IN THE SUPREME COURT OF MISSISSIPPI

No. 2007-IA-01458-SCT

**INVESTOR RESOURCE SERVICES, INC.,
A FLORIDA CORPORATION;
BARBARA ARCHULETTA MORELLI,
and THE ESTATE OF BERNECE RIGIROZZI,** **APPELLANTS**

VS.

**MARVIN CATO, CHARLES CATO,
LAVERNE CATO, and RAINBOW
ENTERTAINMENT, INC.** **APPELLEES**

ON INTERLOCUTORY APPEAL FROM THE CIRCUIT COURT OF WASHINGTON COUNTY, MISSISSIPPI (Civil Action No. CI-2004-251)

BRIEF OF APPELLANTS

ORAL ARGUMENT REQUESTED

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CERTIFICATE OF INTERESTED PARTIES

In order that the Justices of this Court may evaluate possible disqualification or recusal, the undersigned certifies that the following persons have an interest in the outcome of this case:

A. **Plaintiffs/Appellants:** Investor Resource Services, Inc., a Florida Corporation, Barbara Archuletta Morelli, and the Estate of Bernece Rigirozzi.

B. **Aligned with Plaintiffs/Appellants:** Minority shareholders of Rainbow Entertainment, Inc., who, to the best of the Plaintiffs' knowledge, are the following: Michael Less, Joseph Getz, Clifton Lipman, O. T. Marshall, Pinson & Associates PA, Richard L. Macy, Rudy Marich, Richard M. Greene, Stephanie Arnold, Tracia Arnold Fields, Arlen Schultz, Dan Bland, Dr. Robert Fedor, Dr. Fred Leslie, Edward Immon, H. Frank Martin, the Estate of Hamp Bass, John Hill, Lynette Schultz, Mal Kretchmar, Phil Schoettle, and Rich McBride.

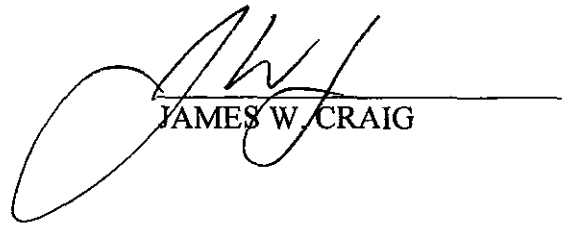
C. **Attorneys for Plaintiffs/Appellants:** Fred L. Banks, Jr., Jerome C. Hafter, James W. Craig, Elizabeth Jane Hicks, Lyle B. Robinson and the law firm of Phelps Dunbar LLP; Robert N. Hunter, Jr., Greensboro, North Carolina.

D. **Defendants/Appellees:** Marvin Cato, Lavern Cato, and Charles Cato ("Cato Defendants"), and Rainbow Entertainment, Inc. ("Rainbow")

E. **Attorneys for Cato Defendants and Rainbow:** John H. Daniels, III and the law firm of Dyer, Dyer, Jones and Daniels; the Hon. Willie Bailey and the law firm of Bailey & Griffin.

F. **Separate Counsel for Rainbow:** James P. Streetman, III, David Lee Gladden, Blayne T. Ingram, and the law firm Scott, Sullivan, Streetman & Fox.

SO CERTIFIED, this the 12th day of September, 2008.



JAMES W. CRAIG

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STATEMENT OF ISSUES

1. Whether the Circuit Court erred by granting Defendants' motion in limine and excluding the expert testimony of Dr. Glenda Glover, PhD., because Dr. Glover was not, at the time of her report and deposition, an actively practicing, licensed Certified Public Accountant.

2. Whether the Circuit Court erred by granting Defendants' motion in limine and excluding the expert testimony of Dr. Glenda Glover, PhD, because Dr. Glover was not "an expert in derivative actions" because she testified that the individual Plaintiffs suffered damages that were compensable in this action.

STATEMENT REGARDING ORAL ARGUMENT

The Plaintiffs respectfully request oral argument pursuant to Miss.R.App.P. 34. This case involves complex underlying facts regarding over six years of self-dealing transactions by officers and majority shareholders of a closely held corporation. Plaintiffs listed Dr. Glenda B. Glover, Ph.D., the Dean of the Business School of Jackson State University, as an expert witness on (1) the duties owed by the directors, officers, and majority shareholders of a closely held corporation to the corporation's minority shareholders, and (2) the damages suffered by the corporation and its minority shareholders as a result of the individual Defendants/Appellees breaches of said duties, and also as a result of fraudulent misrepresentations made by them to the Minority Shareholders, the Appellants here.

Without performing any *Daubert* analysis of the substance of Dr. Glover's opinions, the Circuit Court granted the motion in limine and excluded the witness' testimony because Dr. Glover was not, at the time of her report and deposition, an actively practicing, licensed Certified Public Accountant. The Circuit Court also ruled that Dr. Glover was not "an expert in derivative actions" because she testified that the individual Plaintiffs suffered damages that were compensable in this action.

The Minority Shareholder submits that this Court's understanding of the underlying facts, and the application of the controlling case law to these facts, would be greatly facilitated by oral argument.

STATEMENT OF THE CASE

A. Statement of Proceedings

This case dates back to 2002, when the original shareholder derivative action brought by certain of the shareholders of Rainbow Entertainment, Inc. ("Rainbow") was filed. The named Plaintiffs in this case, who are also the minority shareholders of Rainbow, intervened in that action; in 2004 their Complaint in Intervention was severed from the original action, and Plaintiffs were designated to serve as representative shareholders in this derivative action.

Plaintiffs seek money damages and other relief with respect to the injuries perpetrated upon Rainbow (the nominal corporate defendant) by Marvin Cato, Charles Cato and Lavern Cato (the "Cato Defendants"). Marvin and Laverne Cato are married; Charles Cato is their son.

In their First Amended Complaint, filed by leave of the Circuit Court on March 6, 2006 (R. 5), the named Plaintiffs, on behalf of all minority shareholders of Rainbow ("Minority Shareholders"), asserted both derivative claims on behalf of Rainbow as well as direct claims on behalf of the minority shareholders individually. The Cato Defendants own approximately 60% of the shares of Rainbow's stock and have, with a few brief and minor exceptions, served as the only directors and officers of Rainbow since it was incorporated in 1993. Rainbow's only substantial asset is its 20% ownership of Greenville Riverboat, LLC, which owns and operated the Lighthouse Point Casino in Greenville, Mississippi.

The vast majority of the damages that the Plaintiffs seek to recover are the result of self-dealing by the Cato Defendants or the conferring of improper financial benefits upon themselves at the expense of Rainbow. Because the Cato Defendants are the only directors of Rainbow, any

transaction between them and/or their affiliated companies and Rainbow would be a "director's conflicting interest transaction" under the Mississippi Business Corporation Act. Miss. Code Ann.§§ 79-4-8.60 et seq.

Despite extensive document discovery from Rainbow, and third party document discovery on banks, vendors, and other institutions, the Plaintiffs could not find any general ledger for the corporate accounts. To analyze these transactions, the Minority Shareholders engaged the services of Dr. Glenda Glover, Dean of the School of Business at Jackson State University ("Dr. Glover"). Dr. Glover's expert opinions are set forth in her original report of November 29, 2006, R. 152-251, and her supplemental report dated June 26, 2007. R. 321-391 ("the July 2007 Report"). She was deposed on February 28, 2007. R. 252-320 ("Glover Deposition").

Before forming any opinions, Dr. Glover had to reconstruct a "Schedule of Cash Disbursements" for Rainbow. See Schedules 6 and 6.1 to July 2007 Report, R. 363-91. This preliminary matter was necessary because Rainbow did not produce a complete general ledger or complete bank statements and cancelled checks to Plaintiffs.

From this schedule, Dr. Glover extracted more specific schedules, showing all payments made by Rainbow to Charles Cato and Marvin Cato (Schedule 3, R. 349-56), all payments made for private airplane travel (Schedule 4, R. 357-59), and all dividend payments (Schedule 5, R. 360-62).

Dr. Glover also assembled the documents setting forth Rainbow's income from Greenville Riverboat LLC, and created a schedule of that income. Schedule 2, R. 347-48.

Dr. Glover's substantive opinions encompassed the issues (1) whether the Cato Defendants breached their duties as corporate officers, directors and Minority Shareholders of

Rainbow and (2) the quantum of damages incurred by Rainbow and its minority shareholders as a result of the actions and omissions of the Cato Defendants as majority shareholders, directors and officers of Rainbow.

Shortly before the trial scheduled for August 27, 2007, Rainbow and the Cato Defendants filed a motion in limine seeking exclusion of Dr. Glover's testimony. R. 136. The motion alleged that Dr. Glover was not qualified to be an expert in shareholders' derivative actions; it did not, however, attack the Schedules to Dr. Glover's Report. This was not unexpected, since the authenticity of the underlying documentation for all of the schedules was admitted by the Defendants. R. 408-419.

The Minority Shareholders responded in opposition to the Motion. R. 396. After hearings on August 13 and 17, 2008 R. 575-627, the Circuit Court granted the motion on grounds that (1) Dr. Glover is not qualified to testify as an expert because she has not maintained the CPA license she formerly held; (2) Dr. Glover misrepresented herself as a CPA in active practice; and (3) Dr. Glover is not qualified on the subject of "derivative actions." R. 628.

The first two of these points were not raised or briefed by Defendants in their Motion. Rather, they were injected into the motion by argument of counsel at the hearing. The documents submitted to the Court by Defendants at the August 13/17 hearing on their motion showed that Dr. Glover at one time had a CPA license in the State of Mississippi, but that she had "failed to register" after 2001 and therefore was not in "Goodstanding" with the Board of Public Accountancy. Dr. Glover has since been reinstated as a CPA in Goodstanding in Mississippi. R. 652, and Tennessee, R. 653.

After a motion to reconsider the August 20 ruling was denied by the Circuit Court, the Minority Shareholders filed their Petition for Interlocutory Appeal with this Court on August 23,

2007. Rainbow and the Cato Defendants filed their response on September 7, 2007. By Order of September 25, 2007, this Court granted review of this appeal and stayed proceedings in the Circuit Court.

B. Statement of Facts

1. History of Rainbow Entertainment, Inc. Rainbow is a closely-held Mississippi corporation. The Cato Defendants have at all times relevant to this lawsuit controlled the Board of Directors of Rainbow. Since at least 1995, they have been the only directors of Rainbow. The Cato Defendants are also the only officers of Rainbow, having elected themselves President, Vice President and Secretary, respectively. Marvin Cato has owned a controlling (approximately 60%) interest in Rainbow since its inception, although there has been some testimony that Charles Cato may have purchased all or most of his father's stock.

The history of Rainbow can be viewed as consisting of three phases: (i) April 1993 to February 1995; (ii) February 1995 to the end of 2000; and (iii) 2001 to the present. R. 468-471; 500; 502; 532-34.

Phase I: Rainbow was formed in April 1993, on the same day on which it acquired its one significant asset, a lease from Greenville Marine Corporation ("Greenville Marine") for a site on Lake Ferguson in Washington County which was suitable for building a casino. The Cato Defendants had no expertise in the gaming industry; they had to bring in other parties to assist them. These included an architect, Tom Marshall, who had designed other casino projects and who prepared plans for the casino, initially to be called the Pot-of-Gold Casino. They also included Less, Getz & Lipman, which provided construction law advice, and the former Heidelberg, Woodliff law firm, which had experience in Mississippi gaming law. Finally, they included some of the Plaintiffs here: Investor Resource Services, Inc. ("Investor Resource"),

members of the Morelli family, and others who eventually became the Minority Shareholders in Rainbow. All of these parties would become minority shareholders of Rainbow.

In combination, these third parties developed plans, located experts in operating and managing casinos and sought financing for the project. In exchange for their services, these third parties received stock in Rainbow, and in some cases, rights to additional stock. The Cato Defendants' principal contribution to Rainbow was the Greenville Marine leasehold. However, the lease was nearly terminated because the Cato Defendants failed to make timely rental payments and were about to default on a $250,000 balloon payment required to retain the lease. The Cato Defendants had rejected financing arrangements developed by the prospective minority shareholders, and Rainbow had become virtually insolvent.

By late 1994, Rainbow had few options for going forward. At that time, through contacts developed by some of the prospective minority shareholders, Rainbow was brought into contact with Columbia Sussex Corporation ("Columbia Sussex"), a company in the hotel management business, which was also interested in river gaming and which had a vessel available which could be a suitable casino. A transaction was arranged with the assistance of those minority shareholders in which a new entity would be formed. Columbia Sussex or its subsidiary would own 80% of the new entity, and Rainbow would own 20% by virtue of its contribution of the site lease to the new entity. However, before this new transaction could be consummated, it was necessary for Investor Resource and the Morellis to loan funds to Rainbow and to pledge shares of stock in publicly-traded companies to Greenville Marine in order to convince Greenville Marine to waive defaults under the site lease and to forebear from terminating the lease until the casino project could be completed.

Phase II began with the formation in January 1995 of Greenville Riverboat, LLC ("Greenville Riverboat") by Wimar Tahoe Corporation ("Wimar Tahoe"), a subsidiary of Columbia Sussex, and Rainbow. Greenville Riverboat, using funds provided by Columbia Sussex, built the Lighthouse Point Casino, its land-based facilities and a Fairfield by Marriott Hotel. No action was required from Rainbow in this phase. In fact, the LLC Agreement of Greenville Riverboat specifically prohibited Rainbow from taking any role in management of the casino.

On the other hand, at this time, it became apparent that there were significant debts from Phase I which had not been paid by Rainbow while it was under the management of the Cato Defendants. These included (a) professional service of fees of the two law firms that had represented Rainbow, (b) the professional service fees of the architect, (c) management fees of Premier Gaming, the gaming management company which had been brought in to develop the Pot-of-Gold project, (d) unpaid rent to Greenville Marine on the site lease, and (e) the promissory note due to certain minority shareholders for saving the lease from default. During Phase II, most of these creditors obtained judgments for unpaid services.

Under Wimar Tahoe's management, the Lighthouse Point Casino was opened and quickly became a success. By the year 2000, Greenville Riverboat repaid the indebtedness incurred to build the Casino. At this point, when it became clear that Greenville Riverboat was about to start generating income that would be available to be distributed to Rainbow, the creditors who had obtained judgments against Rainbow began to garnish funds due to Rainbow from Greenville Riverboat. Greenville Riverboat interpled over $1 million into the United States District Court for the Southern District of Mississippi. These funds were eventually distributed

upon orders of United States District Judge Tom Lee to creditors to repay the debts which remained unpaid from Phase I, including those discussed in the previous paragraph.

Phase III began in January, 2001. As noted above, Greenville Riverboat was formed in early 1995, but it did not begin to generate sufficient income to distribute to Rainbow as a minority member until January, 2001. Prior to January, 2001, Rainbow had no income, but rather had net losses. Since that time, Rainbow's sole source of income has been the payments from its 20% equity ownership of Greenville Riverboat. After repayment of the indebtedness incurred by Wimar Tahoe in connection with the construction of the casino, and the payments to Rainbow's creditors through the interpleader, Greenville Riverboat has always generated positive earnings, resulting in fairly regular distributions (generally paid monthly) to Rainbow in respect of its 20% interest in the range of $2 million per year. Receipt of these revenues requires no on-going management activity on the part of Rainbow, which is, by the terms of the Greenville Riverboat LLC Agreement, required to be an inactive member of that company.

Greenville Riverboat has paid Rainbow at least $11.8 million in distributions since January, 2001. R. 347-48. The Cato Defendants have declared and allegedly paid dividends of $.22 per share since then, or approximately $2.2 million. R. 361-62. So then, Rainbow has received income of approximately $9.6 million beyond the distributions to the shareholders.

2. Current Financial Status of Rainbow

According to the most recent financial statements produced by the Defendants, as of June 30, 2006, Rainbow's management claimed that the company had assets of approximately $3.8 million. Approximately $1.5 million of this amount allegedly represents an investment by Rainbow in Emerald Star Casino and Resort, Inc., a separate Mississippi corporation substantially owned by Charles Cato. Also, approximately $480,000 of Rainbow's assets

consists of payables resulting from loans to Charles and Marvin Cato. The financial statements reflect approximately $280,000 in liabilities and approximately $3.5 million in equity. Therefore, since 2001, out of the $9.4 million income received by Rainbow but not paid out in dividends, the Cato Defendants have expended approximately $6.9 million of Rainbow's funds, and have lent just under $2.0 million of Rainbow's funds, to themselves or other businesses that they own.

By and large, Rainbow has nothing to show as a result of any the expenditures made by the Cato Defendants. The vast majority of these funds were expended in self-dealing transactions which benefited one or more of the Cato Defendants to the detriment of Rainbow.

3. Dr. Glover's Expert Testimony.

The salient aspects of the Glover Report are as follows:

A. Dr. Glover's Qualifications. Dr. Glover is uniquely qualified to render opinions about the financial records of Rainbow, and the duties of its corporate officers, directors, and majority shareholders. She is Dean of the School of Business of Jackson State University. Dr. Glover received her B.S. from Tennessee State University, her M.B.A. in Accounting from Clark Atlanta University, and her J.D. from Georgetown University Law Center. She has been, and is presently, a Certified Public Accountant. R. 322, July 2007 Report at 1. She is also licensed to practice law. *Id.*

Dr. Glover is experienced in corporate audits, interpreting and verifying the accuracy of information in financial statements, reviewing business practices, and ensuring that financial systems and business models are applied in a precise manner for the underlying financial data of a corporation. R. 322-23, July 2007 Report at 1-2.

Also, Dr. Glover has significant experience in the private sector with respect to financial reporting and business transactions:

1976-79: Accountant with Arthur Andersen & Company

1979-85: Potomac Electric Power Company (Washington, DC)

1985-90: CFO and Executive VP for Metters Industries, Inc.

Dr. Glover then made a transition into full-time teaching at the university level:

1990-94: Assistant Professor of Accounting, Howard University (where she became Chair of the Accounting Department)

1994-present: Dean of School of Business, Jackson State University

During her teaching career, Dr. Glover has also served on the following boards of directors: the Student Loan Corporation, a publicly traded subsidiary of Citibank (where she has been Chair and Financial Expert for the Audit Committee), the Lenox Group, Regions Bank of Jackson, and the Jackson Airport Authority. R. 324, July 2007 Report at 3.

With regard to questions relating to the proper conduct of directors and officers in a corporation, Dr. Glover's testimony is based upon her personal experience. She has served as both the Chair of and the Financial Expert for the Audit Committee of the Student Loan Corporation, a publicly-traded subsidiary of Citibank. She has also served on the boards of directors of the Lenox Group, Regions Bank of Jackson, and the Jackson Airport Authority.

Dr. Glover's experience as a corporate director and her education qualifies her to testify that corporate officers, directors and majority shareholders violate their legal duties when they engage in self-dealing and when they waste corporate assets. Her exhaustive examination of Rainbow's books and records qualifies her to tell the jury in this case exactly how the Defendants accomplished the looting of millions of Rainbow's assets.

B. Dr. Glover's Opinions About Self-Dealing Transactions. The vast majority of Dr. Glover's report is dedicated to her opinions with respect to what the Mississippi Business Corporation Act ("the Act") calls "director's conflicting interest transactions." Miss. Code Ann.§§ 79-4-8.60 *et seq.* These opinions, which bear the brunt of Defendant's attack, are as follows:

> **Opinion 1**: "Rainbow directors, Marvin Cato and Charles Cato, acted improperly by making numerous payments to themselves allegedly in the form of loan repayments, payroll and expense reimbursements," R. 328-30, July 2007 Report at 7-9.
>
> **Opinion 2**: "The Rainbow directors mismanaged and misused funds, improperly recorded transactions, and committed waste of the corporate assets," R. 330-32, July 2007 Report at 9-11.
>
> **Opinion 5**: "Directors Marvin Cato and Charles Cato acted improperly in the payment of dividends and in making other disbursements," R. 334-35, July 2007 Report at 13-14.
>
> **Opinion 6**: "Directors Marvin Cato and Charles Cato acted improperly and violated their fiduciary duties when they engaged in self-dealing," R. 335-36, July 2007 Report at 14-15.

a) Dr. Glover's Data. The data relied upon by Dr. Glover for these opinions were the financial records of Rainbow and the various banks, financial institutions, and vendors who provided documents under subpoena. As pointed out above, the authenticity of these documents – the underlying data for these sections of the Report – was admitted by Rainbow. R. 408-19.

Dr. Glover was the only expert or lay witness who conducted a thorough review of Rainbow's financial statements, tax returns and bank records to determine the amount of income Rainbow has earned since 2001 and the amount and nature of the disbursements which the Cato Defendants have made from Rainbow's bank accounts. Because the Cato Defendants have not maintained appropriate financial controls and accounting records, Dr. Glover literally had to examine every single bank statement and all of the copies of cancelled checks that the Minority

Shareholders were able to obtain in discovery. Most of the schedules attached to her report are summaries of Rainbow's income and expenses. Having compiled this information, Dr. Glover identified the expenses that were, in her opinion, excessive and/or improper. R. 328-31, July 2007 Report at 7-10.

Based on the Plaintiffs' contention that Rainbow was originally represented to investors as a passive, pass-through entity, Dr. Glover also calculated the amount of income that would have been available for distribution to the Minority Shareholders as dividends if the Cato Defendants had not caused Rainbow to incur those excessive and/or improper expenses. R. 342, July 2007 Report at 21.

What Dr. Glover uncovered in her investigation of Rainbow's finances is shocking. From 1995 to the present, Rainbow's primary asset and sole source of revenue was a 20% ownership interest in Greenville Riverboat. From 2001 until March 2007, Greenville Riverboat has generated positive earnings, resulting in fairly regular distributions (generally paid monthly) to Rainbow in respect of its 20% interest in the range of $2 million per year. Receipt of these reserves required no on-going management activity on the part of Rainbow, which is, by the terms of the Greenville Riverboat LLC Agreement, required to be an inactive member of that company.

Greenville Riverboat has paid Rainbow at least $12 million in distributions from January, 2001 to July, 2007. *See* Schedule 2, R. 346-48. During that time, the Cato Defendants have declared and paid dividends of approximately $2.0 million (of which Charles and/or Marvin Cato received approximately $1.15 million due to their ownership of Rainbow stock). So then, from January 2001 through July 2007, Rainbow has received income of over $9 million beyond its distributions to the shareholders. R. 341, July 2007 Report at 20.

Dr. Glover concluded that in her professional opinion, the salaries to Charles Cato ($120,000 annually, increased recently to $180,000 annually) and Marvin Cato ($96,000 annually, increased, but no Rainbow witness knows the current salary) are excessive in relationship to the duties they have performed as officers of Rainbow. R. 329, July 2007 Report at 8.

Also, bank records reviewed by Dr. Glover indicate that Rainbow had, as of December 31, 2004, paid Charles Cato more than $3.1 million in "loan repayments." Marvin Cato has received more than $1.3 million in "loan repayments." R. 349-56. These "repayments" were allegedly made in respect of loans or advances made by Marvin and Charles Cato during Phase I of Rainbow's history. But although, at the point when the Petition for Interlocutory Appeal was filed, trial was only days away, Defendants had provided no records to indicate that either Marvin or Charles Cato actually expended that much of their personal money on Rainbow's behalf. While there are documents purporting to evidence a $1.2 million loan from Marvin Cato to the corporation on February 11, 1995, the documents produced in this case by the Catos and Rainbow to date do not substantiate that anything the Catos actually spent that amount of money from 1993 to 1995.

Moreover, Rainbow's financial records show a pattern of expenditures for automobiles, travel, and entertainment that are clearly excessive in light of Rainbow's actual business activities. Dr. Glover's report details expenditures in excess of $1 million on private air charters alone, in addition to a sky box at Raymond James Stadium (home of the Tampa Bay Buccaneers), company cars, and other expenses for which the Defendants have produced no proper corporate explanation. R. 331, July 2007 Report at 10. In addition, Rainbow's bank records reflect hundreds of thousands of dollars in checks made payable to cash. The Defendants

have produced no records to justify these transactions. Nor is there any proof that they were approved by a majority of disinterested directors or a majority of the disinterested shareholders.

b) Dr. Glover's Methodology. Dr. Glover's methodology strictly followed the Act, and was confirmed by the testimony of Rainbow and the Cato Defendants' expert. That methodology is the one compelled by the law governing this case – the Mississippi Business Corporation Act and Mississippi's common law of corporations.

Under the Act, there is a defense for the payment of these transactions only *if* (a) the transactions are in fact approved by action of disinterested directors taken in the prescribed manner, or (b) the transactions are in fact approved by action of disinterested shareholders taken in the prescribed manner, or (c) the transactions, judged according to the circumstances at the time of commitment, are established to have been fair to the corporation. [1]

Rainbow's own expert, Professor Barbara Aldave from the University of Oregon, acknowledged that these provisions, which mirror those of the Model Business Corporation Act that she helped draft, place the burden of proof on the Defendants to justify payments made by the corporation to themselves or related parties, if those payments were not approved by two or more disinterested directors or a majority of disinterested shareholders. R. 426-28, 441-42, 451-53.

[1] The director's conflicting interest provisions of the Mississippi Business Corporation Act, Miss. Code Ann. §§ 79-4-8.60 et seq., were amended effective from and after July 1, 2006. The statutory provisions quoted in the appendix hereto are those that were in effect from the time Rainbow was formed in 1993 until July 1, 2006, during which time most of the acts complained of in this case occurred. The 2006 amendment to the statute did not change the fundamental requirement that self-dealing transactions must be approved by disinterested shareholders, however. Pre-Act common law cases are in accord. See *Twin States Realty Co. v. Kilpatrick*, 26 So. 2d 356 (Miss. 1946), and *Knox Glass Bottle Co. v. Underwood*, 89 So. 2d 799 (Miss. 1956). Additionally, the post-Act case law governing closely-held corporations compels the same methodology. *See Fought v. Morris*, 543 So. 2d 167 (Miss. 1989) (establishing that majority shareholder's actions in a close corporation must be "intrinsically fair" to the minority shareholders). Defendant's expert, Professor Barbara Aldave agreed with the applicability of these common law principles to this case. R. 437-39; 452.

Thus, where Rainbow has failed to show approval by disinterested directors, and has also failed to offer any justification for payments to Marvin Cato or Charles Cato, those payments are improper for purposes of the Act. *Id.*

Dr. Glover's analysis is the one required by Mississippi law. Because Marvin and Charles Cato, as officers and/or directors of Rainbow[2], caused the company to disburse money to themselves, or to their benefit, without the approval of non-interested officers or directors, they bear the burden of proof that the disbursements are "intrinsically fair" to the company. So, for example, when Dr. Glover reports that large cash disbursements were made 'with no explanation," R. 328, July 2007 Report at 7, that is a sufficient basis under the Act for a conclusion that the disbursements were improper.

c) Salaries. Salary payments made to Charles and Marvin Cato are a sub-category of these self-dealing disbursements. Dr. Glover reviewed deposition testimony of the parties to determine that (1) the Catos promised investors that no officer or director would be paid a salary, but instead all investors would be paid only through dividend distributions; and (2) the basis for this promise was the Catos' concession that they had no special expertise in gaming management and would have to hire a management company, or partner with an existing gaming entity, to own a casino.

These promises were evidenced by a Private Placement Memorandum circulated by the Catos in 1993, R. 35, and also by oral representations made by them to prospective investors after the Private Placement memorandum offering had expired.

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[2] Rainbow complains that Dr. Glover ignores other persons who allegedly served on the Rainbow Board of Directors. As Dr. Glover testified in her deposition, she acknowledged that some other persons were named in the minutes as directors (although, for many of these others, there are no corporate documents evidencing their election to the Board). R. 282. But in any event, no matter who might have belonged to the Board at one time or another, the fact remains that the Cato's self-dealing transactions were not approved by a majority (but at least two) disinterested directors.

As Dr. Glover explained,

> Payments were made for salaries for Charles Cato and Marvin Cato, notwithstanding the fact that, **according to the sworn testimony of the minority shareholders**, the Catos promised that no salary payments would be made by Charles Cato or Marvin Cato. These oral promises were consistent with the terms of the Private Placement Memorandum, written by the Catos to solicit investments. At page 37 of the Memorandum, it specifically states, "It is not anticipated that any principal officer will receive a salary or other compensation from the Company, other than dividends . . ." This is particularly significant inasmuch as the Private Placement Memorandum also states on page 9, that the "Company officers and directors . . . have no experience in managing casinos, hotels, or restaurants." It is therefore outlandish that Charles Cato and Marvin Cato paid such substantial amounts of the shareholders' money to themselves as salaries knowing that they lacked the expertise or knowledge of the very job they were paying themselves to perform.

R. 329, July 2007 Report at 8 (emphasis added).

In her deposition, Dr. Glover identified the "sworn testimony of the minority shareholders" discussed above as the deposition testimony of Frank Morelli and Charles Arnold. R. 283-84. That testimony clearly states that Charles Cato made the same oral representations to prospective shareholders – that no salaries would be paid to officers – as were set forth in writing in the Private Placement Memorandum. R. 471, 511 (Charles Arnold); R. 556 (Frank Morelli). They were also told that, if they committed resources to saving Rainbow's lease, that Rainbow would be a passive investment company only and would not seek other business. R. 508 (Arnold); R. 545-46 (Morelli).[3]

Dr. Glover also pointed out that the factual representations in the Private Placement Memorandum, if true when made in 1993, would not have been any less true simply because the offering had expired. R. 272; 274; 280; 294-95.

[3] Professor Aldave also recognized that Mr. Morelli and Mr. Arnold alleged that they had received oral representations similar to those made in the Private Placement Memorandum. R. 433.

d) Self-dealing Loan "Repayments." Defendants challenge Dr. Glover's opinions regarding repayment of loans that Marvin and Charles Cato claimed to have made to Rainbow during the Phase I years. Defendants claim that there is evidence of such loans. In her deposition, Dr. Glover explained that, based on her reading of the documents provided by Rainbow and its banks, there was no clear evidence that the Catos actually provided cash in the amount of more than $1.2 million, as they claim. R. 297, Glover Deposition at 182-83.

e) Dividend Distributions. Dr. Glover opined, on the basis of the discovery of the parties, that there was no corporate justification for the self-dealing transactions to (or on behalf of) Marvin and Charles Cato, and that those payments should instead be considered dividends paid to them. In that event, the Catos have distributed dividends to themselves out of proportion to their overall proportionate ownership of the corporation. R. 334-35, July 2007 Report at 13-14. The Minority Shareholders have been injured by not receiving their due share of these dividend distributions.

f) Fiduciary Duties. Dr. Glover and Professor Aldave both testified that the Cato Defendants owed fiduciary duties to Rainbow and to the Minority Shareholders. The existence of such duties is established as a matter of law, *see Faught*, as Professor Aldave expressly recognized. R. 438.

g) Income Taxes. Defendants argued that Dr. Glover's report is flawed because her damage calculations do not take into account the taxes that would have to be paid if the self-dealing transactions were not proper corporate expenses. They did not, however, cite any law governing derivative actions requiring a reduction in any damage award on this basis.[4]

[4] In any event, the argument is misplaced: if the jury in this case finds that the Cato's self-dealing transactions must be repaid to Rainbow, and a judgment to recoup those expenses is actually satisfied, then the corporation can (and must) decide whether any of its prior tax returns must be amended. It defies reason to suggest that the offending officers should get the benefit of what they contend would otherwise have gone to pay taxes.

SUMMARY OF THE ARGUMENT

Issue One: Dr. Glover Need Not Be a Currently Licensed CPA in Order to Render Expert Opinions; and in Any Event, She Has Been Reinstated as a CPA in Goodstanding

The August 20 Order, is governed by the "modified *Daubert* standard" first announced in *Miss. Transp. Comm'n v. McLemore*, 863 So. 2d 31, 38 (Miss. 2003). "Absent other grounds to exclude, an expert's testimony is presumptively admissible when relevant and reliable." *Poole v. Avara*, 908 So. 2d 716, 724 (Miss. 2005).

Because Dr. Glover's data is based on the documents provided by Defendants and the banking institutions and vendors with which they did business, and Dr. Glover's methodology is that derived from Mississippi law, her opinions cannot be considered unreliable under the modified *Daubert* analysis required by *McLemore*.

The Focus is on Expert Knowledge, Not Certifications. There is a distinction between the qualifications of a witness to give expert testimony and the witness' certification to practice a particular profession. *King v. Murphy*, 424 So. 2d 547, 550 (Miss. 1982), established that it is the witness' knowledge, not his or her certification, that qualifies him or her as an expert witness under Miss.R.Evid. 702.

It follows that a professional who was certified at one time, but has allowed that certification to lapse, is not disqualified as an expert witness. This exact question was addressed in *Watts v. Lawrence*, 703 So. 2d 236 (Miss. 1997).

Watts controls on these issues: (1) that any lapse in Dr. Glover's CPA registration does not disqualify her as an expert witness, and (2) that Dr. Glover may testify, whether or not she currently holds a license, without being subject to criminal sanctions under Miss. Code Ann. §§ 73-33-1 and 13 (1972). Plaintiffs respectfully submit that, to the extent the Circuit Court ruled

that Dr. Glover was excluded as an expert witness because she is no longer actively licensed as a CPA, this ruling is contrary to *Watts*.

Moreover, Dr. Glover's certification as a CPA in Goodstanding has been reinstated. This was easily done, because her lapse was a technical one, and was not the result of any misconduct or disciplinary proceedings. This shows, if nothing else, why blinkered focus on "certifications" is not a valid grounds for excluding expert testimony under *McLemore* and *Watts*.

Additionally, the Mississippi Supreme Court and the Court of Appeals has approved expert testimony reconstructing financial records without requirement that the witness be a certified Public Accountant. See Funderburk v. Johnson, 935 So. 2d 1084, 1107-08 (Miss.App. 2006);

No Misrepresentation of Qualifications. The Circuit Court's August 20 Order also held that Dr. Glover had represented herself as a currently licensed Certified Public Accountant in her report and in her deposition. But Dr. Glover specifically testified in her deposition that she no longer practiced as a CPA. To the extent that Dr. Glover may be considered to have misrepresented her credentials regarding CPA licensure, that goes to the weight of her testimony and not its admissibility.

Issue Two: Dr. Glover's Opinion That The Individual Plaintiffs Have Suffered Compensable Damages is Not Grounds for Excluding Her Testimony

Rainbow and the Cato Defendants made much use of Dr. Glover's admission, in her deposition testimony, that she was not an expert in "derivative actions." The Minority Shareholders, however, did not proffer Dr. Glover on that procedural topic. The issue here is not whether Dr. Glover is an expert in "derivative actions" but whether she can testify as to the

"intrinsic fairness" of the salaries, payments and expenses obtained by or on behalf of the Cato family.

But even with respect to the derivative claims, Dr. Glover's assessment of how damages may be measured in this case is not erroneous. Where an action is brought with respect to a closely held corporation like Rainbow, damages can be awarded directly to the minority shareholders. *Derouen v. Murray*, 604 So. 2d 1086, 1091 n.2 (Miss. 1992) ("in the case of a closely held corporation . . . the court in its discretion may treat an action raising derivative claims as a direct action, exempt it from those restrictions and defenses applicable only to derivative actions, and order an individual recovery") (emphasis added); *Era Franchise Systems, Inc. v. Mathis*, 931 So. 2d 1278, 1281 (Miss. 2006) (same). *See also Fought v. Morris*, 543 So. 2d 167 (Miss. 1989) (establishing that majority shareholder's actions in a close corporation must be "intrinsically fair" to the minority shareholders).

Moreover, the derivative action at issue in this case is the legal framework for some – but not all – of the claims raised by the Plaintiffs. The First Amended Complaint also pleads two separate categories of fraud claims. It is well established Mississippi law that these are claims that may be brought directly by the shareholders against Rainbow and the individual Defendants.

In the case of either of these fraud claims, the damages would be assessed on behalf of, and awarded directly to, the shareholders – not to the corporation.

Thus, Dr. Glover's opinions about how damages would be calculated did not show that she was inexperienced in derivative actions. Surely, where this Court has twice approved damages paid directly to minority shareholders of a close corporation in a derivative action, Dr. Glover cannot be faulted for using the same analysis.

LAW AND ARGUMENT

Issue One:

Dr. Glover Need Not Be a Currently Licensed CPA in Order to Render Expert Opinions; and in Any Event, She Has Been reinstated as a CPA in Goodstanding

General Principles. Expert testimony is admissible if specialized knowledge "will assist the trier of fact" and if:

(1) the testimony is based upon sufficient facts or data;

(2) the testimony is the product of reliable principles and methods; and

(3) the witness has applied the principles and methods reliably to the facts of the case.

Miss. R. Evid. 702. This Rule, and therefore the August 20 Order, is governed by the "modified Daubert standard" first announced in *Miss. Transp. Comm'n v. McLemore*, 863 So. 2d 31, 38 (Miss. 2003): "First, the court must determine that the expert testimony is relevant – that is, the requirement that the testimony must 'assist the trier of fact' means that the evidence must be relevant. Next, the trial court must determine whether the proffered testimony is reliable. Depending on the circumstances of the particular case, many factors may be relevant in determining reliability, and the *Daubert* analysis is a flexible one."

In particular, the applicability of any of the *Daubert* factors "depends on the nature of the issue, the expert's particular expertise, and the subject of the testimony." *Id.* at 37. Some issues, for example, may not have been the subject of "peer review publications," and therefore the absence of any such articles does not prevent the Court from admitting the testimony. *Id.*; *see also Poole v. Avara*, 908 So. 2d 716, 723 (Miss. 2005).

While the trial court's "gatekeeping" responsibility is an important one, this Court noted in *Poole* that *Daubert/McLemore* relaxed the standard for admission of expert testimony that had

previously been based on *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923). *Poole*, 908 So. 2d at 722 ("[t]he high Court relaxed [the *Frye*] standard for federal practice in *Daubert*"). Thus, the Court taught that "[a]bsent other grounds to exclude, an expert's testimony is presumptively admissible when relevant and reliable." *Id.* at 724, *quoting McLemore*, 863 So. 2d at 39.

Because Dr. Glover's data is based on the documents provided by Defendants and the banking institutions and vendors with which they did business, and Dr. Glover's methodology is that derived from Mississippi law, her opinions cannot be considered unreliable under the modified *Daubert* analysis required by *McLemore*. For example, in *Walker v. Gann*, 955 So. 2d 920, 930-31 (Miss.Ct.App. 2007), the Court of Appeals affirmed a Circuit Court's ruling admitting expert testimony. As the Court pointed out, the expert's opinions were based on "multiple pieces of evidence."

Similarly, in *Gulley v. State*, 779 So. 2d 1140 (Miss.Ct.App. 2001), the Court of Appeals held that a paralegal/bookkeeper could be the testimonial sponsor of explanatory charts of financial transactions, because the jury would be assisted by receiving a summary of the voluminous data. As in *Gulley*, Dr. Glover's report is, in large part, a summary of many hundreds of pages of bank records, including cancelled checks and other documentary evidence of Rainbow's disbursements..

Nor does it offend *Daubert* for an expert witness to apply generally accepted principles (in this case Mississippi law and GAAP) to organize the evidence and thereby assist the jury. In *Canadian Nat'l Railroad Co. v. Hall*, 953 So. 2d 1084, 1094-95 (Miss. 2007), the Mississippi Supreme Court affirmed a trial court's ruling allowing an expert to testify from his professional training and experience in the area of railroad safety regulations. As in this case, the expert

applied the regulations to the facts in the case. The Court specifically applied *McLemore* in affirming the Circuit Court's decision to admit the testimony.

The Focus is on Expert Knowledge, Not Certifications. This Court recognizes a distinction between the qualifications of a witness to give expert testimony and the witness' certification to practice a particular profession. In the medical negligence case of *King v. Murphy*, 424 So. 2d 547, 550 (Miss. 1982), this Court held that "An expert witness who is knowledgeable of, and familiar with, the state-wide standard of care shall not have his testimony excluded on the ground that he does not practice in this state." *King* established that it is the witness' knowledge, not his or her certification, that qualifies him or her as an expert witness under Miss.R.Evid. 702.

This is the general rule in most jurisdictions. "A witness does not have to possess a license in the particular field involved to qualify as an expert." 32 C.J.S. Evidence §524. "If the witness is qualified, the extent or degree of his qualification affects the weight, but not the admissibility of the testimony." *Id.*

It follows that a professional who was certified at one time, but has allowed that certification to lapse, is not disqualified as an expert witness. This exact question was addressed in *Watts v. Lawrence*, 703 So. 2d 236 (Miss. 1997). In that case, Watts attempted to prevent the construction of a boathouse by his neighbor, Lawrence. Lawrence called a retired real estate broker and appraiser as an expert witness on the question whether the boathouse would decrease the value of Watts' land. Watts objected to the testimony, arguing that because the expert did not have a current real estate license, his testimony violated Miss. Code Ann. §73-34-5 (1972), which states "it shall be unlawful for anyone to engage in real estate appraisal activity in this State without obtaining one of the four real estate appraiser licenses."

This argument – identical to that accepted by the Circuit Court in this case – was rejected by this Court in *Watts*:

> Our Rules of Evidence require only that an expert witness be qualified by knowledge, skill, experience, training, or education. Miss.R.Evid. 702. The record is replete with evidence of Joachim's experience and knowledge in this area. He is a qualified expert under M.R.E. 702. The trial court did not err in allowing his testimony.

Watts, 703 So. 2d at 238-39.

Similarly, in *Grubb v. Hocker*, 326 S.E.2d 698 (Va. 1985), the Virginia Supreme Court reversed summary judgment in a medical malpractice case. The trial court had excluded the opinions of plaintiff's expert, who had practiced medicine and completed Virginia's requirements for licensure as a general practitioner, because he had allowed his Virginia medical license to lapse. Reversing this ruling, the Virginia Supreme Court held that the witness' "lack of current practice in Virginia forms no basis, in itself, for the exclusion of his testimony." *Id.* at 701.

Watts demonstrates (1) that any lapse in Dr. Glover's CPA registration does not disqualify her as an expert witness, and (2) that Dr. Glover may testify, whether or not she currently holds a license, without being subject to criminal sanctions under Miss. Code Ann. §§ 73-33-1 and 13 (1972). To the extent that Dr. Glover may be considered to have misrepresented her credentials regarding CPA licensure, that goes to the weight of her testimony and not its admissibility.

Thus, to the extent the Circuit Court ruled that Dr. Glover was excluded as an expert witness because she was (at the time of the hearing) no longer actively licensed as a CPA, this ruling is contrary to *Watts*. As set forth above, Dr. Glover has more than sufficient training,

education, and experience in both accounting and the duties of members of corporate boards to testify thereto. Indeed, a CPA qualification is not even relevant to the latter of these opinions.

Moreover, as pointed out above, Dr. Glover's certification as a CPA in Goodstanding has been reinstated. R. 652-53. This was easily done, because her lapse was a technical one, and was not the result of any misconduct or disciplinary proceedings. This shows, if nothing else, why blinkered focus on "certifications" is not a valid grounds for excluding expert testimony under *McLemore* and *Watts*.

Additionally, the Mississippi Supreme Court and the Court of Appeals has approved expert testimony reconstructing financial records without requirement that the witness be a certified Public Accountant. *See Funderburk v. Johnson*, 935 So. 2d 1084, 1107-08 (Miss.App. 2006);

No Misrepresentation of Qualifications. The Circuit Court's August 20 Order also held that Dr. Glover had represented herself as a currently licensed Certified Public Accountant in her report and in her deposition. But Dr. Glover specifically testified in her deposition that she no longer practiced as a CPA. At her deposition, Dr. Glover made her qualifications clear:

> [Dr. Glover]: I got my start from Arthur Andersen. When I finished business school, I went to Arthur Andersen in Memphis and worked as an accountant there. And then I worked as a CPA with a utility company and then as a CPA with an engineering firm. And in my role as Dean [of the Business School at Jackson State University], I employ all of my CPA skills. **I don't practice as such, because I don't certify financial statements. That's what the practice of accountancy is.**
>
> Q. How long did you practice public accounting as a certified public accountant?
>
> A. About three years.

R. 254 (emphasis added).

Plaintiffs respectfully submit that Dr. Glover has testified truthfully about both the CPA certification she had earned and her current licensure status. Moreover, her training and previous practice as a CPA is certainly relevant to the issues in this case, even if Dr. Glover's Mississippi license were not in good standing at the time of the motion hearing. Additionally, as Dean of the JSU Business School, Dr. Glover is responsible for the entire curriculum, including accounting and business courses, which is relevant both to the accounting issues in the case and also the issues regarding the Cato Defendants' multiple breaches of their fiduciary duties to Rainbow and the Minority Shareholders.

Thus, Dr. Glover testified truthfully that she uses her background in accountancy in her continuing career, including teaching students to become accountants, but that she is not an actively practicing certified public accountant in day-to-day practice. This is not grounds for excluding her testimony.

Issue Two

Dr. Glover's Opinion That The Individual Plaintiffs Have Suffered Compensable Damages is Not Grounds for Excluding Her Testimony

Rainbow and the Cato Defendants made much use of Dr. Glover's admission, in her deposition testimony, that she was not an expert in "derivative actions." The Minority Shareholders, however, did not proffer Dr. Glover on that procedural topic. Rather, she was designated to testify about significant issues in this action such as: (1) "the damages incurred by Rainbow Entertainment, Inc., by Investor Resource Services, Inc., and the other minority shareholders of Rainbow resulting from the actions and omissions of Marvin Cato, Charles Cato and Laverne Cato as majority shareholders, directors and officers of Rainbow Entertainment, Inc." and (2) "whether the Catos breached their duties as corporate officers, directors and

minority shareholders, by authorizing self-dealing transactions." R. 322, 324, July 2007 Report at 1, 3.

As Dr. Glover testified, "I'm not here as a derivative expert . . . I'm here as a damage expert and to tell you what goes on in a corporate board room, how the corporate – how the corporate officers should act, the duty they have to shareholders." R. 269.

The issue here, however, is not whether or not Dr. Glover is an expert in "derivative actions" but whether or not she can testify whether the salaries, payments and expenses obtained by or on behalf of the Cato family is "intrinsically fair" to the other shareholders. Dr. Glover does not have to be expert in the procedural or substantive legal issues which arise in a derivative action to testify to the unfairness of the distribution of profits in a closed corporation.

But with respect to the derivative claims, Dr. Glover's assessment of how damages may be measured in this case is not erroneous. Where an action is brought with respect to a closely held corporation like Rainbow, damages can be awarded directly to the minority shareholders. *Derouen v. Murray*, 604 So. 2d 1086, 1091 n.2 (Miss. 1992) ("in the case of a closely held corporation . . . the court in its discretion may treat an action raising derivative claims as a direct action, exempt it from those restrictions and defenses applicable only to derivative actions, and order an individual recovery") (emphasis added); *Era Franchise Systems, Inc. v. Mathis*, 931 So. 2d 1278, 1281 (Miss. 2006) (same). *See also Fought v. Morris*, 543 So. 2d 167 (Miss. 1989) (establishing that majority shareholder's actions in a close corporation must be "intrinsically fair" to the minority shareholders).

Moreover, the derivative action at issue in this case is the legal framework for some – but not all – of the claims raised by the Plaintiffs. The First Amended Complaint also pleads two

separate categories of fraud claims. It is well established Mississippi law that these are claims that may be brought directly by the shareholders against Rainbow and the individual Defendants.

First, the Plaintiffs allege that the Defendants made promises or representations about Defendants' future conduct which they had no present intention to perform. *Crystal Springs Ins. Agency, Inc. v. Commercial Union Ins. Co.*, 554 So. 2d 884, 886 (Miss. 1989) (fraud claim may be based on a representation of future conduct "made with the present undisclosed intention of not performing it"). This Court has expressly applied this principle to the promises of a corporation to current or future investors. *Nichols v. Tri-State Brick and Tile Co., Inc.*, 608 So. 2d 324, 329-30 (Miss. 1992).

Second, the First Amended Complaint pleads a claim under the law of "fraudulent concealment," *Marrone Company v. Barbour*, 241 F.Supp.2d 683, 688 n.9 (S.D. Miss. 2002), *citing Davidson v. Rogers*, 431 So. 2d 483, 485 (Miss. 1983), and other times "failure to disclose material facts," *Blackwell v. Metropolitan Life Ins. Co.*, 190 F.Supp.2d 911, 915 (S.D. Miss. 2001), *citing Spragins v. Sunburst Bank*, 605 So. 2d 777, 780 (Miss. 1992) and *Mississippi Bar v. Mathis*, 620 So. 2d 1213 (Miss. 1993).

In the case of either of these fraud claims, the damages would be assessed on behalf of, and awarded directly to, the shareholders – not to the corporation.

Thus, Dr. Glover's opinions about how damages would be calculated did not show that she was inexperienced in derivative actions. Surely, where this Court has expressly approved an award of damages paid directly to minority shareholders of a close corporation in a derivative action, Dr. Glover cannot be faulted for using the same analysis.

CONCLUSION

This Court has held that:

> It was the jury's role to take both sides of the testimony, give each its appropriate weight, and decide the case after hearing all of the evidence.

Poole, 908 So. 2d at 724.

The arguments against Dr. Glover made by Rainbow and the Cato Defendants in the Circuit Court go to the weight, not the admissibility, of Dr. Glover's testimony. The Circuit Court erred in using them to exclude the testimony under *McLemore*. This Court should vacate the August 20 ruling in limine, and remand this case with instructions not to exclude Dr. Glover's testimony on Rule 701 Grounds.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, James W. Craig, do hereby certify that I have this day served a true and correct copy of the above and foregoing by United States Mail, postage prepaid, to the following:

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This the 12th day of September, 2008.

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