IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SHELDON DUBROFF and MERVYN KLEIN on behalf of themselves and all others similarly situated,

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Plaintiffs,

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v. : C.A. No. 3940-VCN

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WREN HOLDINGS, LLC, JAVVA
PARTNERS, LLC, CAMERON FAMILY
PARTNERSHIP, L.P., CATALYST
INVESTORS, L.P., CHRISTOPHER
SHIPMAN, ANDREW T. DWYER,
DORT A. CAMERON, III, HOWARD
KATZ, TROY SNYDER, and NINE
SYSTEMS CORPORATION,

:

Defendants.:

MEMORANDUM OPINION AND ORDER

Date Submitted: January 20, 2009 Date Decided: May 22, 2009

Seth D. Rigrodsky, Esquire and Brian D. Long, Esquire of Rigrodsky & Long, P.A., Wilmington, Delaware, and Laurence Rosen, Esquire, Phillip Kim, Esquire, and Timothy Brown, Esquire of The Rosen Law Firm, P.A., New York, New York, Attorneys for Plaintiffs.

William P. Bowden, Esquire, Andrew D. Cordo, Esquire, and Stacy L. Newman, Esquire of Ashby & Geddes, Wilmington, Delaware, Attorneys for Defendants; Richard G. Haddad, Esquire and Andrew S. Halpern, Esquire, of Otterbourg, Steindler, Houston & Rosen, P.C., New York, New York, Attorneys for Defendants Wren Holdings, LLC, Javva Partners LLC, Cameron Family Partnership, L.P., Andrew T. Dwyer, Dort A. Cameron, III, Howard Katz, Troy Snyder, and Nine Systems Corporation; and Kevin C. Logue, Esquire and Asa R. Danes, Esquire of Paul, Hastings, Janofsky & Walker LLP, New York, New York, Attorneys for Defendants Catalyst Investors, L.P. and Christopher Shipman.

I. INTRODUCTION

The Plaintiffs are two former minority shareholders of Nine Systems Corporation ("NSC" or the "Company"), a now-privately held Delaware corporation that was once known as Streaming Media Corporation, and have brought a purported class action against NSC, some of its former directors, and some of its former shareholders, alleging breaches of fiduciary duties. Defendants Wren Holdings, LLC ("Wren"), Javva Partners, LLC ("Javva"), and Catalyst Investors, L.P. ("Catalyst") were NSC shareholders and debtholders (collectively, the "Entity Defendants"). Wren is 50% owned by Defendant Dort Cameron ("Cameron"), a former member of NSC's five-member board, and 50% owned by Defendant Andrew Dwyer ("Dwyer"). Defendant Howard Katz ("Katz") is the sole equity owner of Javva and was also a member of NSC's board. Catalyst is controlled by its managing partner, Defendant Christopher Shipman ("Shipman"), also a former member of NSC's board.¹

From 1999 until 2001, the Plaintiffs purchased approximately \$6.2 million worth of NSC common stock. They are no longer shareholders of NSC; NSC has been acquired by Akami Technologies ("Akami") by way of merger.

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¹ For convenience, Cameron, Dwyer, Katz, and Shipman are sometimes collectively referred to as the "Individual Defendants."

During 2001 and early 2002, the Entity Defendants made a series of loans to NSC; the aggregate value of these loans is unknown but is not believed to exceed \$5 million.² Subsequently, in August 2002, NSC carried out a recapitalization transaction (the "Recapitalization") by which the Entity Defendants converted the preferred debt they each held into preferred stock. Before the Recapitalization, the Entity Defendants collectively owned 56% of NSC's stock;³ the effect of the Recapitalization was to increase these entities' collective holdings to almost 80%, thereby diluting other shareholders' equity, including the Plaintiffs', from approximately 44% to 22%. The Recapitalization was carried out by written consent of the holders of a majority of the Company's stock, primarily the Entity Defendants. After the Recapitalization, NSC shareholders (including Plaintiffs) received a notice which stated that NSC had completed a 1-for-20 reverse stock split and an exchange of preferred debt for preferred shares.⁵

In November 2006, NSC issued a proxy statement to its shareholders announcing that Akami was acquiring NSC at a purchase price of \$175 million.⁶ Included in the proxy statement was a listing of NSC shareholders and the number

 $^{^2}$ Compl. at ¶ 11.

³ The individual percentages held by Wren, Javva, and Catalyst are not clearly discernible from the Complaint. Their collective holdings are set forth and the Plaintiffs have not asserted that before the Recapitalization any of the Entity Defendants separately held an interest that was otherwise material.

⁴ Compl. at ¶ 68.

⁵ Compl. at ¶ 83.

⁶ Compl. at ¶ 95.

of NSC shares each held. With this information, the Plaintiffs, for the first time, were made aware of their equity dilution. The Plaintiffs brought suit in California (the "California Action"), the state in which NSC's physical operations are located. The California Action was dismissed on forum non-conveniens and lack of personal jurisdiction grounds. The Plaintiffs re-filed in New York state court, but subsequently voluntarily moved to dismiss the action. The Plaintiffs then filed the present action, alleging that the Individual Defendants and the Entity Defendants breached fiduciary duties owed to the minority shareholders, and that the Individual Defendants aided and abetted breaches by the Entity Defendants.

The Defendants have moved to dismiss the complaint with prejudice. They argue that the Plaintiffs' claims are barred by the doctrine of laches; that the Plaintiffs lack standing to assert their claims because their claims are derivative and the Plaintiffs no longer own shares of NSC; and that the Defendants did not fail to disclose material facts. In addition, Javva and Dwyer contend that this Court lacks personal jurisdiction over them. For the reasons discussed below, the Defendants' motion is granted in part and denied in part.

II. APPLICABLE STANDARD

A motion under Court of Chancery Rule 12(b)(6) to dismiss for failure to state a claim will be granted if it appears with reasonable certainty that the plaintiff

could not prevail on any set of facts that can be inferred from the pleading.⁷ In considering a motion to dismiss, the Court is required to assume the truthfulness of all well-pleaded allegations of fact in the complaint.⁸ All well-plead facts of the complaint and inferences that can reasonably be drawn therefrom in favor of the plaintiff are accepted as true.⁹ However, a trial court neither must blindly accept all allegations as true, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences.¹⁰

III. ANALYSIS

A. The Recapitalization

The Plaintiffs' claim—that the Recapitalization diluted their equity—is one of corporate overpayment. "Normally, claims of corporate overpayment [or dilution] are treated as causing harm solely to the corporation and, thus, are regarded as derivative. The reason . . . is that the corporation is both the party that suffers the injury . . . as well as the party to whom the remedy . . . would flow." In *Lewis v. Anderson*, 12 the Delaware Supreme Court held that in order for a

⁷ Kohls v. Kenetech Corp., 791 A.2d 763, 767 (Del. Ch. 2000).

⁸ Gantler v. Stephens, 965 A.2d 695, 7033 (Del. 2009).

⁹ *Id*.

¹⁰ In re Lukens Inc. S'holders Litig., 757 A.2d 720, 727 (Del. Ch. 1999).

¹¹ Gentile v. Rossette, 906 A.2d 91, 99 (Del. 2006). See also In re J.P. Morgan Chase & Co. S'holders Litig., 906 A.2d 808, 818 (Del. Ch. 2005), aff'd 906 A.2d 766 (Del. 2006) (When a "board of directors authorizes the issuance of stock for no or grossly inadequate consideration, the corporation is directly injured and shareholders are injured derivatively") (internal quotation marks omitted).

¹² 477 A.2d 1040, 1046 (Del. 1984).

plaintiff to have standing to assert a derivative claim, the plaintiff, pursuant to 8 *Del. C.* § 327 and Court of Chancery Rule 23.1, must be a stockholder at the time of the alleged wrongdoing and must maintain her stockholder status in the corporate entity throughout the litigation.¹³

Following an acquisition, the acquired company's former shareholders no longer have an equity interest in that entity—i.e., their shares are converted for cash or acquirer company stock. Thus, shareholders of an acquired company generally lose standing to assert a derivative claim on behalf of the acquired company. In *Gentile v. Rosette*, however, the Delaware Supreme Court emphasized that there is an exception to this general rule. There, the Court held that claims based upon equity dilution can be both direct and derivative in certain circumstances. In particular, the Court noted that

[a] breach of fiduciary duty claim having this dual nature arises where: (1) a stockholder having majority or effective control causes the corporation to issue "excessive" shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding

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 $^{^{13}}$ Id. See Feldman v. Cutaia, 956 A.2d 644, 654 (Del. Ch. 2007) (citing Anderson, 477 A.2d at 1046).

¹⁴ See, e.g., In re Syncor Int'l Corp. S'holders Litig., 857 A.2d 994, 998 (Del. Ch. 2004) ("[A] merger which eliminates a shareholder's ownership of stock in a corporation also eliminates his or her status to bring a derivative suit on behalf of the corporation, on the theory that upon the merger the derivative rights pass to the surviving corporation which then has the sole right or standing to prosecute the action." (citing Anderson, 477 A.2d at 1045-46)).

¹⁵ 906 A.2d 91 (Del. 2006).

¹⁶ *Id.* at 99 ("There is, however, at least one transactional paradigm—a species of corporate overpayment claim—that Delaware case law recognizes as being both derivative and direct in character.").

owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.¹⁷

Although equity dilution claims are, by definition, derivative because the corporation has suffered an injury (inadequate payment for its shares) and, therefore, any recovery would flow to the corporate treasury, ¹⁸ the *Gentile*-type of equity dilution claim—one in which a corporation issues more shares to its controlling shareholder and dilutes the minority shareholders' equity—is also direct. As the *Gentile* Court explained:

Because the shares representing the "overpayment" embody both economic value and voting power, the end result of this type of transaction is an improper transfer—or expropriation—of economic value and voting power from the public shareholders to the majority or controlling stockholder. For that reason, the harm resulting from the overpayment is not confined to an equal dilution of the economic value and voting power of each of the corporation's outstanding shares. A separate harm also results: an extraction from the public shareholders, and a redistribution to the controlling shareholder, of a portion of the economic value and voting power embodied in the minority interest. As a consequence, the public shareholders are harmed, uniquely and individually, to the same extent that the controlling shareholder is (correspondingly) benefited. circumstances, the public shareholders are entitled to recover the value represented by that overpayment—an entitlement that may be claimed by the public shareholders directly and without regard to any claim the corporation may have.¹⁹

¹⁷ *Id.* at 99-100.

¹⁸ See supra text accompanying note 11. See also Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004).

¹⁹ Gentile, 906 A.2d at 100 (footnote omitted). See also Gatz v. Ponsoldt, 925 A.2d 1265, 1274 (Del. 2007) ("[W]here a significant or controlling stockholder causes the corporation to engage in a transaction wherein shares having more value than what the corporation received in exchange are issued to the controller, thereby increasing the controller's percentage of stock ownership at the public shareholders' expense, a separate and distinct harm results to the public

Gentile and its progeny make clear that a shareholder's claim can be both derivative and direct in a unique situation: where a controlling shareholder causes the corporate entity to issue more equity to the controlling shareholder at the expense of the minority shareholders. Here, the Plaintiffs are no longer stockholders of NSC because their equity was redeemed when NSC was acquired by Akami Technologies. Therefore, the Plaintiffs lost standing to assert their claims derivatively. The Plaintiffs, however, argue that their claims are also direct under Gentile. It is alleged that the Entity Defendants—none of whom alone is a controlling shareholder—collectively formed a controlling shareholder group. This "control group" caused the Company to conduct the Recapitalization resulting in the accretion of Wren's, Javva's, and Catalyst's equity, and a corresponding dilution of the "minority" shareholders'—including the Plaintiffs'—equity. Accordingly, only if there were some arrangement among the Entity Defendants to act as a control group would the Plaintiffs' challenge to the Recapitalization survive this motion to dismiss.²⁰

shareholders, apart from any harm caused to the corporation, and from which the public shareholders may seek relief in a direct action.").

²⁰ Cf. Iman Anabtawi & Lynn Stout, Fiduciary Duties for Activist Shareholders, 60 STAN. L. REV. 1255 (2008) (arguing that activist shareholders should owe fiduciary duties, basing this reasoning in part on the rationale for imposing fiduciary obligations upon controlling shareholders).

Gentile's linkage of equity dilution claims to a controlling shareholder grows out of the principle that a controlling shareholder owes fiduciary duties to the shareholders of the corporation she controls.²¹ Under Delaware law, "a controlling shareholder exists when a stockholder: 1) owns more than 50% of the voting power of a corporation; or 2) exercises control over the business and affairs of the corporation."²² Although a controlling shareholder is often a single entity or actor, Delaware case law has recognized that a number of shareholders, each of whom individually cannot exert 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 other arrangement—to work together toward a shared goal.²³ In that case, the control group is accorded controlling shareholder status,

²¹ See Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994); Williamson v. Cox Commc'ns, Inc., 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006).

²² In re PNB Holding Co. S'holders Litig., 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

²³ See id. at *10 ("The record . . . does not support the proposition that these various director-stockholders and their family members [(the alleged control group)] were involved in a blood pact to act together. To that point, there are no voting agreements between directors or family member. Rather, it appears that each had the right to, and every incentive to, act in his or her own self-interest as a stockholder."); id. at *9 ("The problem for the plaintiffs here is that they did not prove that the PNB board may be conceived of as a single, monolithic controller."); Emerson Radio Corp. v. Int'l Jensen Inc., 1996 WL 483086, at *17 (Del. Ch. Aug. 20, 1996) ("If Shaw and Blair Fund could be viewed collectively as a 'controlling' stockholder, they would have fiduciary duties to the minority in certain limited circumstances, but the record does not establish that those two shareholders are connected together in any legally significant way (e.g., by common ownership or contract).").

and, therefore, its members owe fiduciary duties to their fellow shareholders. However, a "stockholder is entitled to vote its shares as it chooses, including to further its own financial interest." Accordingly, if all a complaint alleges is that a group of shareholders have "parallel interests," such allegations are insufficient as a matter of law to support the inference that the shareholders were part of a control group. ²⁵

The Plaintiffs' argument that their claims are direct under *Gentile* fails as a matter of law because the Complaint contains no facts from which the Court can infer that the Entity Defendants formed a control group.²⁶ The Complaint states in conclusory fashion that the Entity Defendants "controlled the NSC board of directors,"²⁷ but the Complaint does not point to any facts that could explain how

²⁴ Emerson Radio, 1996 WL 483086, at *17.

²⁵ Williamson, 2006 WL 1586375, at *6 ("[T]he allegation that Cox, Comcast and AT & T [(the alleged control group)] had parallel interests [is in]sufficient to allege that the Cable Companies were part of a 'controlling group.'" (citing *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 550-51 (Del. Ch. 2003))).

As discussed, a stockholder is a controlling shareholder where the stockholder either (1) owns more than 50% of the voting power of the corporation; or (2) exercises control over the business and affairs of the corporation. None of the Defendants individually meets the first test. The Plaintiffs have not alleged that any of the Defendants *individually* met the second test. Accordingly, the Court does not consider whether any of the Defendants individually meets the second test. *See Williamson*, 2006 WL 1586375, at *4 ("To survive [a] motion to dismiss, plaintiff must allege domination and control by [the alleged controlling shareholder or shareholder group] through *actual* control of corporate conduct.") (emphasis in original).

²⁷ Compl. at ¶ 64. *See id.* at ¶ 63 ("Defendants . . . controlled the board of directors."); id ¶ 39 ("At all relevant times, the [Entity Defendants] acted as a group of controlling shareholders of [NSC] to control and dominate the Company and exert their power over the Company and its board of directors to benefit themselves to the exclusion and detriment of the minority shareholders.").

the Plaintiffs would expect the Court to arrive at that conclusion. In their brief, the Plaintiffs argue that

Plaintiffs' claim that Java, Catalyst, and Wren worked in concert as a single controlling shareholder group is *not conclusory* because it is supported by 10 specific facts: that these 3 entities 1) exclusively benefited from the Self-Dealing Transactions, 2) together owned 56% of [NSC's] voting stock, 3) together controlled 4 of the 5 directors of [NSC], 4) agreed to work together to effect Self-Dealing Transactions, 5) had a contractual agreement to work together, 6) did not form an independent committee to evaluate and approve the Self-Dealing Transactions, 7) voted as directors (through their representatives Cameron, Katz and Shipman) to approve the Self-Dealing Transactions, 8) voted together as majority shareholders to approve the Self-Dealing Transactions, 9) did not provide notice to minority shareholders of the Self-Dealing Transactions, and 10) did not request minority shareholders to vote to approve the Self-Dealing Transactions.²⁸

The Defendants contend that only "facts" 4 and 5 are even arguably relevant. They are correct because apart from "facts" 4 and 5, all of the references to the Defendants' conduct do not indicate that the Defendants should be grouped together as a control group—i.e., they do not allege that the Defendants are tied together in some legally significant way. The other references may be consistent with the existence of a control group but they do not establish the necessary linkage among the Entity Defendants.

Facts 4 and 5—that the Defendants agreed to work together to bring about the Recapitalization, and that the Defendants had a contractual agreement to work

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²⁸ Pls.' Br. in Opp'n to Defs.' Mot. to Dismiss at 23 (emphasis in original).

together, respectively—if true, would justify the inference that the Defendants comprised a control group. Unfortunately for the Plaintiffs, those facts are absent from the Complaint; the Complaint is devoid of any facts demonstrating an agreement or that the Defendants were tied together in some legally significant way. In fact, at the hearing on this motion to dismiss, the Plaintiffs conceded that there were no facts in the Complaint from which the Court could infer that an agreement existed.²⁹ At the hearing, the following colloquy took place:

[Counsel for Plaintiffs]: So you know, I think *Gatz v. Ponsoldt* very much permits our cause of action. They talk about—I believe in *Gatz* they talk about asserting actual—or asserting domination, asserting direct control, verbs like that, or nouns like—direct control, having actual control of the transaction. And in this case . . . the facts are very clear that these three shareholders, they—and directors, they, for a number of months, discussed how to do these—this set of transactions. And they talked amongst themselves, how they would do it, and who would do what, exactly what the price would be.

THE COURT: Excuse me. Where do I find those facts in the complaint?

[Counsel for Plaintiffs]: Your Honor, I apologize for that. I was—I did not anticipate this argument. This is—this was not something that defendants had raised before. And I assumed that three shareholders who issued themselves stock—three shareholders who control percent of the company and control the board of directors, when they issue themselves stock, it's pretty obvious it's a controlling group But I agree, Your Honor, and I apologize that we didn't put those [facts] . . . in the complaint.³⁰

²⁹ See Oral Argument Tr. for Hr'g on Mot. to Dismiss (Jan. 20, 2009) at 56-59.

³⁰ *Id.* at 56-57. *See also id.* at 57-58 ("THE COURT: I'm struggling with why, when you received the defendants' opening brief and Argument II.B.2, is, "The Plaintiffs' Claims are Not Direct in Nature Under Gentile Because the Plaintiffs Have Not Adequately Alleged the Existence of a Controlling Stockholder," why you didn't amend your complaint to set forth the

The Plaintiffs' counsel went on to state that, although the Complaint on its face perhaps did not contain any facts from which the Court could infer an agreement of some kind, the documents attached as exhibits to the Complaint documents that form part of the complaint—created such inferences on their own.³¹ The documents which Plaintiffs argue evince an agreement among the Defendants to form a control group, however, do not support their position. In particular, the Plaintiffs point to a document titled "Action By Written Consent Of The Stockholders Of Streaming Media Corporation," claiming that it is an "overpowering fact[] . . . demonstrating a controlling shareholder group." 32 However, this document demonstrates nothing more than the fact that the Entity Defendants each voted for the Recapitalization. And, as discussed, shareholders are entitled to vote based on their own self-interest, regardless of whether their interests are consistent with the interests of other shareholders.³³

The Plaintiffs also claim that the Entity Defendants "signed a shareholders agreement to work together." This conclusion, however, is a mischaracterization

facts that you now claim would have satisfied that standard? [Counsel for Plaintiffs]: Well, Your Honor, I—I think the complaint, as it stands, is sufficient.").

³¹ See id at 57-58 (Counsel contending that the Complaint is sufficient even in the absence of allegations of an agreement because the Court can rely upon the documents attached to the complaint as evidence of an agreement).

³² Pls.' Br. in Opp'n to Defs.' Mot. to Dismiss at 34.

³³ See supra notes 24-25 and accompanying text.

³⁴ Pls.' Br. in Opp'n to Defs.' Mot. to Dismiss at 25.

of the document upon which the Plaintiffs rely. The document, an exhibit to the Complaint, 35 is simply a letter, dated October 18, 2006, from Wren, signed by its principal, Cameron, to NSC notifying NSC of its intention to transfer shares; in it Wren references a "Stockholders Agreement." There is no mention of any of the other Entity Defendants or of the substance of the "Stockholders Agreement." Accordingly, it would be unreasonable to infer from this rather bare letter that the letter represents the Entity Defendants' signed agreement to work together.

Because neither the Complaint nor any supporting document contains any facts from which the Court may infer that the Defendants were tied together in some legally significant way, the Defendants' motion to dismiss the substantive claim regarding the Recapitalization with prejudice must be granted as to the Plaintiffs.³⁶

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³⁵ See Schuss v. Penfield Partners, L.P., 2008 WL 2433842, at *4 (Del. Ch. June 13, 2008) ("While the court may not consider matters outside the pleadings when assessing a motion to dismiss for failure to state a claim, the court may consider documents that are integral to a plaintiff's claim and incorporated into the complaint as well as facts subject to judicial notice.").

³⁶ The Plaintiffs ask the Court to deny the Defendants' motion to dismiss, or, in the alternative, to grant the motion without prejudice. The Plaintiffs presumably would seek to amend the

grant the motion without prejudice. The Plaintiffs presumably would seek to amend the Complaint to include facts from which the Court could infer a common undertaking among the Entity Defendants. The Court declines to do so. Pursuant to Court of Chancery Rule 15(aaa), the Plaintiffs already had ample opportunity to amend the Complaint upon the Defendants' filing of their motion to dismiss. Instead, the Plaintiffs chose to file an answering brief, thereby running afoul of Rule 15(aaa). The Plaintiffs have failed to set forth any good cause that would allow the Court to conclude that dismissal with prejudice would not be just. Accordingly, the claims relating to the substance of the Recapitalization are dismissed with prejudice.

B. The Disclosure Claims

Because the Recapitalization was accomplished by written consent of those stockholders holding a majority of the voting stock, there was neither a vote nor a solicitation of the Plaintiffs' approval. By 8 Del. C. § 228(e), "[p]rompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders . . . who have not consented in writing . . . "37 The Plaintiffs challenge the sufficiency of the notice sent to inform them of the Recapitalization. That notice provided in part: "[NSC] has recapitalized by converting its outstanding subordinated debt into shares of several new series of convertible preferred stock, and by declaring and implementing a one-four-twenty reverse stock split on all outstanding shares of common stock of the Company."38 The notice, however, did not inform the stockholders that the Entity Defendants were the primary recipients of the new convertible preferred Moreover, it did not inform the stockholders of the pricing of the stock.

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³⁷ The Plaintiffs chafe at the notion that the Recapitalization could have been accomplished without their having had an opportunity to vote. They neither cite to 8 *Del. C.* § 228 nor set forth any reasons, such as a provision to the contrary in the Company's certificate of incorporation, as to why the mode of written consent in lieu of a stockholders' meeting was procedurally infirm.

³⁸ Long Aff. Ex. 3 at 1. The Update stated that "a round of \$3.8 million in senior debt was raised from existing investors." *Id.* at 2. It did not state who those investors were or provide any other numbers that would provide a context to enable the Plaintiffs to understand the full consequence of the transaction. The notice also indicated that, if the convertible preferred shares were all converted, 8,989,786 additional common shares would be issued.

conversion of the Entity Defendants' debt into convertible preferred stock.³⁹ The Plaintiffs argue that they were injured by a material omission from the notice because, "had the Update contained accurate and full disclosures, Plaintiffs could have made a claim for rescissory relief."⁴⁰

The notice provided to the Plaintiffs following the Recapitalization accurately described the precise action accomplished through the written consent, but, as the Plaintiffs' contend, material facts—who benefited from the Recapitalization and what benefits did they achieve—were omitted. And such a failure to disclose material facts necessitates the conclusion that the Plaintiffs have stated a claim that the NSC board breached its fiduciary duties regarding disclosure of material information.

Delaware case law has not addressed the question of whether the notice required by 8 *Del. C.* § 228(e) triggers a fulsome disclosure akin to that required when stockholder approval is being solicited.⁴¹ The Court need not delineate the parameters of the disclosure required by § 228(e) because the Court holds that

³⁹ As a result of the Recapitalization, the Entity Defendants' equity holding in the Company, on a fully diluted basis increased from approximately 56% to approximately 80%. This expansion of the Entity Defendants' equity ownership rights was not disclosed.

⁴⁰ Pls.' Ans. Br. at 38.

⁴¹ See Unanue v. Unanue, 2004 WL 2521292, at *8-9 (Del. Ch. Nov. 3, 2004) (discussing, without deciding, this issue). See EDWARD P. WELCH, ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW, § 228.4.6 (5th ed. 2008) (observing that Delaware courts have not resolved the scope of disclosure that must be made in accordance with § 228). For an in-depth discussion of the duty of disclosure see *Pfeffer v. Redstone*, 965 A.2d 676, 684-90 (Del. 2009).

regardless of the precise scope, the Plaintiffs have stated a claim for breach of fiduciary duty.

The Delaware Supreme Court has held that

[w]henever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty. It follows *a fortiori* that when directors communicate publicly or directly with shareholders about corporate matters the sine qua non of directors' fiduciary duty to shareholders is honesty.⁴²

For purposes of the present analysis, it is immaterial whether § 228 requires full fiduciary duty disclosure of all material information as in the context of a request for shareholder action. If it does, the Complaint asserts well-plead facts sufficient for the Court to infer reasonably that the board materially misled shareholders about the Recapitalization. If it does not, there are well-plead facts in the Complaint sufficient for the Court to infer reasonably that the board deliberately omitted material information with the goal of misleading the Plaintiffs and other shareholders about the Defendants' material financial interest in, and benefit

⁴² See Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998); Shamrock Holdings of California, Inc. v. Iger, 2005 WL 1377490, at *5 (Del. Ch. 2005) ("If the statements were not made in connection with seeking shareholder action, there are well-pled facts in the complaint sufficient for me to reasonably infer that the board deliberately misinformed plaintiffs and other shareholders about the process of the search for a new CEO, either by virtue of the statements having been false or misleading when made, or because subsequent events rendered those statements false or misleading when corrective disclosures were not made.").

conferred by, the Recapitalization not shared with other shareholders.⁴³ Thus, the motion to dismiss with respect to the Plaintiffs' disclosure claims must be denied.⁴⁴

C. Laches

The Defendants argue that Plaintiffs' claims are barred by the doctrine of laches because the Defendants were on inquiry notice that interested parties converted their shares. The words set forth in the Update which the Defendants contend put the Plaintiffs on inquiry notice, however, inform only that senior debt converted in the Recapitalization "was raised from existing investors." Because the Update did not state that those "existing investors" were also members of NSC's board of directors (or, more accurately, entities related to those directors),

⁴³ See Shamrock Holdings, 2005 WL 1377490, at *5. This conclusion may, at first glance, appear to be at odds with the previous section of this memorandum opinion. The previous section concluded that the Plaintiffs failed to state a claim for breach of fiduciary duty by the alleged control group because the Plaintiffs did not point to any facts from which the Court could infer that the Defendants agreed to work together. This section concludes that the Plaintiffs have stated a claim for breach of fiduciary duty because of the failure to disclose the fact that certain directors (and the shareholder entities that they represented) were interested in the Recapitalization. If the Defendants were not acting as a control group, then how could their financial interest in the Recapitalization have been material information (the failure of which to disclose in the Update could constitute a breach of fiduciary duty)? The mere failure to plead facts—the grounds for dismissal in the previous section—does not mean that such facts do not exist. Therefore, the Court did not conclude that the Defendants were not acting as a control group; the Court concluded only that the Plaintiffs failed to plead the existence of one. Because corporate fiduciaries may not presume immaterial the fact that members of its board of directors indirectly benefited from a financial transaction to the material detriment of the other stockholders, the Plaintiffs have adequately pleaded a disclosure claim.

⁴⁴ The allegations of the Complaint with respect to aiding and abetting the conduct challenged in the disclosure claim, however marginal, do, nonetheless, survive under the standards of Court of Chancery Rule 12(b)(6). The breach of fiduciary duty claim, however, against the corporation, NSC itself, fails because the Plaintiffs have not established the basis for imposing any duty on it or for treating it as an aider and abetter. Accordingly, any claim against NSC is dismissed.

the Plaintiffs were not put on inquiry notice of an alleged self-dealing transaction.

Accordingly, the Defendants' laches argument must be rejected. 45

D. Personal Jurisdiction

Defendants Dwyer and Javva have moved to dismiss all claims against them for lack of personal jurisdiction.⁴⁶ The Plaintiffs rely upon the so-called conspiracy theory of personal jurisdiction which has five elements:

(1) a conspiracy to defraud existed; (2) the defendant was a member of that conspiracy; (3) a substantial act or substantial effect in furtherance of the conspiracy occurred in the forum state; (4) the defendant knew or had reason to know of the act in the forum state or that acts outside the forum state would have an effect in the forum state; and (5) the act in, or effect on, the forum state was a direct and foreseeable result of the conduct in furtherance of the conspiracy.⁴⁷

The Plaintiffs' argument that personal jurisdiction may be asserted under the conspiracy theory fails under the first *Istituto Bancario* element, for the same reason their claims that the Defendants constituted a control group: conclusory allegations are insufficient.⁴⁸ As discussed above, the Plaintiffs have failed to

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⁴⁵ This conclusion also is informed by recognition that it is a difficult task to pursue successfully a laches defense in the context of a motion to dismiss. *See Reid v. Alenia Spazio*, 2009 WL 962683, at *4 (Del. Apr. 9, 2009). Even though equity will frequently, if not routinely, "borrow" the corresponding statute of limitations, the mere passage of time which enabled, as alleged, certain Defendants to continue keeping from other shareholders knowledge of the benefits of the Recapitalization does not allow, in the context of a motion to dismiss, for dismissal of the disclosure claims.

⁴⁶ See 10 Del. C. § 3104(c)(1). Neither Dwyer nor Javva is a "resident" of Delaware.

⁴⁷ Istituto Bancario Italiano SpA v. Hunter Engineering Co., Inc., 449 A.2d 210, 225 (Del. 1982). ⁴⁸ See Computer People, Inc. v. Best Intern. Group, Inc., 1999 WL 288119, at *7 Del. Ch. (April 27, 1999) ("conclusory and unsupported allegations that there was a conspiracy" are insufficient); supra Section III.A. (dismissing the Plaintiffs' claims for failure to plead the existence of an agreement to form a control group).

allege any facts from which the Court can infer that the Defendants agreed to work together. Such "conclusory allegations . . . that are unsupported by evidence . . . will not be sufficient to overcome a motion to dismiss for lack of personal jurisdiction."⁴⁹ Thus, this Court lacks personal jurisdiction over Dwyer and Javva.

IV. CONCLUSION

For the foregoing reasons, the Defendants' motion to dismiss the Complaint with prejudice is granted with respect to Plaintiffs' challenge to the Recapitalization. The motion of Dwyer and Javva to dismiss for lack of personal jurisdiction is also granted. All claims against NSC are dismissed. The Defendants' motion to dismiss with respect to the disclosure claim asserted in the Complaint is denied.

IT IS SO ORDERED.

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⁴⁹ Computer People, 1999 WL 288119, at *6. To the extent the Plaintiffs rely upon Dwyer's and Javva's other alleged contacts to support personal jurisdiction, such reliance is misplaced. While some of those contacts could in theory establish personal jurisdiction as to the decision to carry out the Recapitalization (although the Court doubts that they do), those contacts are insufficient to establish personal jurisdiction as to the disclosure claim (the only claim that survives this motion to dismiss). In particular, the conclusory allegations regarding any involvement that Javva and Dwyer may have had in the alleged inadequate disclosures are insufficient to support the exercise of personal jurisdiction. Accordingly, the Court cannot exercise personal jurisdiction over Dwyer and Javva.