



COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 SOUTH STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

April 10, 2012

Kevin G. Abrams, Esquire
Abrams & Bayliss LLP
20 Montchanin Road, Suite 200
Wilmington, DE 19807

Blake Rohrbacher, Esquire
Richards, Layton & Finger, P.A.
920 North King Street
Wilmington, DE 19801

Re: *Shocking Technologies, Inc. v. Michael*
C.A. No. 7164-VCN
Date Submitted: March 26, 2012

Dear Counsel:

Defendant Simon J. Michael (“Michael”), Defendant Balch Hill Partners L.P. (“BHP”), and Defendant Balch Hill Capital, LLC (“BHC” and, together with BHP, the “Entity Defendants”) (Michael, BHP, and BHC, together, the “Defendants”) move under Court of Chancery Rule 12(b)(6) for dismissal of certain claims brought against them by Plaintiff Shocking Technologies, Inc. (“Shocking”). The Defendants ask this Court to dismiss Shocking’s fiduciary duty claim against Michael to the extent it seeks his removal from Shocking’s board of

directors (the “Board”),¹ and the Defendants seek dismissal of all of the claims brought against the Entity Defendants. Shocking opposes this motion to dismiss.

The primary issue in this action is whether Michael breached his fiduciary duties. Shocking alleges that, in order to enable himself to gain greater authority over Shocking and to increase his investment in it at a low price, Michael has interfered with its efforts to raise additional capital. These actions, if they happened and are likely to happen again, could imperil Shocking’s existence, because it must raise funds to survive. Shocking pled a colorable claim and the likelihood of irreparable harm, and, thus, the Court granted its motion to expedite.² Trial of limited scope is set for next week.

¹ Shocking seeks Michael’s removal from the Board. Compl. ¶ 70. The parties disagree about whether this objective should be termed a “claim” or a “remedy.” Compare Opening Br. in Supp. of Defs.’ Mot. to Dismiss 5, and Reply Br. in Further Supp. of Defs.’ Mot. to Dismiss 2-3, with Pl.’s Answering Br. in Opp’n to Defs.’ Mot. to Dismiss (“Answering Br.”) 8-9. The Court’s conclusion that Shocking’s fiduciary duty claim should be dismissed to the extent it now seeks Michael’s removal before he is found to have violated his fiduciary duties, but that Shocking’s more general fiduciary duty claim survives, does not hinge on whether the removal of Michael is characterized as a “claim” or a “remedy.”

² *Shocking Techs., Inc. v. Michael*, 2012 WL 165561 (Del. Ch. Jan. 10, 2012).

The principal relief sought by Shocking with regard to the fiduciary duty claim is Michael's removal from the Board. The Court of Chancery may remove a director pursuant to 8 *Del. C.* § 225(c), which states in pertinent part:

If 1 or more directors has been convicted of a felony in connection with the duties of such director or directors to the corporation, or if there has been a *prior judgment on the merits* by a court of competent jurisdiction that 1 or more directors has committed a breach of the duty of loyalty in connection with the duties of such director or directors to that corporation, then, upon application by the corporation, . . . *in a subsequent action brought for such purpose*, the Court of Chancery may remove from office such director or directors if the Court determines that the director or directors did not act in good faith in performing the acts resulting in the prior conviction or judgment and judicial removal is necessary to avoid irreparable harm to the corporation.³

Shocking claims not to seek Michael's removal under § 225(c). Instead, it argues that the Court may remove a director using its inherent equitable powers.⁴ In response, the Defendants argue that § 225(c) is the only means by which the Court may remove a particular director and that Shocking cannot meet the requirements of § 225(c) because there has not been a *prior judgment on the merits* concluding that Michael breached his fiduciary duty of loyalty.

³ 8 *Del. C.* § 225(c) (emphasis added).

⁴ Answering Br. 9 n.3.

Without resolving the question of whether or not the Court has the power to remove a particular director outside of a § 225(c) action, the Court notes that the General Assembly set forth in § 225(c) the circumstances in which the Court is expressly empowered to remove a director. The Court concludes that this action is not so unusual and does not involve such pressing issues that the Court would be moved to exercise any inherent equitable powers (if, indeed, it has such powers) it might have to remove a director outside of a § 225(c) action.⁵ Therefore, Shocking's fiduciary duty claim is dismissed, but without prejudice, to the extent that it seeks Michael's removal. Shocking's more general fiduciary duty claim survives and will be tried as scheduled. If Shocking prevails on this claim and Michael is found to have violated his duty of loyalty, it is possible that such a judgment could serve as the basis for a § 225(c) action.

⁵ The General Assembly has prescribed a reasonable procedure for removing a director who has violated her fiduciary duty of loyalty. It does not infringe in a material fashion on any inherent authority of the Court. There is, of course, significant authority for the proposition that the Court does not have the power, other than as granted by statute, to remove a duly selected director who has breached the duty of loyalty. *See Ross Sys. Corp. v. Ross*, 1993 WL 49778, at *17-18 (Del. Ch. Feb. 22, 1993); Del. H.B. 19 syn. § 10, 145th Gen. Assembly (2009); 1 Edward P. Welch et al., *Folk on the Delaware General Corporate Law* § 225.11, at GCL-VII-263 (5th ed. 2010 Supp.). Thus, regardless of the source of the Court's authority to remove a director, the Court concludes that the consequences of any breach of the duty of loyalty by Michael, if such conduct did occur, will have to await a subsequent proceeding.

Michael is the sole manager and controlling owner of BHC, which is the general partner and investment adviser of BHP. Shocking alleges that Michael acted on behalf of and in furtherance of the interests of the Entity Defendants when engaging in his alleged wrongful conduct. These allegations form the basis of Shocking's aiding and abetting a breach of fiduciary duty claim and tortious interference with a prospective business relationship claim against the Entity Defendants. The Entity Defendants seek dismissal of both of these claims.

It is premature for the Court to rule on the dismissal of these claims. The focus of next week's trial will be on Michael's allegedly wrongful actions and whether his conduct harmed Shocking.⁶ A ruling in Michael's favor on the

⁶ There has been some ongoing debate regarding the focus of the upcoming trial. This is understandable considering that this action involves closely-related claims against defendants who are themselves closely-related. As the Court stated in its Letter Opinion granting expedition: "Because of the limited time to prepare for trial, the scope of the trial will necessarily be limited. The principal questions would seem to be whether Michael violated his fiduciary duties owed as a director of [Shocking] and whether his conduct harmed [Shocking]." *Shocking*, 2012 WL 165561, at *2. At that time, the Court left it to counsel to further refine the scope of the matters to be tried on an expedited basis. *Id.* Comments made at oral argument on this motion, however, made it clear that uncertainty persists. *See* Oral Argument – Defs.' Mot. to Dismiss 6, 26-27, 44. Therefore, to be clearer, only the fiduciary duty claim against Michael and the context in which this alleged breach arose will be tried on an expedited basis. Michael's actions as a director served as the basis for expedition. The matters presented by counsel at the expedited trial should relate to this claim. Of course, it would not be surprising if matters properly presented at the expedited trial also relate to the other claims brought by Shocking or

fiduciary duty claim would moot the aiding and abetting claim against the Entity Defendants and, depending on the Court's factual findings, possibly moot the tortious interference claim brought against all of the Defendants. Conversely, if Michael is found liable on the fiduciary duty claim, the claims against the Entity Defendants would likely proceed. It is at that point, if it is ever reached, that the Court could properly address the Defendants' motion to dismiss the claims brought against the Entity Defendants. Therefore, the Court will not now address the Defendants' motion to dismiss the claims against the Entity Defendants.

For the foregoing reasons, the fiduciary duty claim against Michael is dismissed, without prejudice, to the extent it seeks his removal from the Board, but it, otherwise, survives; and, for now, the Court declines to address the Defendants' motion to dismiss the claims against the Entity Defendants.

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IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap

cc: Paul D. Brown, Esquire
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