evidence shows, however, that the "order" to stop fundraising was a reasonable directive from the Board at a time when the Company was quite desperate for a distribution partner to increase its sales force. The Board wanted Molinaro to focus on finding such a partner in the wake of 3M having withdrawn from the field.

Toni testified that Closure's distribution relationship with J&J was critical to its success.[176] Although Adhezion's Board had considered building a sales team itself, it ultimately chose to take a route similar to Closure's and try to find a strategic partner like J&J.[177] At the time, Medline was still a possible partner. Moreover, Originate had limited additional funds it was willing to invest in Adhezion. According to Gausling, Originate was "looking for someone else to take the lead, that we would participate . . . to say that, you know, we're committed, we'll add capital but we didn't want to be the lead going forward."[178] Gausling's contemporaneous solicitation of Safeguard Scientific corroborates his testimony.[179]

Adhezion also had limited funding options because it was a risky investment. The Company was not performing at the level the parties anticipated when Originate originally invested[180] For example, as part of the deal with Originate, Zimmerman entered into an employment agreement with seven milestones. Zimmerman's employment was terminated when he failed to meet most of those milestones. Gausling testified that

> many of the items that [Zimmerman] specifically said were the value drivers going forward, we put in a performance milestone

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[176] Tr. 510–11 ("Q. With your experience in Adhezion, tell me, do you regard it as the next Closure? A. No, not at all. You know, first of all, they are so strapped in terms of cash, availability of cash, to try and build the business. How do they compete with J&J? How do they distribute their product? . . . You need a pipeline.").

[177] Tr. 511 (Toni) ("Q. With all the money [Closure] raised [$39.5 million], why did you go to Johnson & Johnson rather than develop your own channels of distribution? A. [W]e realized that we never could be able to raise enough money to compete with 200 sales reps. How could we build a 200-sales-rep organization to compete with Ethicon, [J&J's division that sells Dermabond]?"); Tr. 440 (Gausling) ("[W]e, as a collective board, took a strategy that we would go with a corporate partner for distribution versus building a sales team ourselves."). Gausling further explained: "[T]hat's the value drivers for any investor to look at, is how's the business doing and we needed – need strategic partners or some revenue traction or some clarity on the patent situation." *Id.*

[178] Tr. 439.

[179] JX 130; *see also* Tr. 442 (Gausling).

[180] Gausling ascribed the increased riskiness of the Adhezion investment over time to three main reasons: (1) Adhezion needed more money within twelve months of Originate's investment; (2) Zimmerman met only two of his seven performance milestones; and (3) the budgeted revenues for 2008 ($5.6 million) dwarfed the actual revenues ($140,000). Tr. 436–38. Zimmerman does not dispute that he failed to meet many of the milestones in his employment agreement, except to note that Adhezion achieved a third milestone fifteen days after his termination. Tr. 112.

> in his employment agreement, seven items. . . . [I]f he hit those value drivers, then the company would have done what he said it was going to do. He hit two of the seven during that period in time. . . . [H]e had alleged that we would get all seven of those. We got two.[181]

The threat of patent infringement litigation was another looming risk that developed in 2009.[182] One company threatening litigation was J&J, Adhezion's main competitor. J&J had significant resources and every incentive to pursue a patent infringement lawsuit against its competitor Adhezion's product SurgiSeal. In fact, the possibility that Adhezion was infringing J&J's patent dampened 3M's enthusiasm for entering into a distribution agreement with Adhezion.[183] It also influenced Medline's decision not to pursue a license and distribution agreement with Adhezion.

After the Medline transaction fell through, Adhezion embarked on a reformulation of its sterilization process in an effort to design around J&J's patent. During the reformulation, Adhezion did not produce SurgiSeal.[184] Still, Molinaro continued to seek outside investors. He recognized, however, that because the threat of patent infringement litigation had caused the Company to cease production of its main product, there "wasn't much chance of actually securing someone if they did their due diligence."[185]

Zimmerman also emphasizes that the Board did not negotiate to obtain better terms for the Company than those initially presented by Crothall. There is no evidence, however, that any of the directors believed the terms were unfair to Adhezion. Although Molinaro raised an objection to the amount of warrants being granted in the February 2010 Issuance, he ultimately agreed to the original terms. Indeed, he testified that he "always felt that the valuation of the company and the share price was generous."[186]

In the context of all the evidence, Molinaro's failure to obtain a modification of the number of warrants granted in the February 2010 Issuance does not alter my conclusion that this Issuance and the other Challenged Transactions were comparable to third-party transactions. Despite reasonable efforts on behalf of Adhezion to find additional investors,

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[181] Tr. 437.

[182] Tr. 246–47 (Molinaro); JX 48, January 8, 2009 Letter from Medlogic to Adhezion regarding potential patent infringement.

[183] Tr. 251 (Molinaro).

[184] The Company sold out its existing inventory of SurgiSeal by extending the shelf life. Tr. 282 (Molinaro).

[185] Tr. 270.

[186] Tr. 335.

I find that no third party was willing to invest in the Company on terms more favorable to Adhezion. The Kensey Nash offer in November 2009 to buy Adhezion was for $10 million, but only $4 million of that was firm. The fact that the Adhezion Board effectively rejected that offer by making a much higher counteroffer that sought, in part, a firm commitment of $20 million does not warrant a different conclusion. No serious negotiations with Kensey Nash ever took place in the succeeding years. Additionally, Zimmerman sold a significant amount of his shares for only $2 per unit just three months after the February 2010 Issuance.

b. Expert evidence

Defendants Expert, Roy D'Souza, opined that all four Challenged Transactions were fair.[187] Zimmerman's expert, Dr. Helen Bowers, opined that the February 2010 Issuance was unfair but did not seriously question the fairness of any of the other Challenged Transactions.[188] Bowers calculated Adhezion's value to be no less than $15.63 million in February 2010.[189] The February 2010 Issuance valued the Company at $13 million.[190] In her Expert Report, however, Bowers admittedly made a troubling number of computational errors, which Defendants' expert, D'Souza, later identified.[191] To account for these errors, and to make additional corrections, Bowers submitted a Supplemental Expert Report.[192] In any case, D'Souza

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[187] JX 370; JX 372.

[188] Bowers stated that, although she did not perform an analysis for the other three Challenged Transactions, "in the analysis [she] did in this whole matter – [she] did not find anything that would cause [her] to suspect that they were unfair." Tr. 151; *see also* JX 369, Bowers's Expert Report; JX 371, Bowers's Rebuttal Report; JX 376, Bowers's Supplemental Expert Report. Bowers did state in her Rebuttal Report, however, that D'Souza overstated Adhezion's value due to mistakes and errors, and that his calculated valuation "does not support a determination of fairness nor does it support that the disputed transactions were fair." JX 371 at 6, 25–26. As the party with the burden of proof to show that the other Challenged Transactions were unfair, Zimmerman's general criticisms of those transactions, without the benefit of any expert analysis, were insufficient to meet his burden. Furthermore, Defendants' expert credibly concluded that "the capital raising activities of Adhezion during 2009 – 2011 were fair and reasonable." JX 370, Expert Report of Roy P. D'Souza, at 71.

[189] JX 376 at 4. Bowers's discounted cash flow ("DCF") model yielded a value of $16.18 million and her comparable companies, or relative, valuation yielded a value of $13.97. In arriving at a valuation of $15.63, she gave her DCF model 75% weight and her relative valuation 25% weight.

[190] Tr. 273 (Molinaro). In February 2010, the total number of Adhezion units if all outstanding warrants and options were exercised was 3,249,633. Tr. 585–88 (D'Souza). This number multiplied by the $4.00 per unit price equals $12,998,532.

[191] *See* JX 372.

[192] JX 376.

convincingly pointed out in his rebuttal report and at trial several ways in which Bowers's analysis overstates Adhezion's value and understates the attendant risks.[193]

One point the parties strenuously dispute is the value of the warrants issued in the February 2010 Issuance. Defendants contend they had no value because, in their view, the Company's unit price was below the $4 warrant strike price.[194] Bowers, on the other hand, valued the warrants at a $4.29 per unit.[195] Among other things, Bowers used the Black-Scholes method to arrive at this value. Although the Black-Scholes model is a formula for option valuation that is "widely used and accepted by industry figures and regulators,"[196] the model overstates the value of options "which are not liquid, freely tradeable options."[197] Adhezion's warrants are not publicly traded. Therefore, I find Bowers's reliance on the Black-Scholes formula to value Adhezion's warrants to be questionable, if not entirely misplaced.

Bowers used two analytical methods to determine a fair value range for Adhezion: a DCF analysis and a comparable companies analysis. For her comparable companies analysis, Bowers relied, in part, on the 37.6 multiple of enterprise value/EBIT paid by J&J to acquire Closure.[198] The differences between Closure when it was sold to J&J and Adhezion in February 2010, however, are stark. Unlike Closure, Adhezion had no distribution partner, faced a substantial risk of IP litigation, had raised relatively little cash, and would be the third company to enter the market, after the first entrant, J&J, and a new competitor, Medline.[199] Based on these significant differences, I find that Bowers's reliance on Closure as a "firm very similar to Adhezion"

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[193] *See* JX 372 at 9–11 (discussing size risk, legal risks, and regulatory risks). The parties disagree, for example, on how to characterize the Company. Defendants call it an "early-stage" medical products company. Defs.' Answering Post-Trial Br. ("Defs.' AB") 1; Tr. 431 (Gausling). Zimmerman describes Adhezion as a "growth-stage" company, and his expert appears to use that characterization to justify assigning less risk to the Company than Defendants' expert did. Pl.'s Opening Post-Trial Br. ("Pl.'s OB") 1; Pl.'s Reply Post-Trial Br. ("Pl.'s RB") 17; JX 369, Expert Report of Dr. Helen M. Bowers, 8–9 (describing an "expansion-stage" company as one that has products in production, has products that are commercially available, and is experiencing revenue growth though it may not yet show a profit). In the circumstances of this case, I find Defendants' characterization of Adhezion as an early-stage company slightly more appropriate.

[194] Tr. 606–07 (D'Souza); Tr. 517–18 (Toni).

[195] Tr. 142 (Bowers); Tr. 601 (D'Souza).

[196] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 705 n.42 (Del. 2005).

[197] *Louisiana State Employees' Retirement Sys. v. Citrix Sys., Inc.*, 2001 WL 1131364, at *7 (Del. Ch. Sept. 19, 2001); *see also Lewis v. Vogelstein*, 699 A.2d 327, 331 (Del. Ch. 1997) (noting that Black-Scholes "assumes that the options being valued are issued and publicly-traded"); Tr. 598 (D'Souza).

[198] *See* JX 369 at 4; Pl.'s OB 30; *see also* JX 372 at 18.

[199] *See* Tr. 502–09 (Toni).

was unreasonable.[200] In summary, having considered Bowers's expert reports and testimony, as well as Plaintiff's other evidence, I find that Zimmerman has failed to prove any of the Challenged Transactions were less than entirely fair. Based on the same reasons discussed in this Part II.B, I also would find the Challenged Transactions to be entirely fair if Defendants bore the burden on that issue.

C. Aiding and Abetting

To succeed on a claim for aiding and abetting a breach of fiduciary duty, Plaintiff must prove: (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, and (3) knowing participation in that breach by the non-fiduciary.[201] Because the Director Defendants did not breach their fiduciary duties, Zimmerman cannot succeed on his claim against Defendants Originate, Liberty, and Morse for aiding and abetting a breach of fiduciary duty. I therefore find for Defendants on Plaintiff's claim for aiding and abetting.

D. Remedy

Having concluded that Zimmerman is entitled to judgment in his favor on the breach of contract claim but not on the breach of fiduciary duty and aiding and abetting claims, I consider what remedy is appropriate in the circumstances of this case. Zimmerman proposes that the Court reform the terms of the Challenged Transactions. He requests, first, that the Court cancel (1) all the warrants issued and (2) all the options issued pursuant to the 2010 employee option grant. Second, he requests that Defendants be deemed to have received, for each transaction, promissory notes at 10% interest, with no ability to convert into equity, redeemable five years from the date of judgment.

The remedy of reformation typically is used to conform a document to the parties' intent in cases of mutual mistake or fraud.[202] It also can be used to remedy a breach of fiduciary duty, in which case the court has broad authority to fashion an appropriate remedy.[203] Based on the circumstances of this case, however, I do not consider the reformation proposed by Zimmerman to be an appropriate equitable remedy. Rather than rectify

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[200] JX 369 at 4.

[201] *Allied Capital Corp. v. GC-Sun Hldgs., L.P.*, 910 A.2d 1020, 1039 (Del. Ch. 2006).

[202] *Waggoner v. Laster*, 581 A.2d 1127, 1135 (Del. 1990).

[203] *In re Loral Space & Commnc'ns Inc.*, 2008 WL 4293781, at *33 n.161 (Del. Ch. Sept. 19, 2008).

wrongdoing and avoid an unjust enrichment, the proposed reformation would create a windfall for Zimmerman.[204] Adhezion needed the funds that Defendants provided in each of the Challenged Transactions. Zimmerman effectively concedes this point and does not request that the Court rescind the transactions. Instead he asks the Court to allow the Company to keep Defendants' money on different terms. Yet, no evidence suggests that Defendants would have invested in Adhezion on Zimmerman's proposed terms.

In this case, where Defendants have not breached their fiduciary duties, an appropriate remedy would permit Plaintiff to recover any damages he suffered as a result of the Director Defendants' breach of the Operating Agreement. Having concluded that none of the Challenged Transactions has been shown to have been unfair to Adhezion, however, I find that there are no such damages. The Challenged Transactions provided the Company with crucial capital on fair terms. The dilution Zimmerman suffered was in exchange for maintaining some value to his investment in Adhezion. In this Opinion, therefore, I declare that the parties' rights under the Operating Agreement are as discussed in Part II.A, *supra*, but otherwise decline to award any damages beyond nominal damages of $1.

E. Attorneys' Fees

Zimmerman also asks this Court to order Defendants to reimburse the Company for $1,011,559 in legal fees that it advanced to Pepper Hamilton while that firm acted as counsel to Defendants, and not the Company. Zimmerman challenges the legality of this advancement. Whether a party has the ultimate right to an advancement depends on whether his underlying conduct is indemnifiable.[205]

The LLC Act defers completely to the contracting parties "to create and delimit rights and obligations with respect to indemnification and advancement of expenses."[206] Because of this deference, this Court has stated a preference for "interpret[ing] language so as to achieve where possible the beneficial purposes that indemnification can afford."[207]

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[204] *Id.*

[205] *Reddy v. Elec. Data Sys. Corp.*, 2002 WL 1358761, at *5 (Del. Ch. June 18, 2002).

[206] *See Delphi Easter P'rs Ltd. P'ship v. Spectacular P'rs, Inc.*, 1993 WL 328079, at *2 (Del. Ch. Aug. 6, 1993) (interpreting a section of the Delaware Revised Uniform Limited Partnership Act ("DRULPA"), 6 Del. C. § 17-108, which similarly allows a partnership to "indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever").

[207] *Id.* at *2.

Adhezion's Operating Agreement creates broad indemnification rights for directors in Section 6.17:

> *The Company shall indemnify and hold harmless each Director to the fullest extent permitted by law* from all liabilities, losses, costs, expenses and/or damages (including without limitation reasonable attorneys' fees) and for judgments and amounts paid in settlement of an action, suit or proceeding in which such Director is or was a party, or threatened to be made a party, by reason of such Director's relationship with the Company, unless there has been a final adjudication in the action, suit or proceeding or, in the event of settlement of the action, suit or proceeding, counsel to the company is of the opinion *that the Director's act or omission was not taken or made in good faith within the scope of this Agreement and was the result of gross negligence, willful misconduct or fraud on the part of the Director.* The foregoing right of indemnification shall be in addition to any other rights to which the Directors may otherwise be entitled, including, without limitation, as a result of any indemnification agreement entered into between the Directors and the Company, and shall inure to the benefit of the successors, assigns, executors, administrators and personal representatives of the Directors.[208]

This provision requires indemnification for directors unless there has been a final adjudication that the directors' acts were both "not taken or made in good faith within the scope of this Agreement" and were "the result of gross negligence, willful misconduct or fraud on the part of the Director."[209] In this Opinion, I have concluded that the Director Defendants breached the Agreement by failing to obtain the approval of the Common unitholders for the Challenged Transactions. Zimmerman has not shown, however, that any of the Defendants' actions in connection with the Challenged Transactions either were not taken in good faith or resulted from gross negligence, willful misconduct, or fraud. Thus, the Agreement requires indemnification for the Director Defendants in the circumstances of this case. [210]

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[208] Operating Agreement § 6.17 (emphasis added). Plaintiff does not challenge the reasonableness of the attorneys' fees advanced. I therefore do not consider that issue.

[209] *Id.*

[209] *Id.*

[210] In addition to the indemnification provision in the Operating Agreement, the Company

An indemnification provision also appears in the February 2010 Purchase Agreement.[211] Defendants Originate, Crothall, Liberty, and Molinaro are parties to this agreement. Its indemnification provision states in relevant part:

> (b) The Company shall indemnify, defend and hold harmless each Indemnified Party[212] against any and all direct costs, fees, expenses and monetary damages of such Indemnified Party resulting directly from or arising directly out of any third party or governmental action or claim brought against such Indemnified party, primarily relating to the Indemnified Party's status as a security holder, board observer, or as a director of the Company . . . .[213]

This provision provides security holders of Adhezion broad indemnification for expenses arising directly out of any "third party action." Adhezion is both a party to this action as a nominal defendant and a party to the February 2010 Purchase Agreement. Arguably, therefore, Zimmerman's derivative claim brought on behalf of Adhezion is not a "third party action."

Subsection (a) of the above-quoted Section 6.1 directly addresses derivative actions. It provides for indemnification of expenses arising out of or related to any derivative action "based upon, resulting from, relating to or

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also entered into indemnification agreements with at least directors Molinaro and Crothall. Although Defendants assert that "Adhezion entered into indemnification agreements with each of [the] directors," they cited only two exhibits in support of this assertion. Defs.' AB 49 (citing JX 40 (Crothall Indemnification Agreement) and JX 43 (Molinaro Indemnification Agreement)). These agreements expressly address "Advancement of Expenses" and provide that the Company will advance expenses incurred by the contracting director after the director submits a statement requesting the advance *and* a written undertaking. There is no evidence, however, that any director provided an oral or written undertaking to the Company. *See Carlson v. Hallinan*, 925 A.2d 506, 541 (Del. Ch. 2006) (finding that 8 *Del. C.* § 145 permits an undertaking to be in oral or written form). In the corporate context, this Court held in *Carlson v. Hallinan* that a company's advancement of directors' litigation expenses without the directors first submitting an undertaking was *ultra vires*. *Id.* Nevertheless, the Court noted that the directors still could "apply to this Court, pursuant to 8 *Del. C.* § 145(b), for indemnification." *Id.* at 542 n.240. In light of the extensive findings of wrongdoing and liability by Defendants in *Carlson*, however, the Court required the directors to repay the advanced funds to the company pursuant to both 8 *Del. C.* § 145(b) and § 145(e). Because Defendants are entitled to indemnification in this case, I reach a different result.

[211] JX 224 art. 6.

[212] The agreement defines "Indemnified Party" to include "the Purchasers and their affiliates and their respective officers, directors, trustees, agents, representatives, employees, partners and controlling persons." *Id.* § 6.1(a). This broad definition would include Defendant Morse as an agent of Liberty.

[213] *Id.* § 6.1(b). This provision contains a carve-out for claims resulting from a party's grossly negligent or willful misconduct, but it is not relevant here.

arising out of any misrepresentation or breach of any representation, warranty, covenant or agreement by the Company in any Transaction Document."[214] One such representation and warranty by the Company is that the Company "has all power and authority . . . (b) to execute, deliver and perform this Agreement . . . and the Operating Agreement."[215] At a minimum, Plaintiff's breach of contract and breach of fiduciary duty claims "relate to" the Company's breach of this representation and warranty. I conclude, therefore, that either through Section 6.1(a) or 6.1(b) of the February 2010 Purchase Agreement, the non-Director Defendants also are entitled to indemnification.

Having concluded that Defendants are entitled to indemnification, whether Defendants also have a right to advancement is largely moot at this stage in the litigation.[216] Plaintiff's counsel effectively acknowledged as much at oral argument.[217] Furthermore, the Operating Agreement confers upon the Board the authority to "make all decisions and take all actions for the Company not otherwise provided for in this Agreement."[218] Therefore, even though the Operating Agreement does not explicitly address advancement rights, the Board had the authority to approve the advancement of Defendants' legal fees. Because I find that Defendants have not breached the fiduciary duties they owe to the Company or to Zimmerman, I also see no basis for invalidating the Board's decision to advance Defendants' legal fees. Indeed, that decision appears to comport with the Operating Agreement's requirement that the Company indemnify its directors "to the fullest extent permitted by law."[219]

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[214] *Id.* § 6.1(a).

[215] *Id.* § 3.1.

[216] To avoid this result, Zimmerman could have sought, for example, to have this question resolved in advance of trial pursuant to 6 *Del. C.* § 18-111, which permits this Court to "interpret, apply or enforce the provisions of a limited liability company agreement." *See Morgan v. Grace*, 2003 WL 22461916, at *1 (Del. Ch. Oct. 29, 2003) ("The value of the right to advancement is that it is granted or denied while the underlying action is pending.").

[217] Sept. 14, 2012 Post-Trial Oral Arg. Tr. 47 ("*To the extent the Court finds for Plaintiff*, [we request] that it order repayment of advanced attorneys' fees as no longer permitted." (emphasis added)).

[218] Operating Agreement § 6.1(a).

[219] *Id.* § 6.17. The comparable language under Section 6.1(b) of the February 2010 Purchase Agreement is less broad, but still supports the same conclusion as to the non-Director Defendants. That Section requires the Company to indemnify parties to that agreement "against any and all direct costs, expenses and monetary damages of such Indemnified Party resulting directly from or arising directly out of [a claim] primarily relating to the Indemnified Party's status as a security holder." JX 224 § 6.1(b).

Thus, I deny Plaintiff's request for an order directing Defendants to reimburse the attorneys' fees advanced on their behalf by the Company.

III. CONCLUSION

For the foregoing reasons, I find that the Director Defendants breached the Operating Agreement by entering into the Challenged Transactions without obtaining the approval of the Common unitholders. But, I find that the breach caused no damage to Zimmerman and, therefore, award only nominal damages of $1. I further find that Defendants did not breach any fiduciary duties and that, therefore, there can be no liability for aiding and abetting such a breach. Defendants promptly shall submit, on notice, an appropriate form of final judgment.

IN RE NINE SYSTEMS CORPORATION SHAREHOLDERS LITIGATION

No. 3940-VCN

In the Court of Chancery of the State of Delaware

February 28, 2013

Anne C. Foster, Esquire, and Blake Rohrbacher, Esquire, of Richards, Layton & Finger, P.A., Wilmington, Delaware; Lawrence D. Rosenberg, Esquire, Paul V. Lettow, Esquire, James M. Burnham, Esquire, and Matthew F. Kuhn, Esquire, of Jones Day, Washington, D.C.; and Robert C. Michelletto, Esquire, of Jones Day, New York, New York, Attorneys for the Fuchs Plaintiffs.

Richard D. Heins, Esquire, Andrew D. Cordo, Esquire, and Stacy L. Newman, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Richard G. Haddad, Esquire, Stanley L. Lane, Jr., Esquire, and Denaka L. Perry, Esquire, of Otterbourg, Steindler, Houston & Rosen, P.C., New York, New York, Attorneys for Defendants.

NOBLE, *Vice Chancellor*

Many shareholders of Nine Systems Corporation, formerly Streaming Media Corporation, (the "Corporation" or "NSC") were surprised to receive notice in 2006 that Akamai Technologies, Inc. ("Akamai") was proposing to acquire the Corporation for $175 million. Those shareholders had heard virtually nothing from NSC during the preceding four years. When last heard from, NSC was in dire financial straits. Those shareholders soon came to appreciate—maybe some had been afforded some timely knowledge—that three large shareholders in late 2001 and 2002 had expropriated much of the minority shareholders' economic interests and voting power. Those shareholders objected to the series of events—the "self-dealing transactions," as they call them—and brought this action well after Akamai completed its acquisition of the Corporation.

Those shareholders—and the Court for that matter—are now confronted with Defendants' summary judgment motion that, if successful, will defeat many of their claims. In addition to several relatively narrow

issues, the major questions posed by the pending motion are (1) whether there was a control group that, under the teaching of *Gentile v. Rossette*,[1] would allow those former shareholders to continue to have standing to pursue their claims of dilution that supposedly occurred some four years before the Akamai acquisition; (2) whether various groups of shareholders were not owed fiduciary duties at the time of the self-dealing transactions because they either were debt (and not equity) holders or held their interests in the Corporation through yet another entity whose dissolution and subsequent transfer of NSC shares may not have occurred until after those acts; and (3) whether NSC's disclosure of some facts about the dilutive acts provided certain shareholders with enough knowledge to conclude that they were guilty of laches.

I. BACKGROUND[2]

The Plaintiffs are former shareholders of NSC.[3] Some of the Plaintiffs purchased NSC common stock in the spring of 2000. Some invested in NSC through Streaming Media Investment Group, LLC ("SMIG"), which had been established to facilitate investment in NSC.[4] Plaintiffs who invested in 2000 had stock purchase agreements with most-favored nation clauses.[5] In 2001, other Plaintiffs purchased NSC Subordinated Notes with warrants.[6] These were later converted into NSC common stock; they also received anti-dilution protection for their shares.[7] Finally, yet another group of Plaintiffs

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[1] 906 A.2d 91 (Del. 2006).

[2] Although the critical events took place essentially within no more than a few months, the issues developed over several years and are somewhat complicated factually. This factual background is not intended to be (and it is not) comprehensive. For example, the question (and its relevance, if any) of whether NSC had any hope for survival in the absence of a cash infusion from Defendants is avoided. Summary judgment is not an ideal procedural mechanism for detailing an extensive and frequently conflicting fact pattern. The question is not so much what are the undisputed facts as it should be which inferences may reasonably be drawn. The issues are framed in the sections of this Memorandum Opinion in which they are addressed.

[3] Sheldon Dubroff and Mervyn Klein are plaintiffs in Civil Action No. 3940-VCN. Their claims, except for disclosure claims, have been dismissed. In Civil Action No. 6017-VCN, there are forty-three plaintiffs who are sometimes referred to as the "Fuchs Plaintiffs," a title that traces to the Lead Plaintiff in that group, Morris Fuchs. These actions have been consolidated. *See Dubroff v. Wren Hldgs., LLC*, 2011 WL 5137175 (Del. Ch. Oct. 28, 2011) (*"Dubroff II"*).

[4] Transmittal Aff. of Stacy L. Newman in Supp. of Defs.' Mot. for Summ. J. ("Newman Aff.") Ex. 8 (SMIG Subscription Agmt.).

[5] A subsequent investor, one of the Defendants, purchased NSC stock and acquired anti-dilution protection and pre-emptive rights. Thus, the NSC investors at the time with most-favored nation protection received those benefits as well.

[6] Newman Aff. Ex. 18 (Subordinated Note Term Sheets).

[7] *Id.* at Ex. 23.

acquired Senior Secured Notes and Warrants in August 2001.[8] In the spring of 2002, they agreed to surrender the warrants and convert the notes into equity with Preferred A stock issued in August 2002.

The Plaintiffs contend that NSC's three largest shareholders—Defendants Wren Holdings, LLC ("Wren"), Javva Partners, LLC ("Javva"), and Catalyst Investors, L.P. ("Catalyst") (collectively, the "Entity Defendants")—conspired in 2002 to recapitalize the Corporation to the Plaintiffs' detriment. With their ownership of 54.3 percent of NSC, the Entity Defendants designated three of the five members of the board. Defendant Howard Katz served as Javva's managing member and representative on NSC's board. Defendant Christopher Shipman represented Catalyst on the board until 2006 when he was replaced by Tyler Newton. Defendant Dort A. Cameron, III was a co-owner and the board designee of Wren.[9]

The Plaintiffs were generally persuaded to invest in NSC by Abraham Biderman, who then worked for Lipper & Company ("Lipper") and who, on June 12, 2001, also became a director of NSC.[10] Some agreed to a collective holding of NSC shares by SMIG, which may have been established under the auspices of Biderman and which was dissolved on April 22, 2002.[11]

NSC had been founded in 1999 to profit from video streaming on the internet. It struggled financially. Javva invested in late 1999 or early 2000.[12] In March and June 2000, Wren invested. It was roughly October 2000 when Catalyst invested.[13] Lipper began working with NSC in March 2000. Many of its investors—some who are Plaintiffs—accepted membership units in SMIG, but others—some also Plaintiffs—chose to be direct stockholders. In December 2000, Lipper assisted NSC in offering Subordinated Notes that were convertible into NSC common stock at $10 per share, a number that could be adjusted, but not below $5 per share.[14]

By the spring of 2001, NSC's financial troubles necessitated additional funding; initially, relatively small loans met its short-term needs. A new round of equity was considered. After some negotiations, Catalyst, Wren, Javva, those Plaintiffs who would eventually acquire Preferred A shares, and others to a lesser degree purchased the Secured Notes, consisting of a senior

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[8] *Id.* at Ex. 27 (NSC Credit Agmt.).

[9] Defendant Andrew T. Dwyer beneficially controlled just less than fifty percent of Wren. Defendant Troy Snyder joined NSC's board in May 2002.

[10] *Id.* at Ex. 21.

[11] *Id.* at Ex. 38.

[12] *Id.* at Ex. 2.

[13] *Id.* at Ex. 16. (Stock Purchase Agmt.).

[14] *Id.* at Ex. 18.

note and a warrant convertible into common stock.[15] Conversion of the Secured Notes was changed from a floor of $5 per share to $0.50 per share, which also aided those with most-favored nation rights.[16]

Despite turnover in upper management, NSC continued to struggle to pay its bills. A series of board meetings began on December 20, 2001. At that point, the board consisted of Art Williams, NSC's then-new Chief Executive Officer, Katz, Cameron, Shipman, and Biderman. Not only did the board discuss NSC's short-term funding needs during this telephonic meeting, but it also considered a possible route to profitability through acquiring the assets of e-Media, a failing competitor that was approaching bankruptcy, and the streaming division of NaviSite, which was abandoning that aspect of its business. The Plaintiffs claim that the meeting was scheduled for the afternoon (a Friday) that, for religious reasons, made it impossible for Biderman to attend. Defendants contest this claim of motive[17] and assert that Biderman was promptly informed of what occurred at the meeting by the following Monday.[18]

During a meeting on January 7, 2002, Williams pushed the acquisition strategy even though it would require additional funding. All directors, but for Biderman who abstained, voted in favor of the growth effort. The board, on January 10, 2002, with Biderman as the lone dissenter, agreed to acquire e-Media and the streaming division of NaviSite. Wren and Javva would each loan $2.5 million to finance the transactions. Catalyst did not participate. Biderman's opposition was tied to his perception that, as a consequence of the loans, NSC shareholders' interests would be diluted.

NSC revised its acquisition strategy a week later in response to a change in the terms of the NaviSite transaction that required additional cash. The revised plan for recapitalization (the "Recapitalization") was approved unanimously. Two new series of preferred stock would be issued: Series A would be issued in exchange for the existing secured debt (20 percent) and Series B would be issued for the new money raised for the transaction (seven percent). Also, without a change in control, Biderman would remain a director through 2004, and any subsequent equity issuance, absent unanimous board approval, would allow the Series A Preferred holders to redeem their shares with a 50 percent premium to the face amount. This latter provision was designed to assuage concerns about further dilution.

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[15] *Id.* at Exs. 24, 25, 41, 94.

[16] *Id.* at Ex. 23.

[17] Defs.' Opening Br. in Supp of their Mot. for Summ. J. ("NSC Br.") 36.

[18] Biderman frequently asked two colleagues at Lipper, Emily Grad and Patti Koo, to attend meetings on his behalf. It is not clear why they were not asked to attend this meeting.

A board meeting scheduled for February 25, 2002, turned into an informational meeting when a quorum was not achieved.[19] Williams reported that e-Media's integration into NSC was requiring more effort than anticipated, that its revenues were less than anticipated, and that the NaviSite transaction was plagued by a shortage of working capital ($1.3 million). Additional funding was already necessary. Wren and Javva agreed to provide about three-quarters of the funds ($900,000), but Catalyst and Lipper both passed on the opportunity.

Grad and Koo, in Biderman's place, attended the next board meeting on March 6, 2002.[20] The NaviSite acquisition's cash shortfall was the primary topic. Outside financing (and financing from Catalyst and Lipper) still had not been obtained. Wren agreed to a significant increase in the amount it would put up, but insisted that its equity be limited. Eventually, Wren loaned $500,000, and Wren's $700,000 and Javva's $100,000 equity contributions would be covered by additional Preferred B-1 shares. There was discussion at the meeting about the need for the holders of the Secured Notes (in part, Plaintiffs) to agree to a debt exchange for Preferred A shares.

The board next met on April 11, 2002,[21] and the meeting addressed several topics that had been considered during a telephonic meeting a few days before but without Biderman as an invitee.[22] Williams was leaving NSC, and certain issues regarding the Recapitalization were discussed. Grad attended the April 11 meeting in Biderman's place. The need to garner the support of all secured debt holders for the Recapitalization was recognized, but this was the last time that the Recapitalization was addressed specifically by the board. Apparently, it had been decided during the April 9 telephonic gathering—but not discussed at the April 11 board meeting—that Snyder, who had come to NSC as part of the NaviSite acquisition, would take Williams's place as Chief Executive Officer.[23] Snyder was elected to the board and formally designated as NSC's CEO on May 22, 2002.[24]

Although SMIG's Certification of Cancellation was filed on April 22, 2002, its members did not receive certificates for their NSC shares until at

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[19] Newman Aff. Ex. 35 (Feb. 25, 2002 meeting minutes).

[20] *Id.* at Ex. 36 (Mar. 6, 2002 meeting minutes).

[21] The parties dispute whether there was an intervening meeting. During this period, a draft term sheet for the Recapitalization was circulated to Wren, Javva, and Catalyst, but, apparently, not to Biderman.

[22] *Id.* at Ex. 37 (Apr. 11, 2002 meeting minutes).

[23] Aff. of Blake Rohrbacher, Esq. in Supp. of Fuchs Pls.' Br. in Opp'n to Defs.' Mot. For Summ. J. ("Rohrbacher Aff.") Ex. W.

[24] Newman Aff. Ex. 40.

least May 30, 2002.[25] Before then, the SMIG Plaintiffs did not own NSC stock.

In addition, during the same period, additional shares were issued because of most-favored nation provisions, including some about which the Defendants now complain because they claim two Plaintiffs were not parties to any agreement granting most-favored nation status.

The burden of obtaining the consents of the Secured Note holders for the Recapitalization eventually fell to Biderman. On June 18, 2002, he wrote to Plaintiff Herbert Rausman and explained that the Preferred A shares that he and his family would receive upon surrender of their Secured Notes and Warrants would amount to 1.22 percent of NSC's outstanding equity (the "June Update"). One of the documents supplied by Biderman was an "SMC Update" which, among other items, reported: "Although [NSC] contributed only 15% of the revenues of the combined entity, it is estimated that upon recapitalization, [NSC] shareholders (who did not finance the acquisitions) will own over 30% of the new [combined] company."[26] The Plaintiffs argue that Rausman could not and did not understand this "confusing sentence."[27] The sentence informed shareholders that their proportionate interest in NSC had been reduced; it did not, however, inform them who benefited from that dilution or that the Equity Defendants would be providing the new money. A necessary inference from the report is that whoever provided the financing for the two acquisitions would own 70 percent of the combined NSC enterprise (the amalgamation of old NSC, e-Media, and NaviSite). The Secured Note holders eventually executed individually a Preferred A Stockholder Agreement[28] and, in exchange for their Secured Notes and Warrants, received Preferred A shares.

A one-for-twenty reverse stock split, revised from a one-for-ten reverse stock split considered in April 2002, was also approved at this time. Plaintiffs object that after the reverse stock split approved on August 1, 2002,[29] the Entity Defendants issued themselves Preferred B-1 shares.[30] Without the change in the reverse split which raised the effective price (from $0.29 to $0.58 per share), the Preferred B-1 issuance, according to the Plaintiffs, would have triggered anti-dilution protections available to many

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[25] *Id.* at Exs. 41-43 (internal share issuance summary dated May 30, 2002).

[26] Newman Aff. Ex. 44.

[27] NSC Br. 17.

[28] Newman Aff. Ex. 53. The agreements were held by Lipper and not released until the end of July.

[29] *Id.* at Ex. 48.

[30] Rohrbacher Aff. Ex. EEE.

of them.[31] This was all accomplished through written consents of the majority shareholders and did not involve a stockholders meeting.

During August 2002, the board, both through its own actions and through majority shareholder written consents (after consciously eschewing a stockholders meeting) carried out an extensive capital restructuring. Some Plaintiffs had earlier agreed to convert their Senior Notes before this (a necessary precursor to the strategy implemented) but were not afforded an opportunity to participate in the August financing. These Plaintiffs did sign a stockholder agreement dated August 12, 2002.[32] The net effect of all these changes was that the Entity Defendants increased their collective ownership of NSC from roughly 54 percent to 85 percent, and perhaps to even slightly more than 90 percent.[33] The corresponding dilution of Plaintiffs' interests forms the core of their claims.

In October 2002, after the now-challenged transactions had been completed, the Defendants sent a "Fall Update" to NSC shareholders.[34] During the more than three years after the update was sent, NSC provided no information to the Plaintiffs.[35] In February 2006, NSC did communicate with its shareholders.[36] A board meeting was convened on November 15, 2006, to consider the Akamai acquisition, something that Biderman, still nominally a board member, had never heard about, even though it had been under consideration for at least six months.[37] Materials sent in late November 2006 to solicit a stockholder vote on the Akamai transaction[38] engendered an unhappy response from the minority shareholders who were

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[31] The SMIG Stock Purchase Agreement (Newman Aff. Ex. 9 at § 6) (whether there is a signed version may be yet another question) conferred "most favored nation rights" that required, if better terms were offered in a subsequent investment, that the SMIG members would be "offer[ed] the same terms . . . effective as of the date of this Stock Purchase Agreement." Those most favored nation rights were available for a period of eighteen months from the date of the Stock Purchase Agreement, April 4, 2000. The events of the Recapitalization were more than eighteen months later, but NSC, in late September 2001, issued warrants with anti-dilution provisions (Newman Aff. Ex. 25 at § 3) that had an expiration date of September 2006 (or until a majority of the warrants was no longer outstanding). The questions include whether the SMIG Plaintiffs only had those anti-dilution rights until the expiration of their eighteen-month period or whether they acquired the anti-dilution rights for the duration of the warrants. The parties did not address these questions in detail.

[32] Newman Aff. Ex. 53.

[33] *Id.* at Ex. 33; Rohrbacher Aff. Exs. EEE & HHH at 37.

[34] The Complaint in Civil Action No. 3940-VCN stated a claim as to the inadequacies of the disclosures in the Fall Update. *Dubroff v. Wren Hldgs., LLC*, 2009 WL 1478697, at *6 (Del. Ch. May 22, 2009).

[35] Rohrbacher Aff. Ex. G (Horowitz Dep.) at 427.

[36] Newman Aff. Ex. 59.

[37] Rohrbacher Aff. Ex. RRR.

[38] *Id.* at Ex. HHH.

disappointed to realize that their holdings in NSC had been diluted. The Akamai acquisition closed on December 13, 2006.

II. THE ISSUES

A. Summary Judgment Standard

In order to obtain summary judgment, the moving party must demonstrate "that there is no genuine issue as to any material fact and that [it] is entitled to judgment as a matter of law."[39]

> In deciding a motion for summary judgment, the evidence and the inferences drawn from the evidence are to be viewed in the light most favorable to the nonmoving party and the moving party has the burden of demonstrating that no material question of fact exists.[40]

B. Gentile Claims

The Plaintiffs attack the Recapitalization by claiming unfair dilution of equity and voting power.[41] Dilution claims are usually derivative because dilution causes a corporate harm and the corporation is entitled to the remedy.[42] For derivative claims that arise before a merger, shareholders typically lose standing to pursue those claims following a merger because of the "continuous ownership" rule.[43] An exception to that rule may be found in *Gentile* which teaches that a derivative claim may also be a direct claim when a controlling shareholder "extract[s]" or "expropriat[es]" the minority shareholders' economic value and voting power.[44] The Akamai acquisition occurred roughly four years after the challenged actions,[45] and it could not have been foreseen, and was not foreseen, when those events occurred. Unless the *Gentile* exception applies, the Plaintiffs' dilution claims are solely

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[39] Ct. Ch. R. 56(c).

[40] *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH.*, 2013 WL 655021, at *8 (Del. Ch. Feb. 22, 2013) (citation omitted).

[41] Fuchs Pls.' Br. in Opp'n to Defs.' Mot. for Summ. J. ("Fuchs Br.") 35.

[42] *Feldman v. Cutaia*, 951 A.2d 727, 732-33 (Del. 2008); *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). The term "dilution" may be too imprecise in some circumstances; it suffices for present purposes.

[43] *In re New Valley Corp. Deriv. Litig.*, 2004 WL 1700530, at *3 (Del. Ch. June 28, 2004).

[44] *Gentile*, 906 A.2d at 102; *see Dubroff*, 2009 WL 1478697, at *3.

[45] Newman Aff. Ex. 62.

derivative, and, because of the intervening acquisition, their claims must be dismissed.

Unlike the corporation in *Gentile*, NSC had no majority shareholder. A "control group," however, may be the functional equivalent of a controlling shareholder. The Plaintiffs insist that Wren, Javva, and Catalyst, which collectively owned more than 50 percent of NSC's equity and designated a majority of its board, constituted a control group.

Earlier in these proceedings, the Court addressed the concept of a control group:

> Delaware case law has recognized that a number of shareholders, each of whom individually cannot exert total control over the corporation (either through majority ownership or significant voting power coupled with formidable managerial power), can collectively form a control group where those shareholders are connected in some legally significant way—*e.g.*, by contract, common ownership, agreement, or some other arrangement—to work together toward a shared goal.[46]

Establishing the existence of a control group is not an easy task. All supposed members of the control group here owned less than a majority of shares; none alone owed fiduciary duties; and each was free to vote in its self-interest. That they signed on to a common objective (*i.e.*, shared parallel interests) is not determinative.[47] Otherwise, every time a majority acts, its participants could be viewed as members of a control group. Resolution of this fact-intensive inquiry on summary judgment is often difficult. As long as the facts of record support a reasonable inference—not necessarily the better inference—that a control group existed, summary judgment is not appropriate.[48]

With their shareholder voting majority allowing them to use written consents to approve changes requiring shareholder consideration and with their majority control of the board, the representatives of the Entity Defendants worked together to accomplish the Recapitalization. There is evidence supporting the Plaintiffs' contentions that details of the plans were

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[46] *Dubroff*, 2009 WL 1478697, at *3.

[47] *Williamson v. Cox Commc'ns, Inc.*, 2006 WL 1586375, at *6 (Del. Ch. June 5, 2006).

[48] *Bird's Constr. v. Milton Equestrian Ctr.*, 2001 WL 1528956, at *2 (Del. Ch. Nov. 16, 2001) (holding that the Court draws all reasonable "inferences in favor of the non-moving party" on a motion for summary judgment).

developed in advance of meetings and that Biderman was shielded from the discussions. Designees of the Entity Defendants collaborated to develop the structure of the Preferred B-1 shares, which would have the effect of materially diminishing the rights of minority shareholders.

The Defendants emphasize that Catalyst did not acquire any Preferred B-1 shares and argue that this shows that Catalyst did not work toward (or participate in) the common objective.[49] That persuasive fact fails to account for the right held by Catalyst to participate, by way of a 90-day option, on the same terms in the Preferred B-1 issuance.[50] Thus, at the time the strategy was set and carried out, the record suggests that Catalyst had the same incentives and objectives as Wren and Javva. Biderman (and the Plaintiffs) apparently did not know of Catalyst's option and apparently were never offered a comparable opportunity.[51]

Perhaps there was no control group. That, however, is not a conclusion that the Court can reach as a matter of undisputed fact.

In addition, the Defendants attempt to distinguish a *Gentile* claim from "a typical claim of corporate dilution (which is exclusively derivative)"[52] by arguing that a *Gentile* claim requires that "the public shareholders are harmed, uniquely and individually, to the same extent that the controlling shareholder is (correspondingly) benefited."[53] The inquiry has been described as one about whether "a controller expropriates, from [minority shareholders], a large percentage of the corporation's equity, keeps most of the expropriated equity for itself, and gives a small amount to other people."[54] The Defendants point out that, as part of the Recapitalization, the Series B-2 stock, roughly three percent of NSC's equity, went to e-Media and

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[49] NSC Br. 38.

[50] The Defendants dispute that there ever was a 90-day option. They characterize the use of the term "option" as equivalent to "choice" or "opportunity." Defs.' Reply Br. in Further Supp. of their Mot. for Summ. J. ("NSC Reply Br."); *see* Newman Aff. Ex. 33. There is no documentation of the board's approval of any stock option. Without the 90-day option sponsored by Plaintiffs, the underpinning of their *Gentile* argument may largely fall away. This is yet another issue of disputed fact.

[51] The parties frequently disagree about whether (and to what extent) participation opportunities were extended to Biderman and the Plaintiffs. Several discussions regarding investment opportunities were held with Biderman (or Grad or Koo) during early 2002. Timing, full knowledge of material information, and the general approach of the supposed control group all affected the reasonableness of the investment opportunities. Also, it appears that the Defendants did not contact the Plaintiffs individually; instead, they implicitly relied upon Biderman to convey to them whatever information he thought appropriate. Whether that reliance was justified is another topic of disagreement.

[52] NSC Br. 40.

[53] *Id.* (quoting *Gentile*, 906 A.2d at 100).

[54] *Dubroff II*, 2011 WL 5137175, at *8.

two percent of NSC's equity was issued to other stockholders.[55] Even though that is accurate, the net effect of the Recapitalization—controlled by the Entity Defendants—cannot be ignored. Their collective holdings grew from roughly 54 percent to 85 percent (or more), while the minority shareholders' holdings dropped from roughly 45 percent to less than 10 percent.[56] That a small amount went to third parties does not preclude a successful *Gentile* claim at this stage.[57]

The Defendants return to the fact that Catalyst did not purchase Series B-1 stock, and, thus, it did not gain from the diminution of the minority shareholders' interests attributed to the efforts of the purported control group. Stated differently, the "benefits" of the Recapitalization went to Wren and Javva which, together, did not hold a majority of NSC's equity. The measure, however, is what was achieved by the control group that included Catalyst, if there was a control group. Here, control group members—at least for purposes of summary judgment—acquired the benefits of a substantial increase in their holdings at the expense of the minority shareholders, and the fact that Catalyst chose not to participate and allowed Wren and Javva to benefit does not alter the effect of the Recapitalization on the minority shareholders. The focus must be on the control group—not on its individual members.

In sum, the Plaintiffs' claims may not, on summary judgment, be denied the status of direct claims, and, accordingly, the continuous ownership rule, applicable to exclusively derivative claims, does not require their dismissal at this point.[58]

C. The Standing of the SMIG Plaintiffs

The Defendants argue that those Plaintiffs who acquired their NSC stock as the result of SMIG's dissolution do not have standing to assert dilution claims because the decisions that resulted in the dilution were made before they were owed fiduciary duties.[59] Their shares were not issued until at least May 30, 2002.[60]

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[55] NSC Reply Br. 18; Newman Aff. Exs. 63 & 94.

[56] Rohrbacher Aff. Ex. EEE (table of percentage ownership after Recapitalization).

[57] *See Dubroff II*, 2011 WL 5137175, at *8.

[58] A corollary conclusion is that the aiding and abetting claims and the unjust enrichment claim (which might otherwise be exclusively direct) are also direct because they are based on the same facts.

[59] NSC Br. 47.

[60] Newman Aff. Exs. 41-43.

As a general matter, when the terms of a transaction are established—not when the transaction is carried out—is the proper time for assessing whether a breach of fiduciary duty occurred.[61] Although the path to the Recapitalization was established before the SMIG Plaintiffs acquired rights as NSC shareholders, arguably significant terms evidently were not established until August 2002; by then, they were, in fact, shareholders.

They were owed fiduciary duties no later than the end of May, but this is not a matter where events occurring after that date were simply a matter of implementing a transaction with previously fixed terms. The reverse stock split was modified and the terms of the Preferred A and the Preferred B were not finalized.[62] Perhaps the changes were not material, but that is an analysis that should be assisted by a trial record. The board did not formally review or revise the terms of the Recapitalization after mid-April 2002, but it appears that the Entity Defendants (through their representatives) approved various changes. That an informal process seems to have been followed does not defeat the SMIG Plaintiffs' claims. Accordingly, summary judgment on the SMIG Plaintiffs' claims on this ground may not be granted.[63]

D. The Standing of the Preferred A Plaintiffs[64]

The directors of a Delaware corporation owe fiduciary duties to the corporation and to its stockholders.[65] A claim for breach of fiduciary duty "must be based on an actual, existing fiduciary relationship between the plaintiff and the defendants at the time of the alleged breach."[66] The holders

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[61] *See, e.g.*, *7547 P'rs v. Beck*, 682 A.2d 160, 162-63 (Del. 1996).

[62] The percentage of NSC equity allocated to the Preferred B-1 shares increased by approximately 10 percent between May and August 2002.

[63] This also resolves the Defendants' assertion that the SMIG Plaintiffs lack standing to pursue disclosures claims and aiding and abetting claims.

The SMIG Plaintiffs also argue that none of this matters because they acquired their NSC shares by operation of law (on SMIG's dissolution) and did not purchase their shares to "buy into" a derivative suit. *See, e.g.*, *Brown v. Automated Mktg. Sys., Inc.*, 1982 WL 8782, at *2 (Del. Ch. Mar. 22, 1982). The Court does not address this argument.

[64] The term "Preferred A Plaintiffs" refers to fifteen holders of Secured Notes and Warrants to purchase NSC common stock. The Secured Notes were eventually exchanged for Preferred A shares in the Recapitalization. The Preferred A Plaintiffs are: Cindy Hassan, Trust FBO Chaim Abikhzer, Trust FBO Naftali Abikhzer, Nathan Hassan, Rachel Hassan, Trust FBO Jacob Rausman, Emil & Joan Rausman Irrevocable Trust, Barry Wien and Eddy Hsu, Susan Rausman Abikhzer, Herbert Rausman, Rivkah Rausman, Trust FBO Barry Rausman, Trust FBO Moishe Abikhzer, and Elie Hassan. Six of them separately held NSC common stock by June 2001.

[65] *In re Answers Corp. S'holder Litig.*, 2012 WL 1253072, at *6 (Del. Ch. Apr. 11, 2012).

[66] *Omnicare, Inc. v. NCS Healthcare, Inc.*, 809 A.2d 1163, 1169 (Del. Ch. 2002), *rev'd on other grounds*, 818 A.2d 914 (Del. 2003).

of debentures, bonds, and warrants are not stockholders and are not owed fiduciary duties.[67] The Preferred A Plaintiffs did not acquire their shares until after the Recapitalization—its development, its drafting, or its implementation.[68] In short, they lack standing to challenge the Recapitalization.

The Preferred A Plaintiffs argue that they were owed fiduciary duties because they had contracted to exchange their non-stock interest in NSC for Preferred A shares in May or June 2002 on execution of the Subscription and Surrender Agreements.[69] They assert that, as a result, they acquired an equitable interest in NCS's equity and accepted the economic risks of being a stockholder.[70] They no longer had the protections afforded, for example, creditors. Agreeing to purchase stock does not make one a stockholder, especially if the stock will not even be issued until the consummation of the challenged series of actions.[71] In short, the Preferred A Plaintiffs were not stockholders and they have no standing to pursue dilution claims resulting from the Recapitalization.[72] Similarly, they have no standing to pursue disclosure claims because these claims are tied to the inadequacy of the disclosures relating to the dilution which they have no capacity to challenge. Summary judgment on this claim, therefore, is appropriate.[73]

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[67] *See, e.g.*, *Simons v. Cogan*, 549 A.2d 300, 303 (Del. 1988).

[68] The board approved the Preferred A issuance on August 9, 2002, Newman Aff. Ex. 49, and those shares were issued on August 12, 2002, the same day as the issuance of the Preferred B-1 shares. *Id.* at Ex. 50.

[69] Rohrbacher Aff. Ex. Q.

[70] Fuchs Br. 48-49.

[71] *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1172 (Del. 1988) (prospective shareholders owed no fiduciary duties).

[72] The Plaintiffs argue that the Preferred A shares were issued a few days before the Series B-1 shares. Even if that were accurate, there is no evidence that any changes occurred during this brief period or that anything other than purely ministerial steps were taken in implementing the Recapitalization. More importantly, although the Preferred A issuance was approved a few days before the Preferred B issuance, both were issued, according to NSC's stock ledger, on the same day—August 12, 2002. *See* Newman Aff. Ex. 60 at AKAMAI0424, 0426 & *supra* note 68.

[73] To the extent that the Plaintiffs contend that the Preferred A Plaintiffs who were stockholders as of June 2001 were entitled to fiduciary protection with respect to their rights as bondholders and with respect their dilution claims based on that status, that argument is foreclosed by the fundamental nature of corporate securities. The bundle of rights associated with stock ownership is independent of the contractual rights due to debt holders, who are generally owed no fiduciary duty under Delaware law. *See* R. Franklin Balotti & Jesse A. Finkelstein, *1 The Delaware Law of Corporations and Business Organizations* § 5.1, 5-4 & n.7 (2012 Supp.) ("The rights of a security, whether designated debt or equity, will be determined by the terms of the contract.") ("The relative rights of the holders of the securities will be determined by the terms of the certificate of incorporation that Delaware law treats as a contract between the corporation and its stockholders."); *Simons v. Cogan*, 542 A.2d 785, 786 (Del. Ch. 1987), *aff'd*, 549 A.2d 300 (Del. 1988) ("It has now become firmly fixed in our law that among the duties owed by directors of a Delaware corporation to

The Preferred A Plaintiffs also argue that the Entity Defendants were unjustly enriched at their expense.[74] The Defendants contend that their claims are foreclosed by contract.[75] The Preferred A Plaintiffs' contracts were with NSC—not with the Entity Defendants. Perhaps it is sufficient to reject their claims by noting that in the Complaint, they tied those claims to "illicit conduct in derogation of their fiduciary duties to Plaintiffs."[76] With no fiduciary duties owed to the Preferred A Plaintiffs by the board designees of the Entity Defendants, they could not be victims of the conduct alleged. Moreover, even if their allegations should be read more charitably, the Entity Defendants' board designees may have taken advantage of NSC (and its shareholders at the time), but any harm they may have caused to the Preferred A Plaintiffs was derivative of the impact on the value of NSC stock which they were to receive. Harm to a corporation is, in a sense, harm to its stockholders. Unjust enrichment may provide an equitable remedy where remedies at law are inadequate.[77] It is not a doctrinally appropriate methodology, however, for circumventing the limitations resulting from the fact that the harm caused, if any, was to NSC and not to its debenture holders, or the like, directly. If the Preferred A Plaintiffs were denied value that NSC was contractually obligated to provide, the remedy should have been by way of suit against NSC. Limited exceptions like *Gentile* exist to protect shareholders who were owed fiduciary duties and to avoid the consequences of the continuous ownership rule; it does not reach the claims of those who were not owed fiduciary duties. Accordingly, the unjust enrichment claims of the Preferred A Plaintiffs must be dismissed.

E. Cameron Family Partnership, L.P.

Defendant Cameron Family Partnership, L.P. ("CFP") is alleged to have been unjustly enriched by its receipt, as a result of the Recapitalization, of Preferred B-1 shares.[78] CFP denies that it ever received Preferred B-1 stock.[79] The Plaintiffs point to an exhibit that shows CFP's holding of Preferred B-1 stock.[80] The Plaintiffs' deposition inquiry into this topic was

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holders of that corporations' debt instruments, there is no duty of the broad and exacting nature characterized as a fiduciary duty."). It follows then that concurrent stock ownership cannot be the basis for a bondholder to obtain rights that were not otherwise contractually bargained for.

[74] Fuchs Br. 50.

[75] NSC Br. 46-47.

[76] Am. Compl. ¶ 130.

[77] *Addy v. Piedmonte*, 2009 WL 707641, at *22 (Del. Ch. Mar. 18, 2009).

[78] Am. Compl. ¶ 20.

[79] NSC Br. 52.

[80] Newman Aff. Ex. 63.

precluded by the Defendants' counsel.[81] This is one of those questions that should be easily answered. The record, however, with its factual disputes, does not afford the Court that opportunity.

F. Catalyst, Shipman and Self-Dealing

Catalyst and Shipman, its NSC's board representative, seek summary judgment because they did not engage in self-dealing.[82] In the sense that Catalyst gained no actual financial benefit from the Recapitalization, they are correct. If there was no control group, they would be right about their liability. With the control group and the opportunity to have participated in the fruits of the fiduciary breach, Catalyst and Shipman cannot use summary judgment to avoid liability. With the 90-day option, they both had reason to issue the Fall Update with its arguably misleading disclosures. Summary judgment is simply not appropriate.[83]

G. Snyder and Fiduciary Duty

Snyder owed fiduciary duties both as a director and as an officer of NSC. He was not part of the control group but acquired his significant positions at NSC as of May 22, 2002.[84] Although Snyder assumed fiduciary duties late in the process, he conceded that he participated in the conclusion of the Recapitalization and the issuance of the Fall Update.[85]

The Defendants contend that because Snyder derived no direct benefit from the Recapitalization, he maintains the presumption that he discharged his duties with due care and loyalty. However, Snyder's receipt of options, offered at below market rates, in October 2002—just after the Recapitalization was completed—raises a reasonable inference that he was rewarded for going along with the Recapitalization.[86] The suspicious timing of those options is not fully negated by the fact that the board had planned previously to award NSC's prior CEO (Williams) a comparable number of options.[87] Whether Snyder, as an officer or as a director, breached a

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[81] *See* Rohrbacher Aff. Ex. UU (S. Cameron Dep.) at 21-22.

[82] NSC Br. 55-57.

[83] That they could have participated in the Recapitalization but that they refrained from accepting the benefits after they helped launch the course of conduct does not relieve either of them of liability for their conduct and its foreseeable consequences.

[84] The minutes of the May 22, 2002 board meeting reflect Snyder's election as President and Chief Executive Officer. Newman Aff. Ex. 40.

[85] Rohrbacher Aff. Ex. QQ (Snyder Dep.) at 90.

[86] *Id.* at Ex. III.

[87] *Id.* at Ex. U.

fiduciary duty arising from such conduct is, thus, subject to a dispute of material fact.

Snyder's involvement in the Fall Update is also troubling, but again, there exists a question of material fact. When directors are not seeking shareholder action, a breach of their fiduciary duty may occur if they "knowingly disseminate false information" or deliberately misinform shareholders.[88] On the one hand, Snyder seemed to think that the inclusion of investors and their relative holdings after the Recapitalization was not material. If true, his good faith belief would likely not implicate a fiduciary breach under *Malone*.[89] On the other hand, that the Fall Update did not include a reference to the dilution of non-financing shareholders, which had been provided in the June Update, comports with the Plaintiffs' theory that Snyder and the control group purposefully concealed the dilution from minority stockholders.[90] Moreover, "who benefited from the Recapitalization and what benefits did they achieve" were likely material facts to a reasonable shareholder.[91] Thus, especially when viewing the facts in the light most favorable to the Plaintiffs, the Court cannot determine as a matter of law that Snyder did not breach his fiduciary duty of loyalty or good faith.[92]

H. The Fuchs Brothers and Too Many Shares

The Defendants argue that Plaintiffs Morris Fuchs and Bernard Fuchs were credited with owning too many shares of NSC, and that the excess shares (over what they, in fact, owned) allowed them, through the Akamai transaction, to be paid substantially more than they would have received

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[88] *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998).

[89] *Id.* at 10 (noting that when directors are not seeking shareholder action, the issue "is not whether [the] directors breached their duty of disclosure," rather, it is "whether they breached their more general fiduciary duty of loyalty and good faith by knowingly disseminating to the stockholders false information about the financial condition of the company.").

[90] *See Jackson Nat. Life Ins. Co. v. Kennedy*, 741 A.2d 377, 389 (Del. Ch. 1999) ("[I]t follows from the Court's reasoning [in *Malone*] that one who pleads that directors deliberately omitted information from a communication with . . . stockholders under circumstances that suggest an intent to mislead the stockholders has set forth a violation of the fiduciary duty of loyalty . . . .").

[91] *Dubroff*, 2009 WL 1478697, at *5.

[92] In prior opinions the Court did not "delineate the parameters of the disclosure required by § 228(e)." *Id.* at *6. The Court has not made any such delineation here. The record is sufficient for the Court to infer reasonably (and thus preclude summary judgment) either (1) "that the board materially misled shareholders about the Recapitalization" in the context of a request for shareholder action; or (2) "that the board deliberately omitted material information with the goal of misleading the Plaintiffs" in the context where the directors are not seeking shareholder action. *Id.*

even if (a) their proper share totals were used and (b) they obtain all the relief they are seeking in this litigation. According to the Defendants, they were overpaid by factors of eight and eighteen, but their diminution in value, alleged in the Complaint, is only by a factor of five or so.[93] If the Defendants are correct about the Fuchs Brothers' share holdings, they may have received all to which they are entitled.

Information regarding the Fuchs Brothers' holdings of NSC stock came from NSC's official stock ledger which creates a rebuttal presumption.[94] The stock ledger was reviewed or audited several times between 2002 and 2006,[95] and no reason to doubt the Fuchs Brothers' holdings emerged. Part of the confusion now seems to lie in the debate over whether the Fuchs Brothers signed stock purchase agreements. The evidence tends to suggest that they did not, but Morris Fuchs testified in deposition that he did sign a stock purchase agreement.[96]

It may not be difficult to speculate about the eventual outcome of this debate, but enough doubt about material fact lingers, and, thus, summary judgment on this topic is not appropriate.

I. Rausman, his Affiliates, and Laches

On June 18, 2002, Biderman sent to Herbert Rausman information (*i.e.*, the June Update) regarding NSC's request for converting the Secured Notes and Warrants into Preferred A stock. Rausman was a conduit of information not only for the trusts in which he served as trustee, but also for his "affiliates," essentially family members. Rausman was informed that, following the Recapitalization, "[NSC] shareholders (who did not finance the acquisitions) will own over 30 percent of the new [combined] company."[97] Thus, he was on notice that his holdings of NSC (and those of others with whom he worked) of NSC would be diluted. He quibbles that the sentence is confusing, but a reduction in the relative interests of non-participating shareholders is not hard to discern, especially given his background knowledge. What is not clear is who would be supplying the new money. The disclosure could be consistent with new money from existing shareholders or new money from outside sources.

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[93] Am. Compl. ¶ 114.

[94] 8 *Del. C.* § 219(c); *see also W. Airlines, Inc. v. Kerkorian*, 254 A.2d 240, 241 (Del. 1969).

[95] Rohrbacher Aff. Ex. Y.

[96] *Id.* at Ex. XX (M. Fuchs Dep.) at 162; *see also id.* at Ex. WW (B. Fuchs Dep.) at 35 (discussing investment documents for his signature).

[97] Newman Aff. Ex. 44.

If this disclosure adequately put Rausman on notice of the dilution and the surrounding circumstances—to the extent that they may have been material—his claims (and the claims of those with whom he worked) would be barred because no action was brought to recover losses until more than three years later. More specifically, equity would "borrow" the corresponding statute of limitations—three years—and his claim would be barred by laches.[98]

The disclosure did not inform Rausman that the Entity Defendants would provide the new money (and thereby increase their percentage ownership) in a self-dealing transaction. The Court cannot conclude that this self-dealing aspect would not have been material. The Defendants are, of course, correct that, if the source of the new money had been important to him, Rausman could have asked. That approach, if effective, would provide a convenient response to anyone who complains about omitted material facts: they could have asked.

Whether Rausman had sufficient contextual knowledge and understanding of NSC's circumstances as of the June communication in order to conclude that he was on notice to a sufficient extent to find him guilty of laches cannot be resolved on summary judgment as a matter of undisputed material fact.

III. CONCLUSION

For the foregoing reasons, the Defendants are granted summary judgment on the Preferred A Plaintiffs' claims. Otherwise, their motion for summary judgment is denied.

An implementing order will be entered.

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[98] *See, e.g.*, *In re Mobilactive Media LLC*, 2013 WL 297950, at *10 (Del. Ch. Jan. 25, 2013) (citation omitted).