salary and status as an inside director, the Court is skeptical of his ability to objectively evaluate a claim against Liddell. Thus, Robotti has created sufficient reason to doubt Palm's independence.

3. David Houston

David L. Houston has served as a Gulfport director since 1998. He held options exercisable into 20,000 shares of common stock at the time of the Offering, and for this reason Robotti argues that Houston received a personal benefit in the transaction not shared by the other shareholders and is now interested in the litigation.[108] Robotti also claims that "[e]ven were Mr. Houston not interested in the transaction in question he would not be independent."[109] In support of this allegation, it states that Houston has served on the board of Bronco Drilling Company for at least two years (2007 and 2008) and that Bronco is affiliated with Wexford. Wexford allegedly owned 13% of Bronco's stock, which made it Bronco's second largest shareholder. Wexford was also a major Bronco customer and supplier, specifically transacting $5.6 million in business with Bronco during 2007, a year in which it earned total profits of $37 million. The Complaint lists Houston's compensation from Bronco at $81,484 in 2006, and $70,267 in 2007, and concludes that this compensation, combined with the roughly $20,000 in annual director fees that Houston earns from Gulfport, "precludes him from acting independently" of Liddell and the controlling shareholder.[110]

Unlike Mike Liddell, whose options were convertible into a substantial number of shares both before and after the Offering, Houston's options were convertible into only 20,000 shares before the Offering, and slightly less than 40,000 shares after the Offering. Even if the Court assumes for purposes of this section only that operation of the anti-dilution provisions upon the agreements governing the options worked the option-holders a benefit not shared by the stockholders generally, Robotti has still failed to allege how such a benefit could be material to Houston given the number of shares into which his options could be converted.[111] In fact, Robotti presents no argument as to why this amount is material and thus why it would cast doubt as to Houston's ability to act objectively for the Company's interest and not on his own behalf.

Davidson) still controlled Gulfport at the time. The Court will assume this to be the case for the purposes of this memorandum opinion because it concludes that Robotti's pleadings have not overcome the presumption that a majority of the board was independent and disinterested in any event.

[108] *Id.* at ¶¶ 15-16.

[109] *Id.* at ¶ 27.

[110] *Id.*

[111] The "new" shares that Houston had the right to purchase after the Offering represented only .12% of all the shares issued and made available under the options and warrants, as a result of the Offering.

Regarding Houston's independence, the Complaint does no more than suggest that the director fees from Gulfport and Bronco made Houston beholden to Liddell and CD Holding.[112] Annual compensation totaling roughly $100,000, certainly not a pittance, cannot be viewed as an unreasonable sum for two directorships, and director compensation, standing alone, cannot be the basis for asserting a lack of independence.[113] In addition, there is no allegation of fact showing that CD Holding or its affiliates controlled Bronco and thus controlled Houston's directorial compensation from that entity; instead, the Complaint merely alleges that Wexford owned a large percentage of Bronco stock and was an important customer.

4. Scott Streller and Donald Dillingham

Robotti claims that both Streller and Dillingham could not act independently from Liddell and CD Holding. It asserts that, in addition to serving on the Gulfport board, Scott Streller was also a nominee for the board of Diamondback Energy Services—another CD Holding affiliate—at the time Robotti amended its complaint. Diamondback intended to compensate its directors $12,000 a year and give them 6,667 shares of stock in 2008.[114] Robotti states that Streller received $40,231 from Gulfport in director compensation in 2007, and that he received $15,638 in 2006 for serving as director during part of the year. It concedes that Streller's principal income came from the sale of insurance, and it alleges no connection between his insurance activities and Gulfport or its affiliates.[115]

Robotti alleges that Dillingham had "substantial other ties to Mike Liddell and Wexford,"[116] but does not explain, with particularity or otherwise, what these ties may have been. It claims that two of his other business activities were defunct, and thus argues that his director compensation from Gulfport was material to him as one of his primary sources of income. It concedes, however, that he could have received $100,000 a year from his employment as a Senior Portfolio Advisor to

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[112]It also argues that Houston's service on the inactive Compensation Committee indicates that he acquiesced in the wishes of Liddell and CD Holding. This allegation, however, only suggests that Houston was not meeting his responsibilities as a member of that committee by virtue of his inactivity. It sheds little, if any, light on whether he was independent of CD Holding or Liddell.

[113]*See In re The Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *4 (Del. Ch. Mar. 27, 2002) ("Allegations as to one's position as a director and the receipt of director's fees, without more . . . are not enough for purposes of pleading demand futility.") (citation omitted).

[114]Compl. ¶ 22.

[115]*Id.* at ¶ 28. Streller currently operates an agency for Farmer's Insurance and Farmer's Financial Solutions. *Id.*

[116]*Id.* at ¶ 29.

Avondale Investments, for which Robotti makes no allegations concerning possible affiliation with Gulfport or CD Holding.[117]

As with Houston, Robotti has failed to raise a reasonable doubt regarding Streller and Dillingham's independence.[118] As described above, director compensation alone cannot create a reasonable basis to doubt a director's impartiality. Robotti cites only Streller and Dillinghams' current compensation as Gulfport directors and the potential compensation they could have received for sitting on the Diamondback Board, of which they were nominees at the time the second complaint was amended. The two directors also seemed to have received ample compensation from independent outside sources, which diminished the materiality of their director fees. The facts as alleged are therefore insufficient to support demand excusal.

Although Robotti raised a reasonable doubt regarding Mike Liddell and James Palm's independence, it has not done the same for David Houston, Scott Streller, and Donald Dillingham. Because a majority of the Demand Board was independent and disinterested, Robotti has not sufficiently pleaded demand futility. To the extent that its claims are derivative, those claims must be dismissed on this basis as well.

V. CONCLUSION

Robotti has failed to state a claim upon which relief can be granted. For one, the Plaintiff's claim is derivative in part and Robotti failed to adequately plead demand excusal. More importantly, based upon the facts as alleged, the Court cannot conclude that the Defendants received a personal benefit in the challenged transaction that was not either shared by the public shareholders or owed to the Defendants before they proceeded with the Offering. Thus, the Plaintiff's claim for self-dealing by interested fiduciaries fails as a matter of law. Additionally, the facts do not support an inference that the Defendants consciously disregarded their fiduciary duties or entirely abdicated their responsibilities. The Complaint is therefore dismissed.

An implementing order will be entered.

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[117] *Id.* The Complaint suggests that Dillingham has also been nominated to the Diamondback board, but does not say so expressly or elaborate in any detail. *Id.*

[118] Robotti also argues that Streller's membership on the defunct compensation committee indicates his lack of independence. This is substantially the same argument which Robotti made with respect to Houston's service on the same committee. *See supra* note 112.

MAHYAR AMIRSALEH, PLAINTIFF, V. BOARD OF TRADE OF THE CITY OF NEW YORK, INC

No. 2822-CC

Court of Chancery of the State of Delaware, New Castle

January 19, 2010

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CHANDLER, *Chancellor*

After careful consideration of the trial testimony, deposition transcripts, and post-trial briefing in this matter I find that defendants' conduct did not amount to bad faith and, accordingly, was not a breach of the implied covenant of good faith and fair dealing. The considerations underlying this factual finding are described below.

I. BACKGROUND

This dispute arose out of the merger, on January 12, 2007, of the New York Board of Trade ("NYBOT") with and into CFC Acquisition Company, a wholly owned subsidiary of IntercontinentalExchange, Inc. ("ICE"). The facts surrounding the merger—and this dispute more generally—are fully delineated in my prior two opinions in this matter.[1] The reader's familiarity with my prior opinions is presumed in the writing of this Opinion.

In connection with the merger, NYBOT owners (known as members) were effectively given the option of being cashed out or receiving a combination of ICE common stock and cash in exchange for their membership interests. NYBOT members had to express their merger

[1] *Amirsaleh v. Bd. of Trade of the City of N.Y., Inc.*, 2008 WL 4182998 (Del. Ch. Sept. 11, 2008); *Amirsaleh v. Bd. of Trade of the City of N.Y., Inc.*, 2009 WL 3756700 (Del. Ch. Nov. 9, 2009).

consideration preference by completing and timely submitting an election form to a third-party vendor known as Computershare.[2] Those members who did not submit a timely election form were cashed out. The ICE common stock and cash option was worth more than the straight cash option, so naturally most members did not wish to be cashed out.

The initial deadline for submitting an election was January 5, 2007. Plaintiff, a NYBOT member, missed this deadline. Many other NYBOT members missed the deadline as well. After the January 5 deadline, however, election forms continued to roll in. Defendants initially decided not to accept late elections, but on January 17, 2007, they changed their minds and began accepting all late elections. Late elections continued to be accepted through January 18, 2007, at which point defendants closed the late election window. Plaintiff submitted his form on January 19, 2007, but it was rejected as untimely and his membership interests were cashed out.

Plaintiff sued defendants as a third-party beneficiary under the merger agreement alleging breach of contract and breach of the implied covenant of good faith and fair dealing. I dismissed plaintiff's breach of contract claims on defendants' motion for summary judgment in September 2008.[3] In the fall of 2009, after additional discovery, plaintiff sought summary judgment on his implied covenant claim. I denied plaintiff's motion because a genuine issue of material fact was in dispute; namely, was bad faith the driving force behind defendants' decision to open a short, indeterminate window of time during which late elections were accepted?[4] A three-day trial was held from November 16 through November 18, 2009 to resolve this important question of fact.

II. APPLICABLE LAW

My November 2009 Opinion in this matter discusses at length the relevant contours of the implied covenant of good faith and fair dealing under Delaware law.[5] As explained in that opinion, plaintiff bore the burden of proof at trial to prove that defendants' discretionary decision to open a short temporal window for the acceptance of late elections was made in bad faith.[6] To do this, plaintiff had to show that the decision was motivated by an improper purpose, that it was the result of a culpable mental state.[7] Plaintiff could have met this burden by demonstrating that defendants' decision to

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[2]Computershare was responsible for calculating and distributing the merger consideration due each NYBOT member based on the elections made.

[3]*Amirsaleh*, 2008 WL 4182998, at *5-7.

[4]*Amirsaleh*, 2009 WL 3756700, at *3.

[5]*Id.* at *4-5.

[6]*Id.* at *6.

[7]*Id.* at *5.

open the late acceptance window was solely based on the fact that certain "connected" members failed to get their forms in on time.[8] Plaintiff could also have met this burden by demonstrating that certain "connected" members received special treatment in submitting late elections, including holding open the election window just long enough to ensure that all "connected" members late elections were accepted.[9]

My November 2009 Opinion also explained that bad faith would not be found if it appeared that defendants' decision to accept late submissions was driven by considerations of customer satisfaction (i.e., trying to accommodate as many late filers as possible) balanced against leaving Computershare enough time to calculate and distribute merger consideration by January 29, 2007, the distribution deadline under the merger agreement.[10] Moreover, bad faith would not be found if it appeared that defendants made reasonable efforts to give all members making late elections the same or substantially similar assistance turning in their late forms.[11] With the applicable law thus demarcated, we proceeded to trial.

III. FACTUAL FINDINGS

This trial has convinced me that defendants did not act in bad faith in deciding to open a short window of acceptance for late elections. That said, I am also convinced that defendants' process for addressing late elections could have been better organized and executed.

A. A suboptimal process

When it became apparent that some NYBOT members had missed the January 5, 2007, election deadline, defendants vacillated in deciding whether to accept late forms. Initially, defendants decided against it, unless the member could show that he or she missed the deadline because of an error on defendants' part (e.g., mailing the election booklet to the wrong address). Before deciding not to accept late forms, defendants considered whether the January 5 deadline should be extended to January 8 because the National Day of Mourning on January 2 (recognizing President Ford's passing) had shut down the mail service for a day. On January 9 defendants decided not to extend the deadline because they had not received any election forms in the mail the previous day. As the days progressed, however, defendants began receiving late elections from members who had missed the deadline, some of which were coupled with complaints about the

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[8] *Id.* at *6.
[9] *Id.*
[10] *Id.*
[11] *Id.*

election process and threats to sue if the late election was not honored. Defendants began keeping a record of these complaints, apparently for the purpose of analyzing whether any of them had merit. Defendants eventually decided not to use this list, however, and on January 17, 2007, the ICE legal team concluded that defendants should begin accepting all late submissions, regardless of the reason for the members' tardiness. Defendants' decision to accept all late submissions beginning January 17 was primarily driven by ICE CEO Jeffrey Sprecher's desire to accommodate as many late elections as possible.[12]

The opening and closing of the late election acceptance window could have been much better organized. Plaintiff spent much of the trial identifying alternative approaches that would have more effectively accomplished the goals of accommodating late elections in an efficient manner. Some of plaintiff's suggestions make a great deal of sense from a "best practices" point of view. For example, when the late acceptance window was opened on January 17 it was unclear how long it would remain open; no firm deadline was set for closing the window. Accordingly, on January 17, when NYBOT's Member Services Department began contacting members who had not submitted an election form, they were unable to provide members with any date or time certain by which late elections needed to be submitted in order to be accepted. Member Services made persistent efforts on January 17 and 18 to contact all members who had missed the January 5 deadline, but could offer no guarantee that late elections would be accepted if submitted in response to Member Services' contact.

No late elections were accepted after January 18, 2007. The decision not to accept any elections that came in after this date was made "in the moment," most likely late in the evening of January 18 or early in the morning January 19.[13] Defendants' reason for closing the window "on the fly" as they did was hotly contested at trial and is an important part of my decision in this case.[14] At any rate, defendants' haphazard opening and closing of the late election window convinces me that the whole process was somewhat disjointed.

Defendants also could have done a better job ascertaining exactly how much time was needed to calculate and distribute the merger

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[12]Sprecher's role in the decision to accept late elections was more or less limited to instructing the ICE legal team to research whether late elections could legally be accepted, as described at greater length below. He didn't make the actual decisions to open or close the acceptance window.

[13]Tr. at 214-16. Defendants cannot document when the decision to close the election window actually occurred. The testimony at trial was that it was a decision made after consulting with Computershare over the phone. The exact time of the decision could not be recalled.

[14]As described below, I find defendants' decision to close the election window was not motivated by bad faith.

consideration by the distribution deadline on January 29, 2007. At trial, email correspondence between defendants' representatives and Computershare regarding the acceptance of late elections were introduced into evidence.[15] This correspondence plainly demonstrates that in defendants' consultations with Computershare it was never determined exactly how much time Computershare needed to perform its duties.[16] Rather, defendants opened the late acceptance window only to close it less than 48 hours later after Computershare voiced concerns about its ability to meet the January 29 deadline.[17] I am left with the impression that defendants' efforts to accommodate late elections could have been better coordinated with Computershare.

The shortcomings in defendants' process do not amount to a breach of the implied covenant of good faith and fair dealing however. In my November 2009 opinion I reasoned that "plaintiff would have had no claim for breach of the implied covenant if defendants had declined to accept late elections altogether."[18] I further reasoned that "general efforts by defendants to accommodate all late elections would rightly be viewed as *exceeding* the implied covenant's requirements."[19] Such general efforts, even if poorly organized and executed, would be devoid of the "bad faith" required to establish a breach of the implied covenant. As discussed below, I find that defendants' efforts were targeted at *all* members who missed the January 5 deadline, rather than a select few. Accordingly, these efforts went beyond what was required by the implied covenant, even though they were less than optimal.

B. The decision to open a late election acceptance window

Plaintiff could have met the burden in this case by demonstrating that defendants' decision to open a short window of acceptance was solely based on the fact that certain "connected" members failed to get their forms in on time. Plaintiff's evidence did not meet this burden, principally because it did not convince me that the three NYBOT members plaintiff characterized as "connected"—John MacIntosh, Eric Bolling, and Kevin Davis—were in fact "connected." Moreover, I find that the decision to open a late election acceptance window was motivated by a desire to accommodate all members who missed the January 5 deadline, rather than any one or all three of these individuals.

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[15] *See e.g.*, JX 111, JX 136.

[16] Tr. at 231-32.

[17] Tr. at 233.

[18] *Amirsaleh v. Bd. of Trade of the City of N.Y., Inc.*, 2009 WL 3756700, at *6 (Del. Ch. Nov. 9, 2009).

[19] *Id.*

During trial plaintiff sought to demonstrate that MacIntosh, Bolling, and Davis had special connections with defendants' key decision makers and that they used these connections to convince defendants to accept their late elections.[20] Plaintiff's fundamental contention is that before MacIntosh, Bolling, and Davis contacted key members of defendants' management defendants had concluded that no late elections would be accepted, but defendants changed their minds solely to permit MacIntosh, Bolling, and Davis to submit late elections. To explain why I don't accept plaintiff's theory of the case, I will discuss the evidence of Bolling, Davis, and MacIntosh's "connectedness" and whether the decision to accept late elections was specifically designed to help these individuals.

I begin with Bolling. Plaintiff sought to prove at trial that Bolling was connected because he was able to place a call directly to ICE CEO Jeffrey Sprecher on January 12, 2007, to inform Sprecher that he missed the January 5 deadline and request help with his late election.[21] Plaintiff's theory is that Sprecher had a desire to help Bolling because Bolling was well known as being one of the largest natural gas traders at NYMEX and was, therefore, a potential ICE customer.[22] Plaintiff introduced an excerpt of Sprecher's deposition testimony wherein Sprecher explained that after his conversation with Bolling he asked his legal team "on behalf" of Bolling if bolling's late election could be accepted.[23] Based on this deposition testimony, plaintiff characterizes Sprecher's conversation with his legal team as being solely aimed at helping Bolling submit a late election form. Plaintiff also introduced evidence during trial that Sprecher called Bolling back and recommended that he submit his form while ICE researched whether it could be accepted.[24]

Sprecher testified at trial, however, that he instructed his legal team to research whether defendants could accept late elections from *anyone* in Bolling's position.[25] Sprecher explained that he gave this instruction because he was aware (or at least became aware) when discussing the matter with his legal team that others besides Bolling had missed the January 5 deadline.[26]

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[20]Plaintiff predominantly focused on proving the connectedness of Bolling and Davis at trial, but spent some time focusing on MacIntosh as well. To be thorough, I analyze all three individuals' relationships with, and alleged influence over, defendants.

[21]Tr. at 468.

[22]Of course, Bolling was already an ICE customer because he was a NYBOT member, and ICE had just acquired NYBOT. But Bolling was also a potential customer in the sense that he might, in the future, leave NYMEX and begin using an ICE exchange. Tr. at 470-72.

[23]Sprecher Dep. at 40-41; Tr. at 473.

[24]Tr. at 479-80.

[25]Tr. at 448-50.

[26]Sprecher could not recall whether Bolling informed him during the call that others had missed the election deadline or whether his legal team informed him that others were in Bolling's situation. Tr. at 475 ("[O]nce I heard there were other people, and it might be a bigger universe, I said we should really look hard at this issue."). It doesn't matter whom Sprecher learned this

As the finder of fact I am responsible for evaluating witness credibility and I find Sprecher's testimony believable. By this testimony, Sprecher concedes that the late election window was opened in part to assist Bolling, but it was also opened to assist over thirty other NYBOT members who had failed to submit their election forms on time. Admittedly, Bolling was the person who first made Sprecher aware that at least one person (Bolling himself) had missed the election deadline. Had Bolling not made this call, we are left to speculate as to when and how Sprecher would have been made aware that NYBOT members had missed the deadline. But we are not left to speculate as to his response. I am persuaded that Sprecher would have requested that his legal team research whether late elections could be accepted if *any* of the other deadline-missing NYBOT members had called him. Thus, the opening of the late election window does not appear to have been driven by a desire to accommodate Bolling alone, but rather by Sprecher's desire to accommodate anyone in Bolling's position.[27]

My finding that Sprecher's concern extended beyond Bolling to all his tardy peers is supported by multiple pieces of evidence introduced during trial. For, starters, Sprecher did not have a personal, financial, or other relationship with Bolling.[28] Before the January 12 phone call, Sprecher had spoken to Bolling on only two occasions, and then only briefly.[29] At no time did Sprecher promise Bolling special assistance that would not be given to other NYBOT members.[30] Nor did Sprecher promise Bolling that his late election would be accepted; he simply promised Bolling that he would look into the issue and follow up.[31] When Sprecher called Bolling back he recommended that Bolling turn in the form, but cautioned that he could not guarantee its acceptance because defendants were still reviewing whether late forms could be accepted at all.[32] Sprecher also told Bolling to inform any other members on the floor of the NYMEX that if they missed the deadline they should still submit their form.[33] This is hardly the talk of someone who is trying to offer illicit, clandestine help to a favored acquaintance. In fact, before the late acceptance window was opened on January 17, many members who had missed the January 5 deadline were similarly told by defendants' representatives (other than Sprecher) that they could still submit

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information from, as he sought to accommodate all who had missed the deadline.

[27]Tr. at 459 ("I was aware that there were others in Mr. Bolling's situation, so he became a figurehead for the problem.").

[28]Tr. at 444-47.

[29]*Id.*

[30]Tr. at 447. No evidence was introduced at trial in the form of documents or testimony that directly contradicts Sprecher's testimony on this point. The only possible contradiction would be an inferential one arising from the fact that Bolling received some help from defendants in filling out his form. *See infra* note 57. But I decline to make this inference.

[31]*Id.*

[32]Tr. at 450-51.

[33]*Id.*

their forms but had no guarantee of acceptance.[34] Thus, the assurances Sprecher offered to Bolling were no different than assurances offered to other NYBOT members. Finally, there was no testimony suggesting that it was highly unusual for Bolling to be able to contact Sprecher directly; nor was there any testimony that plaintiff could not have contacted Sprecher if he had tried. In fact, Sprecher testified that he regularly takes calls from customers such as Bolling and had plaintiff attempted to contact him he would have taken his call.[35]

Now to Davis. During trial plaintiff introduced evidence that Davis called Sprecher a few days after Bolling.[36] Sprecher knew Davis was a large ICE customer and the CEO of one of the world's largest commodity exchange clearing firms.[37] Davis's call did not concern late election forms but Sprecher brought the topic up.[38] Sprecher asked Davis if he had submitted his election form on time.[39] Davis did not know.[40] Sprecher recommended that he find out and submit it if that hadn't already been done.[41] Plaintiff contends that Sprecher asked Davis about his election because he wanted to ensure a powerful person like Davis was taken care of. Along with Bolling, plaintiff contends that the late election window was opened to assist Davis, but not everyone else.

I find that Davis did not have a special connection with Sprecher that inappropriately influenced the decision to open the late election acceptance window. Multiple pieces of evidence support this finding. First, Davis and Sprecher had a frosty relationship. They had been adversaries in past business dealings.[42] While there was some overlap in the professional circles they ran in, nothing about their relationship suggests to me that Sprecher would have had any desire to offer aid to Davis to the exclusion of other NYBOT members. This is supported by Sprecher's credible testimony at trial that he never followed up with Davis to learn if Davis's election had been submitted.[43] Moreover, Sprecher testified that he never even mentioned his conversation with Davis to his legal team,[44] so when they made the

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[34]Tr. at 541-42; 647-54.

[35]Tr. at 492.

[36]Tr. at 482.

[37]Tr. at 484-85.

[38]*Id.*

[39]Tr. at 487.

[40]*Id.*

[41]Tr. at 453.

[42]Tr. at 454-56.

[43]Tr. at 452-57. There is a piece of circumstantial evidence that, with the right inference, could be viewed as contradicting this part of Sprecher's testimony; Davis's form was the last accepted before the late election window was closed. From this, plaintiff would have the Court infer that Sprecher instructed his legal team to hold the window open just long enough for Davis to get his form in. In *Section C* of this Opinion I explain why I do not accept this inference.

[44]Tr. at 456. This was consistent with ICE Assistant General Counsel Andrew

decision to open the late election window it could not have been because of Davis. According to Sprecher, after his brief phone call with Davis, he did not do a thing further with Davis's election.[45]

Finally, to MacIntosh. Plaintiff contends that MacIntosh wielded special influence over defendants' decision to accept late submissions by means of his personal and professional relationship with NYBOT Chairman Frederick Schoenhut. MacIntosh was a NYBOT floor broker who contacted Schoenhut on January 6, 2007, the day after the election deadline, expressing concern that he had failed to turn his form in on time.[46] Schoenhut emailed Audrey Hirschfeld, NYBOT General Counsel, and Helene Recco, Director of NYBOT Member Services, asking if it was possible for MacIntosh's late form to be accepted.[47] Schoenhut suggested that some leniency should be given to MacIntosh because the National Day of Mourning on January 2 had shut down the mail for a day.[48] On January 6, Recco simply responded that it would be "worth a shot" for MacIntosh to submit his form but made no guarantees or assurances that MacIntosh's form would be accepted and made no promises of special assistance.[49] On January 7, Hirschfeld responded:

> They should accept it.—was on the phone with ice and computershare and the fact is that no calculation is made until the day of closing so nobody is harmed if they accept a form that is a day late oir (sic) so. I would not advertise this but I think we can give some comfort to him . . . Truth is the 5th was a date that was set on the assumption that we close on the 12th and because the merger agreement said the forms need to be in 5 days in advnce (sic) of closing. But nothing is happening till closing, whenever that is.[50]

At trial Hirschfeld testified that at the time of this email she believed defendants might accept forms that came in on January 8, including MacIntosh's, because of the National Day of Mourning on January 2.[51] Hirschfeld explained that by this email she didn't mean to suggest that leniency would be given to MacIntosh but not to others; she was simply expressing her opinion that MacIntosh's form would be accepted because Computershare did not have to do calculations until January 12th and

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Surdykowski's testimony that he did not know who Davis was when making the decision to open and close the election window. Tr. at 357, 359, 373.

[45]Tr. at 457.

[46]Tr. at 571.

[47]*Id.*

[48]*Id.*; JX 45.

[49]JX 45.

[50]JX 47.

[51]Tr. At 579.

because she had personally participated in internal discussions about extending the deadline for everyone to the 8th.[52] I found this to be a reasonable explanation of Hirschfeld's response to Schoenhut given that Schoenhut had specifically suggested that leniency be given on the basis of the National Day of Mourning. Moreover, I found Hirschfeld to be a credible witness on this point. In any event, neither Schoenhut, nor Hirschfeld, nor Recco advised anyone at ICE about MacIntosh's plea for help, so his request was not considered by the ICE legal team that decided to open the late election window.[53] Moreover, Hirschfeld's belief that filings submitted January 8th would be accepted turned out to be incorrect. On January 9th, defendants determined not to accept any late forms, including MacIntosh's.[54] MacIntosh's form was not accepted until January 17, when all other late forms that had been submitted up to that point were also accepted.[55]

C. Alleged special treatment of certain members

Plaintiff could also have met his burden by demonstrating that Bolling, Davis, or MacIntosh received special treatment in submitting late elections, including holding open the election window just long enough to ensure that any one or all three of these individuals' late elections were accepted. I find that no special treatment was given to any of these individuals. I have already discussed at length my finding that Bolling, Davis, and MacIntosh were not "connected;" they did not, in fact, enjoy any special privilege or relationship with defendants that set them apart from other NYBOT members. Nevertheless, to be thorough I independently analyze defendants' efforts to assist late filers to demonstrate why I don't believe Bolling, Davis, or MacIntosh received special assistance.[56]

Plaintiff sought to demonstrate at trial that Bolling and Davis were given special assistance because they had access to critical information that was not given to others, particularly during the period between Bolling's January 12, 2007 call to Sprecher and defendants' decision on January 17, 2007 to accept all late elections accumulated. Specifically, plaintiff demonstrated that during this period Bolling and Davis were informed that (1) there was an election deadline that passed, (2) there was an election form (in addition to the pledge form) that had to be submitted, and (3) the late election form should be submitted quickly because there was a chance it

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[52]Tr. At 579.

[53]Tr. at 540-41, 648.

[54]*See* Tr. at 329, 540-41; *see also* JX 64.

[55]Tr. at 361, 541; JX 109.

[56]Plaintiff's efforts at trial were focused on demonstrating that Bolling and Davis received special assistance. No special assistance allegedly received by MacIntosh was explored other than the contact he had with Schoenhut (which, as we have seen, did not result in any special assistance).

might be accepted.[57] I conclude that these are insufficient bases upon which to draw an inference that Bolling and Davis were given preferential treatment that was denied others in this process. As I will explain, the assistance Bolling and Davis received was not identical to the assistance plaintiff received, but it was substantially similar.

The fact that Bolling and Davis may have been told by Sprecher that the election deadline had passed and that an election form (rather than a pledge agreement) needed to be submitted is of no consequence. Bolling already knew he missed the deadline; that's why he called Sprecher. Moreover, the deadline had been disclosed in the election booklet that had been previously mailed to every member, including plaintiff. Plaintiff testified that he never received this booklet, but it has already been determined in this case that defendants mailed the booklet to plaintiff's correct address and that, under the merger agreement, this was all defendants were required to do to inform plaintiff of the election deadline.[58] In the first instance, defendants followed a uniform procedure to inform all NYBOT members of the January 5 deadline. Thereafter, Davis was not being treated preferentially simply because Sprecher pointed out the deadline had passed. Plaintiff (and every other NYBOT member) should have known that. Essentially the same thing can be said of Sprecher's informing Bolling and Davis that an election booklet needed to be submitted apart from a pledge agreement. This information had previously been disclosed in a uniform manner to all NYBOT members in the proxy.[59] Everyone should have known this when Sprecher discussed it with Bolling and Davis.

What deserves some consideration is the fact that Bolling and Davis were told a few days earlier than plaintiff and other members that they should submit their late elections. The thrust of plaintiff's argument is that Bolling and Davis were given a significant advantage over other NYBOT members because Sprecher personally told them before January 17 that they

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[57]Pl.'s Post Trial Br. at 7-8; *see also* Tr. at 692-94, 713-16, 783-88, 792-94. Plaintiff also demonstrated that some help was given to Bolling and Davis in completing and submitting their forms. Specifically, Hirschfeld's assistant helped Bolling complete his election form when he hand delivered it to NYBOT offices with questions about it and Recco forwarded Davis's election to Computershare after he sent it directly to her. Tr. at 585-89, 670-71; JX 144. This assistance does not demonstrate preferential treatment. There was no evidence introduced at trial suggesting that if plaintiff had questions regarding how to complete his form he would have been refused help by defendants. I do not know what alternative Hirschfeld's assistant had other than to help Bolling when he made an *in person* request for help in completing his form. I am convinced the same assistance would have been offered to any person requesting it. Moreover, Recco testified that it was common for members to mistakenly submit their forms to Member Services and that she routinely forwarded them to Computershare, so this was not special assistance that only Davis received. Tr. at 671.

[58]*Amirsaleh v. Bd. of Trade of the City of N.Y., Inc.*, 2008 WL 4182998, at *5-6 (Del. Ch. Sept. 11, 2008).

[59]Proxy at 79, 93.

should take a chance and submit their forms. I do not find that this amounts to special treatment. Bolling and Davis were told to submit their forms solely because they had directly contacted Sprecher, something plaintiff could have done himself. It was not due to some conscious effort on defendants' part to give Bolling or Davis an edge in submitting their late elections. When Sprecher spoke to these individuals no decision had been made as to whether late elections would be accepted; the matter was being researched. Sprecher had no idea whether late elections could legally be accepted.[60] I cannot conclude that defendants had an obligation to begin contacting every member at this point simply because Sprecher recommended to Bolling and Davis that they turn their late forms in. Sprecher's advice in this regard is not extraordinary; he was simply suggesting that Bolling and Davis do what they should have done before the deadline on the off-chance that the forms might still be accepted. During this same period, other members came to the conclusion that submitting a late form would be worth a shot and sent their forms in after January 5 but before January 17 without being told by anyone associated with defendants that they should do so. In addition, before the late acceptance window was opened, other members who had missed the January 5 deadline were told by defendants' representatives (other than Sprecher) that they could still submit their forms but had no guarantee of acceptance.[61] Plaintiff was as free as anyone to submit an election form at any time after January 5 on the off-chance that it might be accepted.

What is most important is this: as soon as the decision was made to accept late elections on January 17, NYBOT Member Services began contacting *all* members—including plaintiff—who had yet to submit a form.[62] Member Services persisted in their efforts on January 18, making multiple calls to some members who were hard to reach, including plaintiff.[63] This was an appropriate effort to treat all members in a substantially similar manner. I am satisfied that no person associated with defendants was trying to favor one member over another in the general effort to give late filers a second chance. While plaintiff argues that Member Services could have done more to contact members after the decision was made to accept late elections, it can hardly be suggested that Members Services did not make a consistent effort to encourage all unresponsive members to act and to act quickly. Having determined in good faith that calling and leaving messages for each individual member who had not submitted an election was the quickest and most effective way to reach them under the circumstances, defendants did all that was required by the implied covenant of good faith and fair dealing.

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[60]Tr. at 453.
[61]Tr. at 541-42, 647-54.
[62]Tr. at 761-70; JX 112, 114.
[63]JX 112; Tr. at 763-64, 769-70.

I now turn to plaintiff's final major contention regarding special treatment. Plaintiff sought to prove at trial that defendants held the late election window open just long enough to allow Bolling and Davis to submit their forms. Plaintiff introduced evidence that, on the afternoon of January 18, before the election window was closed, ICE Assistant General Counsel Andrew Surdykowski reviewed a list of members prepared by Computershare who had not yet submitted a form.[64] Davis was on this list.[65] Bolling was not, as he had submitted his form the previous day.[66] When Computershare employee Donnie Amado sent the list to Surdykowski he warned Surdykowski that the late election window needed to be cut off "asap" in order to meet the January 29 distribution deadline.[67] Surdykowski had the ultimate authority to decide when to close the late election window.[68] According to plaintiff, Surdykowski decided to keep the election window open longer, despite Amado's warning, so that Davis could submit his form. Plaintiff produced a January 19 email from Amado to Surdykowski seeking confirmation that Davis's form—the last submitted on January 18—was to be the last form accepted.[69] Plaintiff contends that this circumstantial evidence proves the window was only held open long enough for Davis to get his form in.

Plaintiff's evidence was undermined by the direct testimony of Surdykowski and Sprecher at trial. Sprecher testified that he never mentioned Davis's name to anyone on his legal team and that he never followed up on the status of Davis' election after his brief phone call with him.[70] Surdykowski testified that he did not know who Davis was and did not know Davis had spoken to Sprecher at the time he decided to close the election window.[71] Surdykowski further testified that he closed the window in the face of increasing pressure from Computershare to cut off late acceptances and because he had his own concerns about Computershare's ability to meet the distribution deadline.[72] I found the testimony of Surdykowski and Sprecher to be credible in this regard and accordingly conclude that Surdykowski could not have been watching for Davis's form

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[64]Tr. at 226-28.

[65]Tr. at 229; JX 136.

[66]JX 136.

[67]*Id.*; Tr. at 226.

[68]*See* Tr. at 214-15.

[69]JX 152.

[70]Tr. at 456-57.

[71]Tr. at 357, 359, 373.

[72]Tr. at 367-71. As discussed, opening the late election window without some idea as to when it should be closed was a less than optimal approach to handling late elections. But this does not demonstrate that defendants had the bad faith necessary to establish a breach of the implied covenant. Defendants' efforts to assist late elections could have been better organized and executed, but this does not mean such efforts were designed to accommodate Bolling, Davis, or MacIntosh.

when the election window was closed. It was coincidence (perhaps an unfortunate one) that Davis's form was the last submitted on January 18. Moreover, I find that the election window was not held open just long enough for Bolling because of the simple fact that the window was held open for more than 24 hours after Bolling had submitted his form.

IV. CONCLUSION

Plaintiff bore the burden of proof at trial to prove that defendants' discretionary decision to open the late election acceptance window was made in bad faith. Plaintiff failed to produce evidence that convinced me that defendants opened the window for the improper purpose of aiding only Bolling, Davis, and MacIntosh. Moreover, plaintiff's evidence did not convince me that Bolling, Davis, or MacIntosh received special treatment in submitting late elections. Although the late election process could have been better organized and executed, it was nevertheless a good faith (albeit imperfect) attempt to accommodate all NYBOT members who had missed the January 5 deadline. Accordingly, defendants did not breach the implied covenant of good faith and fair dealing.

An order has been entered consistent with this Memorandum Opinion.

FRANK C. WHITTINGTON, II V. DRAGON GROUP L.L.C.

No. 2291-VCP

Court of Chancery of the State of Delaware, New Castle

February 15, 2010

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Richard L. Renck, Esquire, Andrew D. Cordo, Esquire, Ashby & Geddes, Wilmington, Delaware; Attorneys for Defendants Marna McDermott, Sarah Whittington, Ruth Whittington, Matthew Minotti, and Dorothy A. Minotti

PARSONS, *Vice Chancellor*

This case is the latest in a long-running dispute between a brother in the Whittington family and his siblings over ownership of a Delaware business. The Whittingtons have come to the Court of Chancery on several occasions asking the Court to resolve disputes between the siblings regarding their assets and those of their deceased ancestors. In the latest iteration of these disputes, I ruled that laches prevented the brother from pursuing his claim to an ownership interest in a business entity owned by his siblings. In holding that laches barred the brother from making his claim, I relied on my earlier decision that a three-year statute of limitations applied by analogy to the brother's claims. The brother appealed, and the Delaware Supreme Court determined that the analogous statute of limitations is twenty years instead of three. The Supreme Court, therefore, remanded the matter to this Court to reconsider its laches holding by applying a twenty-year statute of limitations for purposes of analogy.

After receiving additional briefing and hearing oral argument of the parties on remand, I submit this report to the Supreme Court with my findings of fact and conclusions of law on the laches issue. For the reasons stated in this Memorandum Opinion, I conclude that, when viewed in the context of a twenty-year limitations period, the evidence does not support barring the brother's claims for laches.

I. BACKGROUND

A. The Parties

Plaintiff, Frank C. Whittington, II ("Frank"), brought this action to force his siblings to recognize his alleged membership in Dragon Group, L.L.C. ("Dragon Group"), a Delaware limited liability company.[1] Defendants include Frank's four siblings, each of whom are members of Dragon Group. These siblings are: Thomas D. Whittington, Jr. ("Tom"), Richard Whittington, L. Faith Whittington, and Dorothy W. Minotti (collectively, the "Sibling Defendants").[2] The remaining Defendants include other members of Dragon Group and other of Frank's relatives.

B. Facts and Procedural History

The factual and procedural history of this case is recited in *Whittington I* and summarized by the Delaware Supreme Court in its decision remanding the question of laches to this Court.[3] Therefore, I highlight only briefly the relevant portions of that history.

1. Facts

On June 14, 2001, Frank and a number of his siblings settled a prior dispute by entering into an Agreement in Principle (the "AIP"). As part of the AIP, Frank's share of stock in Whittington Ltd. ("Ltd."), another family-owned entity, would be carried forward into Dragon Group. Although Dragon Group existed at this point, Frank and his siblings could not agree to the terms of an operating agreement for the company. On September 23, 2002, Tom distributed an Offering Memorandum to all Ltd. members, offering them a stake in Dragon Group and proposing terms for the operating agreement. To accept the offer, Ltd. members had to pledge all their Ltd. stock and return to Tom a signed copy of the Offering Memorandum by October 15, 2002. Frank complied with the Offering Memorandum's requirements, except that he increased his percentage share in the operating agreement portion of the Offering Memorandum to reflect the share to which he believed he was entitled.

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[1] *Whittington v. Dragon Gp. L.L.C. (Whittington I)*, 2009 WL 1743640, at *1 (Del. Ch. June 11, 2009), *rev'd*, 2009 WL 4894305 (Del. Dec. 18, 2009).

[2] Unless otherwise noted, all background facts recited in this Opinion are drawn from *Whittington I* and are supported by the evidence cited therein.

[3] *Whittington v. Dragon Gp. L.L.C. (Whittington Remand)*, 2009 WL 4894305, at *10 (Del. Dec. 18, 2009).

In November 2002, Tom informed Frank's counsel that Dragon Group deemed Frank's changes to the operating agreement a counteroffer, which it rejected. Frank then filed a Motion for Order Compelling Defendants' Compliance with Court Order and Directing Performance by Substitute (the "2002 Motion"). Vice Chancellor Lamb denied the 2002 Motion in a Letter Opinion dated March 4, 2003 (the "March 2003 Opinion"). There, the Court ruled that the "terms of the [Dragon Group] LLC operating agreement will be those that were established at its inception, adjusted to reflect Frank Whittington's percentage ownership interest."[4] Frank interpreted the quoted language to mean that he had an interest in Dragon Group and that it was at the increased level he had indicated. Defendants interpreted the Court's denial of the 2002 Motion to mean that they had prevailed and Frank had no interest in Dragon Group. Defendants thereafter refused to recognize Frank as a member of Dragon Group.

In May 2003, Frank became frustrated by Defendants' refusal to provide him with Dragon Group's financial information. Because of this and other disputes over various family-owned entities, Frank proposed that his siblings buy out his interests in all of those entities. The Sibling Defendants rejected Frank's proposed buy-out on July 7, 2003 and told Frank's counsel, Jay Katz, that they did not consider Frank a member of Dragon Group.

In August 2003, the Sibling Defendants held annual shareholders meetings for the various family-owned entities. Although Frank attended meetings for the other entities, his siblings excluded him from Dragon Group's annual meeting on the ground that he had no interest in Dragon Group.

In April 2004, Frank received a K-1 from Dragon Group. But, on April 14, 2004, Tom sent Frank a letter informing him that the K-1 was sent by accident. That letter explicitly stated that Frank was not a member of Dragon Group.

In late 2004, Dragon Group called on its members to make a capital contribution. In response, on January 12, 2005, Dragon Group received $36,152 from its members. Frank did not receive notice of the capital call and did not contribute.

In October 2005, during settlement negotiations between Frank and his siblings, Tom and Frank discussed a buy-out proposal whereby either party could buy out the other. In related correspondence with Frank, Tom acknowledged that Frank still asserted an interest in Dragon Group.

The parties never reached a settlement, and Frank eventually filed this action in the Court of Chancery.

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[4] *Whittington v. Farm Corp.*, C.A. No. 17380, slip op. at 4–5 (Del. Ch. Mar. 4, 2003).

2. Procedural history

Frank filed his Complaint in this action on July 20, 2006 against Dragon Group and the Sibling Defendants. On October 25, 2006, Frank moved for summary judgment, which I denied on May 8, 2007. On June 22, 2007, Frank amended his Complaint to add the remaining Defendants.[5] In February 2008, Defendants moved for summary judgment, which I denied in June 2008. One of the issues raised in the briefing on Defendants' motion for summary judgment was the analogous statute of limitations for purposes of a laches analysis.[6] In ruling on Defendants' motion, I held the analogous statute of limitations was three years, and not twenty years, as Frank had argued.[7] After ruling on that motion, I held a four-day trial from June 10 to 13, 2008 and heard post-trial argument on January 30, 2009.

In this litigation, Frank seeks three types of related relief. He requests that the Court (1) enforce Dragon Group's operating agreement and uphold Frank's 23.65% interest in it, (2) compel Dragon Group to disburse his proportionate share of its profits, and (3) provide an accounting of Dragon Group's profits to determine his share.

Defendants argued that either the statute of limitations or the doctrine of laches barred Frank from bringing his claim. They further contested Frank's claimed interest in Dragon Group and argued that if he had an interest, it was less than the 23.65% he claimed. Frank asserted that the doctrines of res judicata, collateral estoppel, and judicial estoppel barred Defendants' defenses.

I ruled on June 11, 2009 in *Whittington I* that the doctrine of laches barred Frank's claim. In doing so, I relied on my earlier decision that the analogous statute of limitations for his claim was three years. On appeal, Frank argued that his claim was based on a breach of a contract under seal and that the analogous statute of limitations, therefore, should be twenty years and not three. The Supreme Court agreed and remanded to this Court the issue of whether laches still bars Frank's claim in light of its holding that the analogous statute of limitations is twenty years.

C. Parties' Contentions

Frank urges the Court to find that laches does not bar his claim to ownership in Dragon Group. First, he argues that the Court should place great emphasis on the twenty-year statute of limitations and find that laches

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[5]In September 2007, Frank dismissed his claims against Defendant Marna C. Whittington without prejudice.

[6]*Whittington v. Dragon Gp. L.L.C.*, C.A. No. 2291, slip op. at 11–13 (Del Ch. June 6, 2008).

[7]*Id.* at 13.

does not apply because Frank filed his claim with seventeen years to spare. Second, Frank argues that no extraordinary circumstances exist that would make it inequitable for the Court to allow his claim to proceed. Third, Frank dismisses as either self-inflicted or immaterial the prejudice claimed by Defendants. Fourth, he argues that this Court can fashion an equitable remedy that accounts for any failure on his part to share in Dragon Group's investment risks.

Defendants ask the Court to reaffirm its previous laches holding despite the significantly longer analogous statute of limitations because the holding in *Whittington I* was not dependent on the three-year statute of limitations. Defendants further contend that because Frank's Complaint seeks specific performance, an extraordinary circumstance exists that justifies a finding of laches even though the analogous statute of limitations has not run. Finally, Defendants assert that they suffered prejudice as a result of Frank's delay in that they assumed additional risks while Frank waited to bring this suit.

II. ANALYSIS

A. Scope of Review

On Frank's appeal from *Whittington I*, the Delaware Supreme Court ruled that this Court applied the wrong analogous statute of limitations.[8] It therefore remanded "for reconsideration [the Court of Chancery's] laches holding by applying a twenty-year statue of limitations for purposes of analogy."[9]

Defendants assert that, on remand, this Court's scope of review is limited by the "law of the case" doctrine.[10] In particular, they argue that I cannot reconsider any findings or conclusions regarding my prior laches holding and that I am bound to consider only the change in the applicable statute of limitations. I disagree.

The "law of the case" doctrine "is designed to prevent the relitigation of prior determinations and inconsistent judgments."[11] When an appellate court remands a case to the trial court, "the trial court must proceed in accordance with the mandate and the law of the case established on appeal."[12] "The trial court is required to implement both the letter and the

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[8] *Whittington Remand*, 2009 WL 4894305, at *10.

[9] *Id.*

[10] Defs.' Opening Br. ("DOB") 13; Defs.' Reply Br. ("DRB") 3–5. On remand, Plaintiff also filed an opening and reply brief; they will be referred to as "POB" and "PRB," respectively.

[11] *Fanean v. Rite Aid Corp. of Del., Inc.*, 2009 WL 4842461, at *3 (Del. Dec. 3, 2009).

[12] *Motorola v. Amkor Tech., Inc.*, 958 A.2d 852, 860 (Del. 2008) (quoting *Ins. Corp. of Am. v. Barker*, 628 A.2d 38, 40 (Del. 1993)).

spirit of the mandate, taking into account the appellate court's opinion and the circumstances it embraces."[13] "While the mandate does not control a trial court as to matters not addressed on appeal, the trial court is bound to strictly comply with the appellate court's determination of any issues expressly or impliedly disposed of in its decision."[14] Generally, the trial court is "free to make any order or direction in further progress of the case" that is not inconsistent with, nor settled by, the appellate court's decision.[15] There are, however, exceptions to this rule. As the Delaware Supreme Court recently explained:

> The law of the case becomes applicable when the Court applies a legal principle to an issue based on facts that have stayed constant over the course of the litigation. Only upon a showing of the existence of newly discovered evidence, a change in the law, or a resulting manifest injustice should the Court reopen decisions that it has already adjudicated. Without such a showing, there can be no new consideration.[16]

According to Defendants, because the Supreme Court recited certain of this Court's factual findings in its Opinion, it implicitly disposed of those factual issues.[17] In support of their argument, Defendants cite *Chavin v. PNC Bank, Delaware*, in which this Court opined that it "probably" could not reconsider certain claims that the appellee previously advanced before the Supreme Court and which that court implicitly decided by ruling against the appellee and refusing to hear reargument.[18]

Defendants' reliance on *Chavin* is misplaced. Unlike the situation in *Chavin*, in this case the Supreme Court has not ruled either implicitly or explicitly on facts or conclusions of law regarding the appellant's (Frank's) claims. The Court only determined that the AIP is a contract under seal[19] and that the applicable statute of limitations for legal claims analogous to a claim for specific performance based on an alleged breach of the AIP is twenty years. Because it found the AIP to be a contract under seal, the Supreme Court directed this Court to reconsider its laches holding and report back its findings of fact and conclusions of law.[20] If all the findings of fact and conclusions of law were unalterable, as Defendants contend, the Supreme

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[13] *Id.*
[14] *Barker*, 628 A.2d at 40.
[15] *Motorola*, 958 A.2d at 860 (quoting *Barker*, 628 A.2d at 40).
[16] *Fanean*, 2009 WL 4842461, at *3.
[17] DRB 4.
[18] 830 A.2d 1220, 1221–22 (Del. Ch. 2003).
[19] *Whittington Remand*, 2009 WL 4894305, at *10.
[20] *Id.*

Court's mandate to report anew those findings would make little sense.

Notwithstanding the foregoing, I do not accept Frank's invitation to review *de novo* the many factual issues he raised in his briefs on remand. Specifically, I decline to reconsider my previous findings that: Dragon Group's 2003 shareholders meeting took place in August rather than October;[21] Frank knew or should have known about his claim by July 15, 2003; and Katz told Frank in early July 2003 that the Sibling Defendants did not consider Frank a member of Dragon Group. To my mind, the change in the analogous statute of limitations provides no basis for altering any of those findings.

B. Standard for Laches

Laches is an equitable defense based on the maxim that "equity aids the vigilant, not those who slumber on their rights."[22] Although there are no hard and fast rules regarding laches, courts typically find laches in situations where a plaintiff unreasonably delays in bringing a lawsuit after learning that someone has infringed upon his rights, thereby prejudicing the defendant.[23] The principal inquiry is whether it would be inequitable to permit the plaintiff's claim to be enforced.[24] Defendants seeking to invoke laches generally must prove that the claimant (1) knew of his claim, (2) unreasonably delayed in bringing his claim, and (3) injured or prejudiced the defendant by his unreasonable delay.[25]

1. Frank's knowledge of his claim

Defendants must show that Frank was on at least inquiry notice of his claim and thereafter unreasonably delayed filing that claim, thereby causing Defendants prejudice.[26] Inquiry notice exists when the plaintiff learns of "facts sufficient to put a person of ordinary intelligence and prudence on inquiry which, if pursued, would lead to the discovery [of

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[21] I note, however, that whether the 2003 shareholders meeting occurred in October, as opposed to August, is immaterial to the pending question on remand based on the longer analogous statute of limitations and my prior holding that Frank knew or should have known about his claim by July 15, 2003.

[22] *Reid v. Spazio*, 970 A.2d 176, 182 (Del. 2009) (citing 2 POMEROY'S EQUITY JURISPRUDENCE §§ 418, 419 (5th ed. 1941)); *Adams v. Jankouskas*, 452 A.2d 148, 157 (Del. 1982).

[23] *Reid*, 970 A.2d at 182. *See also U.S. Cellular Inv. Co. v. Bell Atl. Mobile Sys., Inc.*, 677 A.2d 497, 502 (Del. 1996); *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 210 (Del. 2005).

[24] *Reid*, 970 A.2d at 183.

[25] *Id.* at 182–83; *Homestore*, 888 A.2d at 210.

[26] *Quill v. Malizia*, 2005 WL 578975, at *14 (Del. Ch. Mar. 4, 2005).

injury]."[27] Courts expect plaintiffs to act once they reasonably suspect that someone has violated their rights; therefore, the statute of limitations runs from the time a plaintiff should have known of his injury.[28]

The Supreme Court's decision in the *Whittington Remand* did not disturb my finding in *Whittington I* that Frank knew about the alleged breach of the AIP by July 15, 2003. As I stated in that Opinion, even if Katz failed to advise Frank that Defendants did not consider Frank a member of Dragon Group, as Frank alleges, he reasonably should have inquired about why Defendants rejected the settlement offer Katz made on his behalf on July 7, 2003.[29] Had he made that inquiry, he would have learned Defendants did not consider him a member of Dragon Group. Therefore, Defendants have met their burden on this point.

2. Unreasonable delay

In determining whether a plaintiff unreasonably delayed in bringing his claim, an equity court acts "upon considerations of conscience, good faith, and reasonable diligence."[30] The primary inquiry is whether it would be inequitable to permit a claim because the plaintiff's "inexcusable delay [led] to an adverse change in the condition or relations of the property or the parties."[31] To determine whether delay is inexcusable, the court considers whether the plaintiff exercised "that degree of diligence which the situation . . . in fairness and justice require[s]."[32]

Although courts of equity are not bound by statutes of limitations, they still look to analogous statutes of limitations, if any, as evidence of what constitutes a reasonable delay.[33] In ordinary circumstances, "a suit in equity will not be stayed for laches before, and will be stayed after, the time fixed by the analogous statute of limitations at law."[34] "Absent a tolling of the limitations period, a party's failure to file within the analogous period of limitation will be given *great weight* in deciding whether the claims are barred by laches."[35]

If defendants demonstrate that unusual or extraordinary circumstances exist which make it inequitable to give a plaintiff the full filing time provided in the analogous statute of limitations, an equity court

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[27] *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 319 (Del. 2004).

[28] *U.S. Cellular*, 677 A.2d at 504 n.7.

[29] *Whittington I*, 2009 WL 1743640, at *6.

[30] *Reid*, 970 A.2d at 183.

[31] *Id.* at 183.

[32] *Scotton v. Wright*, 117 A. 131, 136 (Del. Ch. 1922).

[33] *Whittington Remand*, 2009 WL 4894305, at * 6.

[34] *Reid*, 970 A.2d at 183; *see also O'Brien v. IAC/Interactive Corp.*, 2009 WL 2490845, at *5 (Del. Ch. Aug. 14, 2009).

[35] *Whittington Remand*, 2009 WL 4894305, at * 6 (emphasis added).

may decide that equity and justice require a plaintiff to file suit more quickly.[36] As this court has stated previously:

> [L]aches will typically arise earlier than the end of the limitations period when a plaintiff seeks a judicial order involving compulsions such as an injunction or an order of specific performance. Remedies of this kind will only issue if the plaintiff acts with dispatch, and are normally foreclosed to a plaintiff who sits on its hands until near the end of the analogous limitations period.[37]

a. The statute of limitations does impact this case

Defendants argue that the Supreme Court's holding that the analogous statute of limitations is twenty years does not impact any of my previous findings other than those relating to Frank's having filed his Complaint after the analogous statute of limitations had run. According to Defendants, none of my reasoning was tied to the three-year statute of limitations, and, therefore, nothing should change with the application of a twenty-year limitations period.

Contrary to Defendants' argument, this Court must give "great weight" to the fact that Frank filed his Complaint well within the twenty-year analogous statute of limitations.[38] I based my previous ruling, in part, on "the nature of the contract at issue."[39] At that time, I did not consider the contract at issue to be a contract under seal. In reconsidering my laches ruling on remand, I must analyze Frank's conduct in light of his having entered into a contract under seal with a twenty-year statute of limitations.

b. In light of the circumstances, Frank's delay was not unreasonable or inexcusable

When considered in the context of a twenty-year statute of limitations, Frank's delay was not unreasonable or inexcusable. Important factors for determining whether a delay is unreasonable or inexcusable include whether the plaintiff filed within the analogous statute of limitations,[40] whether Defendants had notice of the plaintiff's intention to

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[36] *Reid*, 970 A.2d at 183.

[37] *Whittington I*, 2009 WL 1743640, at *9 (quoting *State ex rel. Brady v. Pettinaro Enters.*, 870 A.2d 513, 527 (Del. Ch. 2005)).

[38] *See Whittington Remand*, 2009 WL 4894305, at *6.

[39] *Whittington I*, 2009 WL 1743640, at *11.

[40] *Whittington Remand*, 2009 WL 4894305, at *6; *Reid v. Spazio*, 970 A.2d 176, 183 (Del. 2009).

assert his rights,[41] whether the plaintiff acted reasonably under the circumstances,[42] and whether the delay is attributable solely to the plaintiff's conduct.[43]

Frank filed his claim with nearly seventeen years to spare under the analogous statute of limitations. Though this fact is not dispositive, Frank's relatively prompt filing supports his argument that he acted reasonably after he was put on notice of Defendants' intent to exclude him from Dragon Group.

Perhaps more telling are the actions Frank took during the time between learning of his claim and filing his Complaint. As noted earlier, Frank previously sued Defendants in this Court and received what he thought was a favorable ruling vindicating his interest in Dragon Group. Though the March 2003 Opinion may have been subject to different interpretations, Frank's interpretation was reasonable. Instead of relying solely on the March 2003 Opinion and doing nothing for three years, however, Frank tried on several occasions thereafter, and even as late as October 2005, to assert his interest in Dragon Group by offering to sell to Defendants his interest in that entity, as well as other entities owned by the Whittington family. In fact, Tom acknowledged that Frank still claimed an interest in Dragon Group on October 17, 2005.[44] Therefore, this is not a case where Defendants had no notice of Plaintiff's claim during the period of delay.

As for whether Frank's conduct was reasonable under the circumstances, I find that it was. The March 2003 Opinion dealt with virtually the same issue that underlies the merits of this dispute. That Opinion arguably recognized the validity of the interest Frank claimed in Dragon Group; at a minimum, the Opinion left a cloud over both Frank's and Defendants' claims to an interest in the company. With twenty years to file under the analogous statute of limitations, Frank had no reason to rush back to court before exhausting the possibility of an out-of-court settlement with his siblings. Rather, he tried on several occasions between mid-2003 and

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[41] *See Reid*, 970 A.2d at 184 (in holding that plaintiff's delay was not unreasonable, the court noted that the defendants were on notice for years that the plaintiff "intended to pursue his rights vigorously"); *Steele v. Ratledge*, 2002 WL 31260990, at * 3 (Del. Ch. Sept. 20, 2002) (in barring plaintiff's claim to tear down a fence on his property, the court noted that the plaintiff failed to object to the defendant's action in building that fence until ten years after its construction); *Garber v. Whittaker*, 2 A.2d 85, 87–88 (Del. Ch. 1938) (in rejecting a laches defense where a plaintiff sued four years after the defendants allegedly breached a contract under seal, the court noted that the plaintiff made "repeated efforts" to settle the claim and that the defendants could not have been "lulled into a belief that the complainant considered the matter between them as closed").

[42] *Scotton v. Wright*, 117 A. 131, 136 (Del. Ch. 1922).

[43] *See Adams v. Jankouskas*, 452 A.2d 148, 157–58 (Del. 1982) (rejecting a laches defense and noting that the defendant's failure to fulfill her statutory duty to put the plaintiff on notice that his rights were being challenged cut against a finding of laches).

[44] PX 69 at D1656.

late-2005 to settle the matter with Defendants and filed his claim only after those settlement negotiations failed. Had Frank decided to wait and do nothing for three years, Defendants' argument might be more persuasive, but that is not this case.

Finally, I stand by my prior holding that Frank is solely responsible for his delay.[45] The relevant question, however, is: in light of the surrounding circumstances, including that fact, whether it would be inequitable to permit Frank's claim to be enforced. Given the uncertainties associated with the March 2003 Opinion and Defendants' response to it, the twenty-year statute of limitations, and Frank's attempts during the interim to settle with Defendants, I answer that question in the negative and do not find Frank's delay unreasonable.

c. Unusual or extraordinary circumstances

Defendants further assert that Frank's requested relief creates an unusual or extraordinary circumstance that makes it inequitable for the Court to allow Frank's claim to proceed. Defendants argue that because Frank essentially seeks a mandatory injunction, his petition automatically creates such a circumstance and requires him to act with greater alacrity.

Although "laches will typically arise earlier than the end of the limitations period when a plaintiff seeks . . . specific performance,"[46] that does not mean any particular delay in bringing a claim for specific performance necessarily will cause the claim to be barred by laches. In this case, Frank filed his claim three years and five days after he had notice of that claim. Given the twenty-year statute of limitations period, he did not file his claim anywhere near the end of the limitations period. Thus, Frank's failure to file his claim sooner did not create an unusual or extraordinary circumstance or otherwise constitute an unreasonable delay.

Additionally, Defendants' own actions undermine their assertion that it would be inequitable to allow Frank's claim to proceed. In the wake of the March 2003 Opinion, Defendants steadfastly asserted that the Opinion meant Frank had no interest in Dragon Group, and they rejected Frank's arguments to the contrary. In my opinion, even if Defendants' position was reasonable, it was far from self-evident and involved some risk. Defendants, like Frank, could have reduced that risk by petitioning the Court for clarification, but they chose not to do so. While Defendants elected to ignore Frank's competing claim, they cannot avoid the risks associated with their choice, especially when Frank had the benefit of an analogous twenty-year statute of limitations.

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[45] *Whittington I*, 2009 WL 1743640, at *12.

[46] *Id.* at *9 (quoting *State ex rel. Brady v. Pettinaro Enters.*, 870 A.2d 513, 527 (Del. Ch. 2005)).

3. Prejudice

To succeed in asserting a laches defense, Defendants also must prove that the plaintiff's "inexcusable delay [led] to an adverse change in the condition or relations of the property or the parties."[47]

Defendants aver that Frank's delay caused them material prejudice because between July 2003 and July 2006, Defendants undertook investment risks that Frank did not. Specifically, Defendants contend that (1) they exposed themselves to the risk that Dragon Group would fail, (2) Dragon Group took on additional risk when it mortgaged its assets, and (3) they contributed money to Dragon Group when Frank did not, increasing their risk exposure if Dragon Group failed.[48] In support of their position, Defendants rely on *Quill v. Malizia*, in which the court found prejudice where the defendants bore the economic risks of real property during the time that the plaintiff waited to assert his claim in that property.[49] The court in *Quill* found that, in addition to creating certain evidentiary difficulties, the plaintiff's delay prejudiced the defendants by clouding the defendants' title to the property in question during the interim, thereby making it difficult for them to dispose of the property.[50]

The alleged prejudice to Defendants here pales in comparison to the prejudice in *Quill*, especially when viewed in the context of a twenty-year statute of limitations. As explained in *Whittington I*, Defendants did suffer some prejudice,[51] but their own conduct contributed to that prejudice. With regard to Defendants' Ltd. stock being at risk in Dragon Group, Frank's Ltd. stock would have been subjected to the same risks had Defendants not rejected his proffered pledge of his stock and continual attempts to participate in Dragon Group.

Defendants arguably experienced some additional prejudice when Dragon Group took a $4 million loan from Ltd. The degree of prejudice must be evaluated, however, in the circumstances of that transaction. Because the shareholders of Dragon Group and Ltd. were essentially the same,[52] the only risk Defendants incurred was the possibility that they would foreclose on themselves if Dragon Group defaulted on the mortgage. Consequently, I do not assign much weight to this purported prejudice.

Defendants also complain that Frank, unlike Defendants, did not participate in Dragon Group's capital call in early 2005. Yet, Defendants did not inform Frank of this capital call and never invited him to participate in it.

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[47] *Reid v. Spazio*, 970 A.2d at 183.

[48] DOB 17–18.

[49] 2005 WL 578975, at *14 (Del. Ch. Mar. 4, 2005).

[50] *Id.*

[51] *Whittington I*, 2009 WL 1743640, at *13.

[52] If I exclude Frank, the shareholders in Dragon Group and Ltd. apparently would be identical.

Although there is some prejudice to Defendants in that they put more money at risk if Dragon Group failed, they chose to deny Frank's asserted interest and rely, instead, on their own interpretation of the March 2003 Opinion. Moreover, the amount of the capital contribution was fairly marginal in terms of the expected value of the Dragon Group investment. In these circumstances, I conclude Defendants have not shown that the nature and degree of any prejudice they endured as a result of Frank's delay in filing this action was sufficient to render that delay either unreasonable or inexcusable.[53]

In sum, even if Frank's delay did cause Defendants some prejudice, I find that laches does not bar his claim. Considering the totality of the circumstances, and in light of the twenty-year analogous statute of limitations, Frank's delay was not inexcusable. While Frank waited three years to file, he did not mislead Defendants to think he would not assert his rights. Frank repeatedly communicated with Defendants or their representatives, asserting his claim that he was a member of Dragon Group and attempting to settle the matter through negotiation. When these efforts failed, Frank brought suit nearly seventeen years before the analogous limitations period would have expired. Therefore, I hold that the equities favor Frank and laches will not bar him from seeking relief through litigation.

III. CONCLUSION

Consistent with the Supreme Court's remand, I have reconsidered my laches holding in *Whittington I* by applying a twenty-year statute of limitations for purposes of analogy, instead of the three-year analogous limitations period I previously applied. For the reasons stated in this Memorandum Opinion, I find that Defendants have not met their burden of showing that Frank unreasonably delayed in filing his claim for breach of the AIP. Defendants also have not shown extraordinary or unusual circumstances that would make it inequitable for this Court to allow Frank to continue pursuing his interest in Dragon Group. Therefore, I report to the Supreme Court that, after reconsideration on remand, I conclude that Frank's claims are not time-barred under the doctrine of laches.

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[53]Frank also contends that even if Defendants experienced prejudice, his conduct did not cause that prejudice. POB 18–19. Asserting that the only prejudice I should consider is the prejudice caused by his delay, Frank argues that his failure to put his Ltd. stock at risk did not cause Defendants to put their stock at risk. Likewise, Frank avers that his failure to tender any money during Dragon Group's capital call did not cause Defendants to tender their money. Having determined that Defendants have failed to prove laches for the reasons previously discussed, however, I need not address Frank's causation argument.

SELECTICA, INC. v. VERSATA ENTERPRISES, INC.

No. 4241-VCN

Court of Chancery of the State of Delaware, New Castle

Date Decided February 26, 2011

Gregory V. Varallo, Esquire, Lisa A. Schmidt, Esquire, John D. Hendershot, Esquire, Ethan A. Shaner, Esquire, Scott W. Perkins, Esquire, and Jillian G. Remming, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware, and Jonathan S. Kitchen, Esquire and Christian H. Cebrian, Esquire of Cox, Castle & Nicholson LLP, San Francisco, California, Attorneys for Plaintiffs and Counterclaim Defendants Selectica, Inc., James Arnold, Alan B. Howe, Lloyd Sems, James Thanos, and Brenda Zawatski.

Martin P. Tully, Esquire, Megan Ward Cascio, Esquire, Leslie A. Polizoti, Esquire, and Ryan D. Stottmann, Esquire of Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Delaware, and Noel M. Hensley, Esquire, and Nicholas Even, Esquire of Haynes and Boone LLP, Dallas, Texas, Attorneys for Defendants and Counterclaim Plaintiffs Versata Enterprises, Inc. and Trilogy, Inc.

NOBLE, *Vice Chancellor*

I. INTRODUCTION

This is an action for declaratory judgment with respect to the validity of (1) the implementation of a rights agreement adopted by the plaintiff company in attempt to preserve certain net operating loss carryforwards perceived to be at risk as a result of share purchases by the defendants; (2) certain subsequent actions taken by plaintiff's board of directors in response to defendants' purposeful trigger of the rights agreement; and (3) the amended and restated rights agreement established in the wake of the rights agreement's triggering. The defendants who triggered the rights agreement have countersued seeking to have the rights agreement and other actions by plaintiff's board of directors declared invalid, void, and unenforceable, as well as the entry of an order enjoining or rescinding them. The defendants also seek damages for alleged breaches of fiduciary duty by the plaintiff's board.

II. BACKGROUND

A. *A Brief Explanation of NOLs*

At its core, this case is about the value of net operating loss carryforwards ("NOLs") to a currently profitless corporation, and the extent to which such a corporation may fight to preserve them. For convenience, the Court provides a brief overview—although perhaps a simplistic and certainly incomplete one—of the concepts surrounding NOLs, their calculation, and possible impairment.

NOLs are tax losses realized and accumulated by a corporation that can be used to shelter future (or immediate past) income from taxation.[1] If taxable profit has been realized, the NOLs operate to provide a refund of prior taxes paid or to reduce the amount of future income tax owed. Thus, NOLs can be a valuable asset, as a means of lowering tax payments and producing positive cash flow. However, NOLs are considered a contingent asset; their value is contingent upon the firm's reporting a future profit (or having an immediate past profit). Should the firm fail to realize a profit during the lifetime of the NOL (20 years), the NOL expires worthless. The precise value of a given NOL is impossible to determine since its ultimate use is subject to the timing and amount of recognized profit at the firm. If the firm never realizes taxable income, at dissolution, its NOLs, regardless of their size, would have zero value.

In order to prevent corporate taxpayers from benefiting from NOLs generated by other entities, Internal Revenue Code Section 382 establishes limitations on the use of NOLs in periods following an "ownership change." If Section 382 is triggered, the law places a restriction on the amount of prior NOLs that can be used in subsequent years to reduce the firm's tax obligations.[2] Of course, once NOLs are so impaired, a substantial portion of their value is lost. The precise definition of an "ownership change" under Section 382 is rather complex. At its most basic, an ownership change occurs when more than 50% of a firm's stock ownership changes over a three-year period. Specific provisions in Section 382 define the precise manner by which this determination is made. Most importantly for the Court's purposes, the only shareholders considered in the context of calculating an ownership change under Section 382 are those who hold, or have obtained during the testing period, a 5% or greater block of the corporation's shares outstanding.[3] Calculating the likelihood of a Section

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[1]NOLs may be carried backward two years and carried forward twenty years.

[2]The annual limitation on the use of past period NOLs following a change in control is calculated as the value of the firm's equity at the time of the ownership change, multiplied by a published rate of return, the federal long term exemption rate.

[3]Consequently, it is understood that in most acquisitions an "ownership change" under Section 382 occurs because the acquirer purchases more than 50% of the target's stock.

382 ownership change at a given company at a particular time is extraordinarily difficult and requires making a number of factual assumptions, subject to varied interpretations of the correct application of Section 382, upon which reasonable experts may disagree.[4]

With this general background in place, the Court now turns to the facts of this case.[5]

B. *The Parties*

Plaintiff and Counterclaim-Defendant Selectica, Inc. ("Selectica" or the "Company") is a Delaware corporation, headquartered in California and listed on the NASDAQ Global Market. It provides enterprise software solutions for contract management and sales configuration systems. Selectica is a micro-cap company with a concentrated shareholder base: the Company's seven largest investors own a majority of the stock, while fewer than twenty-five investors hold nearly two-thirds of the stock.[6]

Defendant and Counterclaim-Plaintiff Trilogy, Inc. ("Trilogy") is a Delaware corporation also specializing in enterprise software solutions. Trilogy stock is not publicly traded, and its founder, Joseph Liemandt, holds over 85% of the stock. Defendant and Counterclaim-Plaintiff Versata Enterprises, Inc. ("Versata") is a Delaware corporation and subsidiary of Trilogy; it provides technology powered business services to clients. Before the events giving rise to this action, Versata and Trilogy beneficially owned 6.1% of Selectica's common stock.[7]
Following their intentional triggering of Selectica's shareholder rights agreement through the purchase of additional shares, the joint beneficial ownership of Versata and Trilogy was diluted from 6.7% to approximately 3.3%.[8]

Counterclaim-Defendants James Arnold, Alan B. Howe, Lloyd Sems, Jim Thanos, and Brenda Zawatski are members of the Selectica Board of Directors (the "Board").[9] Zawatski and Thanos also served as Co-Chairs

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[4]*See, e.g.*, DX 777; DX 787; PX 127; Tr. 1298-312.

[5]The facts evidencing "what happened" are largely uncontested. The inferences to be drawn from those facts and the motivations of those involved are, however, fertile sources of debate.

[6]PX 121. However, because of the shareholder rights plan first instituted in 2003, no stockholder holds more than 15% of the outstanding shares.

[7]PX 103.

[8]PX 104; DX 746; Tr. 133.

[9]Alan Howe was elected to the Board on January 12, 2009, after the events at issue in this case. He has not been charged with any breach of fiduciary duty and has not been served with process. Selectica asserts that Howe is not subject to personal jurisdiction in this Court and seeks to have him dismissed as a Counterclaim-Defendant. Trilogy purports to name Howe as a Counterclaim-Defendant solely "in order to afford [Trilogy] complete relief." Answer and Counterclaims of Defs. Trilogy, Inc. and Versata Enterprises, Inc. ¶ 62.

of the Board during the events at issue in the case.[10] In this role, they handled the day-to-day operations of the Company, as Selectica has been without a Chief Executive Officer since June 30, 2008.

C. *Selectica's Historical Operating Difficulties and Relationship with Trilogy*

Selectica, since it became a public company in March 2000, has lost a substantial amount of money and failed to turn an annual profit, despite routinely projecting near-term profitability. Its IPO price of $30 per share has steadily fallen and now languishes below one dollar per share, placing Selectica's market capitalization at roughly $23 million at the end of March 2009.[11] By its own admission, its value today "consists primarily in its cash reserves, its intellectual property portfolio, its customer and revenue base, and its accumulated NOLs."[12] By consistently failing to achieve positive net income, Selectica has generated an estimated $160 million in NOLs for federal tax purposes over the past several years.[13]

Selectica has had a complicated and often adversarial relationship with Trilogy, stretching back at least five years. Both compete in the relatively narrow market space of contract management and sales configuration. In April 2004, a Trilogy affiliate sued Selectica for patent infringement and secured a judgment that required Selectica, among other things, to pay Trilogy $7.5 million. While the suit was pending, in January 2005, Trilogy made an offer to buy Selectica for $4 per share in cash—a 20% premium from the then-trading price—which the Board rejected. Nevertheless, during March and April of that year, a Trilogy affiliate acquired nearly 7% of Selectica's common stock through open market trades. In early fall 2005, Trilogy made than another offer for Selectica's shares at a 16%-23% premium, which was also rejected. In September 2006, a Trilogy-affiliated holder of Selectica stock sent a letter to the Board questioning whether certain stock option grants had been backdated.[14] The

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[10]On August 19, 2009, Thanos stepped down as Co-Chair and Zawatski became sole Chair of the Board and continued to handle the Company's daily operations. Defs./Counterclaim Pls.' Second Mot. for Judicial Notice under Del. R. of Evidence 201 ("RJN2"), Ex. A at 4.

[11]Defs./Counterclaim Pls.' Mot. for Judicial Notice Under Del. R. of Evidence 201 ("RJN"), Ex. A at 35, 53.

[12]Pre-Trial Br. of Pl. Selectica, Inc. and Counterclaim Defs. ("Selectica Pre-Trial Br.") at 5.

[13]Tr. 34-35, 379-80.

[14]A special committee empanelled by the Board ultimately concluded that certain options had, in fact, been backdated. Consequently, Selectica was required to restate its financial statements to record additional stock-based compensation and related tax effects for past option grants and incurred fees associated with the investigation in excess of $6.2 million. DX 214 at 21; DX 260 at 14. This episode also led to the resignation of Selectica's then-Chairman and Chief Executive Officer Stephen Bannion (who had been the Company's Chief Financial Officer at the time of the

following month, Trilogy filed another patent lawsuit against Selectica, which was settled in October 2007, when Selectica agreed to a one-time payment of $10 million, plus an additional amount of not more than $7.5 million in subsequent payments to be made quarterly. In late fall 2006, Trilogy sold down its holdings in Selectica.[15]

D. *The Role of Steel Partners*

Steel Partners is a private equity fund that has been a Selectica shareholder since at least October 2006 and is its largest shareholder. One of the apparent investment strategies of Steel Partners is to invest in small companies with large NOLs with the intent to help pair the failing company with a profitable business in order to reap the tax benefits of the NOLs.[16] Steel Partners has actively worked with Selectica to calculate and monitor the Company's NOLs since the time of its original investment.

By early 2008, Steel Partners was advocating a quick sale of Selectica's assets, leaving an NOL shell that could be merged with a profitable operating company in order to shelter the profits of the operating company.[17]

In October 2008, Steel Partners informed members of the Board that it planned to increase its ownership position to 14.9%, just below the 15% trigger of the 2003 Pill, which it later did. Jack Howard, President of Steel Partners, lobbied for a Board seat twice in 2008, citing his experience dealing with NOLs, but was rebuffed.[18]

E. *Selectica Investigates its NOLs*

In 2006, at the urging of Steel Partners, the Company directed Alan Chinn, its outside tax adviser, to perform a high-level analysis into whether the Company's NOLs were subject to any limitations under Section 382 of the Internal Revenue Code. Chinn concluded that five prior changes in ownership had caused the forfeiture of approximately $24.6 million of NOLs.[19] Selectica provided the results of this study to Steel Partners, though not to any other Selectica shareholder. In March 2007, again at Steel Partners's recommendation, Selectica retained a second accountant who

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grants of question) and the appointment of then-Director Robert Jurkowski to the Chief Executive and Chair position.

[15]From late fall 2006 until October 2008, neither Trilogy nor its affiliates owned any Selectica stock.

[16]*See, e.g.*, Howard Dep. at 25-27, 56-60, 109-11; Thanos Dep. at 61-62; PX 63; DX 211.

[17]Howard Dep. at 57-60.

[18]Tr. 994-1000; Thanos Dep. at 60-63.

[19]The Company disclosed this information in its financial statements for fiscal year 2008. DX 394 at F-22.

specialized in NOL calculations, John Brogan of Burr Pilger & Mayer LLP, to analyze the Company's NOLs more carefully and report on Chinn's Section 382 analysis.[20] Brogan had previously analyzed the NOLs at other Steel Partners ventures. Brogan ultimately determined that Chinn's conclusions were erroneous. The Company engaged Brogan in additional work on the topic of NOLs in June 2007. One of Steel Partners's employees, Avi Goodman, worked closely with Brogan on the matter, although Brogan was working for and being paid by Selectica and received no compensation from Steel Partners. Brogan's draft letter opinion, concluding that the Company had not undergone an "ownership change" for Section 382 purposes since 1999, was shared with Steel Partners, although again not with any other outside investors.

In the fall of 2007, Brogan proposed a third, more detailed, Section 382 study, which Selectica's then-CEO Robert Jurkowski opposed. In February 2008, the Board voted against spending $40,000-$50,000 to fund this Section 382 study. By July, however, the Board asked Brogan to update his study, and he delivered the draft opinion that, as of March 31, 2008, the Company had approximately $165 million in NOLs.[21] Brogan was later asked to advise the Board in the fall of 2008 on the updated status of its NOLs when the Board moved to amend its rights plan.

F. *Lloyd Sems Joins the Board*

In April 2008, the Board began interviewing candidates for an open board seat, giving preference to the Company's large shareholders.[22] Selectica investor Lloyd Sems had previously expressed interest in joining the Board and had sought support from certain shareholders, including Steel Partners, through Howard, and Lloyd Miller, another large Selectica shareholder not affiliated with Steel Partners.[23] Both Miller and Howard wrote to the Board in support of Sems's appointment,[24] although he was already favored by the Board by that time.[25] In June 2008, Sems was appointed to the Board.[26]

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[20]Selectica concedes that it valued Steel Partners's recommendation in these matters as it found its principals to be knowledgeable on the topic of NOLs. Pl.'s Pre-Trial Br. at 6.

[21]During this time, Brogan included Howard in nearly all correspondence relating to his analysis of Selectica's NOLs, even when Company directors were not. *See, e.g.*, DX 427; DX 456. This was brought to the attention of the Board in September, which then asked Brogan to desist. Tr. 102-03, 230-32, 251-57, 997; Zawatski Dep. at 194-95. The Board did not investigate what Howard had learned or whether Steel Partners had traded on the information provided.

[22]Zawatski Dep. at 133-35.

[23]Tr. 278-79; Sems Dep. at 21-22; Howard Dep. at 74-77.

[24]DX 303; Tr. 762; Jurkowski Dep. at 75-80.

[25]Tr. 938-41. Jurkowski testified that, at the time the Board was considering Sems as a potential director, Jurkowski viewed Sems as an investor who "was interested in what we were

As large shareholders, Sems, Howard, and Miller had periodically discussed Selectica as early as October 2007. At that time, Sems had emailed Howard, stating, "I wanted to get your opinion of how or if you would like me to proceed with [Selectica]." Howard replied, "Lloyd [Miller] said he would call you about [Selectica]."[27] Both before and after his appointment to the Board, Sems discussed with Howard and Miller a number of the proposals that Sems ultimately advocated for as a director, including that Selectica should buy back its stock,[28] that Selectica should consider selling its businesses,[29] that the NOLs were important and should be preserved through the adoption of a 5% pill,[30] and that Jurkowski should be removed as CEO.[31] As a Board member, Sems also reached out to Howard and Miller from time to time on other issues, including seeking recommendations for chief financial officer candidates,[32] investment bankers to conduct the sale process,[33] and attorneys in the run up to this litigation,[34] although the Board apparently adopted none of Howard's recommendations.[35]

G. *Selectica Decides to Restructure and to Explore Strategic Alternatives*

In early July 2008, after determining that the Company needed to change course, the Board terminated Jurkowski as CEO and eliminated a number of management positions in the sales configuration business.[36] Later that month, prompted by the receipt of five unsolicited acquisition offers over the space of a few weeks,[37] the Board announced that it was in the process of selecting an investment banker (ultimately, Jim Reilly of Needham & Company) to evaluate strategic alternatives for the Company and to assist with a process that ultimately might result in the Company's

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going to do to grow the business, and perhaps as an investor, anything that he could do to actually help us grow the business, as opposed to somebody who just focused on some of the financial elements of the company." Jurkowski Dep. at 77-78.

[26]DX 379. 27 DX 2

[27]Sems explained that this email was a follow-up seeking their opinion on his efforts to join the Board, which he had previously discussed with both, and was sent in an attempt to gain support. Sems Dep. 192-94. In the context of the entire email, this is a plausible explanation, certainly more plausible than as a unilateral offer to be controlled by Steel Partners.

[28]DX 609; DX 610; DX 419 at 4; DX 455 at 2-3. The Board had previously concluded that this was not in the Company's best interest. DX 238; DX 281.

[29]Sems Dep. 21-23; DX 549.

[30]Sems Dep. 16-19; Tr. 766-69.

[31]DX 376; DXs 265-67; Sems Dep. 189-91.

[32]DX 402. In reply, Howard queried, "Should we push to sell the company before [bringing] in a new cfo?" *Id.*

[33]Tr. 743-44; DX 430.

[34]DX 707.

[35]Tr. 744; Howard Dep. at 142-44; DX 707.

[36]The day that the Company released its 8-K announcing the resignations of those officers, Howard wrote an email to Sems, stating, "[Call] me about the news—great job." DX 416.

[37]Tr. 318-19.

sale.[38] In view of the potential sale, the Board decided to forgo the expense of replacing Jurkowski and, instead, asked Zawatski and Thanos jointly to assume the title of Co-Chair and to perform operational oversight roles on an interim basis.

H. *The Needham Process*

Needham has actively carried out its task of evaluating Selectica's strategic options since its selection by the Board. Needham first discussed with the Board the various strategic choices that the Company could take, including a merger of equals with a public company, a reverse IPO or other going-private transaction, the sale of certain assets, and the use of cash to acquire another company, as well as stock repurchases or the issuance of dividends, should Selectica decide to continue as an independent public company in the absence of sufficient market interest for an acquisition.[39]

In October 2008, Needham prepared an Executive Summary of the assets and operations of Selectica and subsequently reached out to potential buyers, remaining in communication with various interested parties throughout the remainder of the year and into the first part of 2009.[40] By February 2009, at least a half-dozen parties had come forward with letters of intent and were in the process of meeting with Selectica management and conducting due diligence in the Company, while Needham evaluated their various proposals for the purchase of all or part of Selectica's operations.[41] As of April 2009, Selectica, through Needham, had signed a letter of intent and entered into exclusive negotiations with a potential buyer.[42]

I. *Trilogy Begins Buying*

On July 15, 2008, Liemandt called Zawatski to inquire generally about the possibility of an acquisition of Selectica by Trilogy. On July 29, Trilogy Chief Financial Officer Sean Fallon, Trilogy Director of Finance Andrew Price, and Versata Chief Executive Officer Randy Jacops participated in a conference call with Selectica Co-Chairs Zawatski and Thanos on the same topic. During the call, Thanos inquired as to how Trilogy would calculate a value for the Company's NOLs. Fallon replied that Trilogy, "really [did not] pursue them with as much vigor as other[s] might

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[38]*See, e.g.*, PX 47; PX 67; Tr. 35-40, 182-83, 930-32.

[39]Reilly Dep. at 31-32.

[40]Reilly Dep. at 137-54. None of the potential buyers expressed specific interest in Selectica's NOLs. Reilly Dep. at 14.

[41]Reilly Dep. at 11-14.

[42]Reilly Dep. at 135-36.

since that is not our core strategy."[43] The following evening, Fallon contacted Zawatski and outlined two proposals for Trilogy to acquire Selectica's business: (1) Trilogy's purchase of all of the assets of Selectica's sales configuration business in exchange for the cancellation of the $7.1 million in debt Selectica still owed under the October 2007 settlement with Trilogy; or (2) Trilogy's purchase of the entire operations of Selectica for the cancellation of the debt plus an additional $6 million in cash. Fallon subsequently followed up with an email reiterating both proposals and suggesting that either proposal would allow Selectica to still make use of its NOLs through the later sale of its corporate entity.[44]

Shortly thereafter, the Board rejected both proposals. The Board made no counterproposal and there were no follow-up discussions. On October 9, 2008, Trilogy made a second bid to acquire all of the Selectica's assets for $10 million in cash plus the cancellation of the debt, which the Board also rejected. Trilogy was invited to participate in the sale process being overseen by Needham, but Trilogy was apparently unwilling to sign a non-disclosure agreement, which was a prerequisite for participation.[45] Around this same time, Trilogy had begun making open-market purchases for Selectica stock, although the Board was apparently not aware of this fact at the time.[46]

On the evening of November 10, Fallon contacted Zawatski and informed her that Trilogy had purchased more than 5% of Selectica's outstanding stock and would be filing a Schedule 13D shortly, which it did on November 13.[47] On a subsequent call with Zawatski and Reilly, Fallon explained that Trilogy had begun buying because it believed that "the company should work quickly to preserve whatever shareholder value remained and that we were interested in seeing this process that they announced with Needham, that we were interested in seeing that accelerate..

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[43] *Id.* However, as part of its 2005 effort to acquire Selectica, Trilogy had performed "a pretty detailed analysis" of Selectica's NOLs. Johnston Dep. at 21 (Sherie Johnston, Trilogy's tax director, performed the analysis). Johnston testified that this analysis was occasionally updated and that similar analyses had been performed on a dozen or so other acquisition targets. *Id.* at 22-26. On or around November 18, 2008, Price and Fallon asked about obtaining an updated change in control calculation for Selectica but, due to other more pressing matters, Johnston never performed it. *Id.* at 27-35.

[44] PX 78. That this was his suggestion was confirmed by Fallon in his deposition. Fallon Dep. at 98-99.

[45] Reilly Dep. at 46. Fallon also told John Reilly from Needham that "if he were to make another proposal . . . that it would be lower than the last proposal that they had made. . . ." *Id.*

[46] Fallon Dep. at 118-19.

[47] The November 13, 2008, Schedule 13D reported that Versata and affiliates had purchased 1,437,891 shares of Selectica stock, increasing its ownership to 5.1%. PX 102.

. ."[48] Within four days of its 13D filing, Trilogy had acquired more than 320,000 additional shares, representing an additional 1% of the Company.[49]

J. *The November 16 Board Meeting & Decision to Adopt the NOL Pill*

In the wake of Trilogy's decision to begin acquiring Selectica shares, the Board took actions to gauge the impact of these acquisitions, if any, on the Company's NOLs, and to determine whether anything needed to be done to mitigate their effects. Sems immediately asked Brogan to revise his Section 382 analysis—which had not been formally updated since July—to take into account the recent purchases. This was delivered to Sems and the Company's new CFO, Richard Heaps, on November 15, showing that the cumulative acquisition of stock by shareholders over the past three years stood at 40%, which was roughly unchanged from the previous calculation, due to some double counting that occurred in the July analysis.[50]

The Board met on November 16 to discuss the situation and to consider amending Selectica's shareholder rights plan, which it had had in place since February 2003. As with many poison pills employed as protection devices against hostile takeovers, Selectica's initial pill had a 15% trigger. The Board considered an amendment that would reduce that threshold trigger to 4.99% in order to prevent additional 5% owners from emerging and potentially causing a change in control event, thereby devaluing Selectica's NOLs.[51] Also present at the meeting were Heaps, Brogan, and Reilly, along with Delaware counsel.

Heaps gave an overview of the Company's existing shareholder rights plan and reviewed the stock price activity since Trilogy had filed its Schedule 13D, noting that shares totaling approximately 2.3% of the Company had changed hands in the two days following the filing.[52] Brogan reviewed the Section 382 ownership analysis that his firm had undertaken on behalf of the Company, noting that additional acquisitions of roughly 10% of the float by new or existing 5% holders would "result in a permanent limitation on use of the Company's net operating loss carryforwards and that, once an ownership change occurred, there would be no way to cure the

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[48]Fallon Dep. at 144.

[49]PX 103.

[50]PX 72. A more formal analysis was provided on November 26, finding a 38.8% change in ownership over the relevant period. DX 688.

[51]Sems had previously recommended reducing the poison pill threshold trigger to 5% at the Board's July 23, 2008, meeting. The Board decided to defer consideration of the recommendation until it received additional information on the potential legal consequences of such an action. DX 455 at 2-3. *See also* Sems Dep. 165-66; Tr. 740-42 (contesting the stated rationale in the Board minutes of protecting against hostile takeovers and testifying that his then stated rationale was the protection of the NOLs).

[52]PX 89 at 2, 4.

use limitation on the net operating loss carryforwards."[53] He further advised the Board that "net operating loss carryforwards were a significant asset" and that he generally advises companies to consider steps to protect their NOLs when they experience a 30% or greater change in beneficial ownership. Lastly, Brogan noted that, while he believed that the cumulative ownership change calculations would decline significantly over the next twelve months, "it would decline only modestly, if at all, over the next three to four months," meaning that "the Company would continue to be at risk of an ownership change over the near term."[54]

Reilly discussed the Company's strategic alternatives and noted that Steel Partners and other parties had expressed interest in pursuing a transaction that would realize the value of Selectica's NOLs, while also reviewing potential transaction structures in which the Company might be able to utilize its NOLs. Reilly responded to questions from the Board, and noted that "it is difficult to value the Company's net operating loss carryforwards with greater precision, because their value depends, among other things, on the ability of the Company to generate profits," and confirmed that "existing stockholders may realize significant potential value" from the utilization of the Company's NOLs, which would be "significantly impaired" if a Section 382 ownership change occurred.[55]

At the request of the Board, Delaware counsel reviewed the legal standards that apply under Delaware law for adopting and implementing measures that have an anti-takeover effect.[56]

The Board then discussed amending the existing shareholder rights plan, and what the terms of such an amendment might be, including the pros and cons of providing a cushion for preexisting 5% holders, the appropriate effective date of the new shareholder rights plan, whether the Board should have authority to exclude purchases by specific stockholders from triggering the rights plan, and whether a review process should be implemented to determine periodically whether the rights plan should remain in effect.

The Board then unanimously passed a resolution amending Selectica's shareholder rights plan, decreasing the beneficial ownership trigger from 15% to 4.99%, while grandfathering in existing 5% shareholders and permitting them to acquire up to an additional 0.5% (subject to the original 15% cap) without triggering the NOL Pill.[57]

The resolution also established the Independent Director Evaluation Committee (the "Committee") as a standing committee of the Board to review periodically the rights agreement at the behest of the Board and to

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[53] *Id.* at 4.
[54] *Id.*
[55] *Id.* at 5.
[56] *Id.*
[57] *Id.* at 10-11.

"determine whether the Rights Agreement continues to be in the best interest of the Corporation and its stockholders," as well as to review "the appropriate trigger percentage" of the pill, based on corporate and shareholder developments, any broader developments relating to rights plans generally—including academic studies of rights plans and contests for corporate control, and any other factors it deems relevant.[58] The Board set April 30, 2009, as the first date that the Committee should report back its findings.[59]

K. *Trilogy Buys through the Pill*

The Board announced the amendment of Selectica's rights agreement on Monday, November 17. Early the following morning, Fallon emailed Trilogy's broker, saying, "[W]e need to stop buying SLTC. They announced a new pill and we need to understand it."[60] Fallon also sent Liemandt a copy of Selectica's 8-K containing the amended language of the NOL Pill.[61] Trilogy immediately sought legal advice about the NOL Pill.[62] The following morning, Liemandt emailed Price, with a copy to Fallon, asking, "What percentage of [Selectica] would we need to buy to ruin the tax attributes that [S]teel [P]artners is looking for?"[63] They concluded that they would need to acquire 23% to trigger a change in control event.[64]

Later that week, Trilogy sent Selectica a letter asserting that a Selectica contract with Sun Microsystems constituted a breach of the October 2007 settlement and seeking an immediate meeting with Selectica purportedly to discuss the breach,[65] despite the fact that members of its management had been put on notice as to the contract as early as July.[66] Fallon, Liemandt, and Jacops from Trilogy, along with Zawatski, Thanos, and Heaps from Selectica met on December 17. The parties' discussions at this meeting are protected by a confidentiality agreement circulated in advance. However, Selectica contends that "based solely on statements and conduct outside that meeting, it is evident that Trilogy threatened to trigger

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[58] *Id.* at 11.

[59] *Id.* at 12.

[60] PX 22. SLTC is Selectica's NASDAQ stock symbol.

[61] PX 21.

[62] Fallon Dep. at 158-61.

[63] DX 649. Liemandt testified that his question meant, "what is the amount that we can buy without hurting it, which is the other way of asking, what's the amount you can buy to ruin it." Liemandt Dep. at 101. Price testified, however, that he understood the question as being more straightforward, specifically, "what percentage would we have to buy to trigger a change of control as per section 382." Price Dep. at 151.

[64] DX 649.

[65] PX 24.

[66] PX 48.

the NOL Pill deliberately unless Selectica agreed to Trilogy's renewed efforts to extract money from the Company."[67]

On December 18, Trilogy purchased an additional 30,000 Selectica shares, and Trilogy management verified with Liemandt his intention to proceed with buying through the NOL Pill.[68] The following morning, Trilogy purchased an additional 124,061 shares of Selectica, bringing its ownership share to 6.7% and thereby becoming an Acquiring Person under the NOL Pill.[69] Liemandt testified that the rationale behind triggering the pill was to "bring accountability" to the Board and "expose" what Liemandt characterized as "illegal behavior" by the Board in adopting a pill with such a low trigger.[70] Fallon asserted that the reason for triggering the NOL Pill was to "bring some clarity and urgency" to their discussions with Selectica about the two parties' somewhat complicated relationship by "setting a time frame that might help accelerate discussions" on the direction of the business.[71]

Fallon placed a brief telephone call to Zawatski on December 19 to advise her that Trilogy had bought through the NOL Pill. During a return call by Zawatski later that evening, Fallon indicated that Trilogy felt, based on the conversations from December 17, that Selectica no longer wanted Trilogy as a shareholder or creditor. He then proposed that Selectica agree to purchase Trilogy's shares back, accelerate the payment of its debt, terminate its license with Sun, and make a payment to Trilogy of five million dollars "for settlement of basically all outstanding issues between our companies."[72] Zawatski recalled that Fallon indicated to her that Trilogy had triggered the pill "to get our attention and create a sense of urgency"; that, since the Board would have ten days to determine how to react to the pill trigger, "it would force the board to make a decision."[73]

L. *The Board Considers its Options and Repeatedly Requests a Standstill*

The Selectica Board had a telephonic meeting on Saturday, December 20, to discuss Trilogy's demands and an appropriate response.[74] The Board discussed "the desirability of taking steps to ensure the validity of the shareholder rights plan," and ultimately passed a resolution authorizing the filing of this lawsuit, which occurred the following day.[75] On December

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[67]Selectica Pre-Trial Br. at 16.
[68]PX 104.
[69]*Id.*
[70]Liemandt Dep. at 126.
[71]Fallon Dep. at 200-01.
[72]*Id.* at 212.
[73]Zawatski Dep. at 283.
[74]PX 91.
[75]*Id.* at 3.

22, Trilogy filed an amended Schedule 13D disclosing its ownership percentage[76] and the Selectica Board met telephonically yet again to discuss the litigation, eventually agreeing to have a representative contact Trilogy to seek a standstill on any additional open market purchases while the Board used the ten-day clock under the NOL Pill to determine whether to consider Trilogy's purchases "exempt" under the rights plan, or else how Selectica would go about implementing the pill.

The amended rights plan allowed the Board to declare Trilogy an "Exempt Person" during the ten-day period following the trigger, upon its determination that Trilogy would not "jeopardize or endanger the availability to the Company of the NOLs. . . ."[77] The Board could also decide during this window to exchange the rights (other than those held by Trilogy) for shares of common stock.[78] If the Board did nothing, after ten days, the rights would "flip in" automatically, becoming exercisable for $36 worth of newly-issued common stock at a price of $18 per right.[79]

The Board met again by telephone the following day, December 23, to discuss the progress of the litigation and to consider the potential impact of the various options under the NOL Pill.[80] The Board agreed to meet in person the following Monday, December 29, along with the Company's financial, legal, and accounting advisors, to evaluate further the available options. The Board also voted to reduce the number of authorized directors from seven to five.[81]

On Wednesday, December 24, the Board met once again by telephone upon learning that the Company's counsel had not succeeded in convincing Trilogy to agree to a standstill.[82] The Board resolved to have Zawatski call Fallon to determine whether Trilogy was willing "to negotiate a standstill agreement that might make triggering the remedies available under the Shareholder Rights Plan, as amended, unnecessary at this time."[83] Zawatski spoke with Fallon on the morning of December 26. Fallon stated that Trilogy did not want to agree to a standstill, that relief from the NOL Pill was not Trilogy's goal, and that Trilogy expected that the NOL Pill would apply to it.[84] Fallon reiterated that the ten-day window would help "speed [the] course" towards a resolution of their claims.[85]

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[76]PX 104.
[77]PX 99 § 1(n).
[78]*See* PX 101 § 24(a).
[79]*See id.* §§ 7(b), 11(a)(ii).
[80]PX 93.
[81]*Id.* at 3.
[82]PX 94.
[83]*Id.* at 2.
[84]Fallon Dep. at 219-20; PX 112.
[85]PX 112 at 1.

The Board and its advisors met again on December 29.[86] Thanos provided an update on recent developments at the Company, including financial results, management changes, and the Needham process and provided an overview of the make-up of the Company's shareholder base. Reilly then provided a more detailed report on the status of the Needham process to the Board. Thereafter, Brogan gave a presentation on his firm's updated analysis of Selectica's NOLs, finding that the Company had at least $160 million of NOLs and that there had been a roughly 40% ownership change by 5% holders over the three-year testing period, which would not be expected to "roll off" in the near term, and that "there was therefore a significant risk of a Section 382 ownership change."[87] Brogan subsequently discussed the possible consequences of the two principal mechanisms for implementing the triggered NOL Pill to the change in control analysis, finding that employing a share exchange would not likely have a materially negative impact on the Section 382 analysis, while expressing more concern over the uncertain effect of a flip-in pill on subsequent ownership levels (specifically, the possibility that a flip-in pill would, itself, trigger a Section 382 ownership change), as well as what steps could be taken to reduce this uncertainty.[88] Reilly once again addressed the Board to explain the ways he believed the NOLs would be valuable to the Company in its ongoing exploration of strategic alternatives, and to reiterate his opinion that an ownership change would "reduce the value of the Company."[89]

The Board also discussed Trilogy's settlement demands and found them "highly unreasonable" and "lack[ing] any reasonable basis in fact," and that "it [was] not in the best interests of the Company and its stockholders to accept Trilogy/Versata's settlement demands relating to entirely separate intellectual property disputes as a precondition to negotiating a standstill agreement to resolve this dispute."[90] The Board discussed Trilogy's actions at some length, ultimately concluding that they "were very harmful to the Company in a number of respects," and that "implementing the exchange was reasonable in relation to the threat imposed by Trilogy," in particular, because the NOLs were seen as "an important corporate asset that could significantly enhance stockholder value," and because Trilogy had intentionally triggered the NOL Pill, publicly suggested it might purchase additional stock, and had refused to negotiate a standstill agreement, despite the fact that an additional 10% acquisition by a 5% shareholder would likely trigger an ownership change under Section 382.[91]

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[86]PX 95.
[87]*Id.* at 3.
[88]*Id.* at 4.
[89]*Id.*
[90]*Id.* at 6.
[91]*Id.* at 9-10.

The Board then authorized Delaware counsel to contact Trilogy in writing, one final time, to seek a standstill agreement, and also passed resolutions delegating the power of the Board to the Committee to determine whether or not to treat Trilogy or its acquisition as "exempt," and nominating Alan Howe as a new member of the Board.

On the evening of December 29, Selectica's Delaware counsel emailed Trilogy's trial counsel at the Board's instruction, seeking a standstill agreement "so that the Board could consider either declaring them an 'Exempt Person' under the Rights Plan . . . or alternatively, settle the litigation altogether in exchange for a long term agreement relating to your clients' ownership of additional shares."[92] The following afternoon, Trilogy's counsel responded that Trilogy was not willing to agree to the proposed standstill.[93]

Two days later, on December 31, the Board met telephonically once again, and was informed of Trilogy's latest rejection of a standstill agreement.[94] The Board discussed its options with its legal advisors and ultimately concluded that the pill should go into effect and that employing an exchange was the best option, and should be done as soon as possible in order to protect the NOLs, even at the risk of disrupting common stock trading. The Board directed advisers to prepare a technical amendment to the NOL Pill to clarify the time at which an exchange would become effective.[95]

M. *The Board Adopts the Amended and Restated Pill and Dilutes Trilogy*

On January 2, the Board met telephonically once more, reiterating its delegation of authority to the Committee to make recommendations regarding the implementation of the NOL Pill, and passed a resolution expressly confirming that the Board's delegation of authority included the power to effect an exchange of the rights under the NOL Pill and to declare a new dividend of rights under an amended rights plan (the "Reloaded NOL Pill").[96] The Board then adjourned and the Committee—comprised of Sems and Arnold—met with legal and financial advisors, who verified that there had been no new contact whatsoever with representatives from Trilogy, reiterated that the NOLs remained "a valuable corporate asset of the Company in connection with the Company's ongoing exploration of strategic alternatives,"[97] and advised the Committee members of their

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[92]PX 70.
[93]*Id.*
[94]PX 96.
[95]*See id.* at 3; PX 100.
[96]PX 97 at 1-2.
[97]*Id.* at 8.

fiduciary obligations under Delaware law.[98] Reilly presented information about the current takeover environment and the use of poison pills (specifically, the types of pills commonly employed and their triggering thresholds), and reviewed the Company's then-current anti-takeover defenses compared with those of other public companies.[99] Reilly asserted that "a so-called NOL rights plan with a 4.99% trigger threshold is designed to help protect against stock accumulations that would trigger an 'ownership change,'" and that "implementing appropriate protections of the Company's net operating loss carryforwards was especially important at present," given Trilogy's recent share acquisitions on top of the Company's existing Section 382 ownership levels.[100] Finally, Reilly reviewed the proposed terms and conditions of the Reloaded NOL Pill, discussed the methodology for determining the exercise price of the new rights, and made recommendations regarding the same. The Committee sought reconfirmed assurances by its financial and legal advisors that the NOLs were a valuable corporate asset and that they remained at a significant risk of being impaired, which the advisors provided.[101]

The Committee concluded that Trilogy should not be deemed an "Exempt Person," that its purchase of additional shares should not be deemed an "Exempt Transaction," that an exchange of rights for common stock (the "Exchange") should occur, and that a new rights dividend on substantially similar terms ought to be adopted. It passed resolutions to implement these conclusions, thereby adopting the Reloaded NOL Pill and instituting the Exchange.[102] The Exchange doubled the number of shares of Selectica common stock owned by each shareholder of record, other than Defendants. Consequently, the Exchange reduced Defendants' beneficial holdings from 6.7% to 3.3%. The implementation of the Exchange led to a freeze in the trading of Selectica stock from January 5, 2009 until February 4, 2009, with stock price frozen at $0.69.[103] The Reloaded NOL Pill will expire on January 2, 2012, unless the expiration date is advanced or extended, or unless these rights are exchanged or redeemed by the Board some time beforehand.[104]

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[98] *Id.* at 10.

[99] PX 38. At that time, Selectica had the following defensive measures in place as indicated in Reilly's presentation: (1) classified board; (2) board fills all director vacancies; (3) shareholders cannot call special meetings; (4) no action by written consent; (5) supermajority vote to remove directors; (6) locked-in charter or bylaw provision; (7) no cumulative voting; and (8) blank check preferred stock. *Id.* at 21. Selectica has since submitted for stockholder vote a proposal to declassify the staggered board terms. RJN2, Ex. A at 2, 10.

[100] *Id.* at 6.

[101] *Id.* at 8.

[102] *Id.* at 10-21.

[103] DX 762; DX 796 at 2.

[104] PX 101 § 7(a).

N. *The Parties' Contentions*

Selectica seeks a declaratory judgment that the actions of the Board and the Committee in (1) adopting the NOL pill on November 16; (2) authorizing the Exchange on January 2; and (3) adopting the Reloaded NOL Pill and issuing a new rights dividend on January 2, were valid and proper. Trilogy's counterclaim seeks a declaratory judgment that the NOL Pill and Reloaded NOL Pill are invalid, void and unenforceable, or else unenforceable as to Trilogy, as well as an order enjoining or rescinding the Exchange and requiring Selectica to redeem permanently the new rights dividends issued under the Reloaded NOL Pill. Trilogy also seeks money damages for breaches of fiduciary duty.

Selectica asserts that the actions of the Board and the Committee were valid under Delaware law and were appropriate exercises of their fiduciary responsibilities under *Unocal*: specifically, that the Board acted reasonably in concluding that the NOLs constituted a potentially valuable asset that was threatened by Trilogy's actions, and that the adoption of the NOL Pill, implementation of the Exchange, and adoption of the Reloaded NOL Pill and declaration of a new rights dividend were not preclusive but were reasonable and proportionate responses to the identified threat.

To the contrary, Trilogy argues that both the NOL Pill and Reloaded NOL Pill should be declared invalid either because (1) they are both anti-takeover devices that, either per se or on the facts of this case, preclude an effective proxy contest; or (2) they were not a reasonable and proportionate response to a reasonably perceived threat because the Board failed to establish that the NOLs had a value worth protecting and that this value was threatened by Trilogy's purchases.

III. DISCUSSION

A. *The Poison Pill under Delaware Law*

The principal question before the Court is the reasonableness of a board's adoption of a low-threshold poison pill in order to protect assets of speculative and questionable value absent an explicit plan for how such value might be realized.

Since their first appearance nearly thirty years ago, shareholder rights plans—so-called "poison pills"—have been the subject of much debate. Some commentators have suggested that poison pills may be detrimental to shareholder interests because they help perpetuate existing management, preclude value-adding transactions from taking place, and