EFiled: Jul 24 2009 3:41PM EDT
Transaction ID 26279888
Case No. 4167-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

LATESCO, L.P., a Texas limited partnership, and BRETT STEWART,	)	
Plaintiffs,	)	
v.	)	C.A. No. 4167-VCL
WAYPORT, INC., a Delaware corporation, TRELLIS PARTNERS OPPORTUNITY FUND, LP, NEW ENTERPRISE ASSOCIATES VIII, L.P., NEW ENTERPRISE ASSOCIATES 8A, LP, JOHN LONG, DAVE VUCINA, KATE MITCHELL, JACKIE KIMZEY, JOHN EVANS, LARRY KATZEN, DOUG MCCORMICK, and CHUCK WILLIAMS,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: June 11, 2009
Decided: July 24, 2009

Bruce E. Jameson, Esquire, Marcus E. Montejo, Esquire, PRICKETT JONES & ELLIOTT, P.A., Wilmington, Delaware, *Attorneys for the Plaintiffs.*

Gregory V. Varallo, Esquire, John D. Hendershot, Esquire, Peter C. Wood, Jr., Esquire, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware, *Attorneys for Defendants Wayport, Inc., Dave Vucina, Kate Mitchell, Jackie Kimzey, John Evans, Larry Katzen, Doug McCormick, and Chuck Williams.*

M. Duncan Grant, Esquire, Matthew A. Kaplan, Esquire, PEPPER HAMILTON, LLP, Wilmington, Delaware; Roger A. Lane, Esquire, Courtney Worcester, Esquire, Andrew H. DeVoogd, Esquire, PEPPER HAMILTON LLP, Boston, Massachusetts, *Attorneys for Defendants Trellis Partners Opportunity Fund, LP, New Enterprise Associates VIII, LP, New Enterprise Associates 8A LP, and John Long.*

LAMB, Vice Chancellor.

A stockholder sought to monetize a part of his illiquid, minority interest in the private company he co-founded but in which he was no longer an insider. His sales of stock were governed by an agreement that gave the corporation and certain insiders rights of first refusal. In what would become the first of two sets of transactions, the stockholder sold shares to a third party after the company and its private equity investors waived their rights of first refusal. Shortly thereafter, the stockholder entered negotiations with the same third party for a second set of sales transactions at a somewhat lower price. This time, two of the company's private equity investors (but not the company or its directors) exercised their rights of first refusal. Complicating the issues, in the second sales transactions the stockholder was asked, and agreed, to sell more shares than originally negotiated with the third party. Later, the stockholder discovered that the company had entered into a transaction, sometime during the negotiation of the second sales transactions, whereby it sold less than 10% of its assets at what is claimed to be an advantageous price. More than a year later, the entire company was sold to a large strategic buyer for a price substantially higher than the price in either of the stockholder's two sales transactions.

Less than two weeks after the sale of the company, the stockholder filed this action against the company, certain of its directors and officers, and the two private equity investors who bought shares in the second round of transactions. The stockholder claims, *inter alia*, breaches of fiduciary duties and fraud. The stockholder does not allege that there were discussions to sell the entire company during either of the two sales transactions or that there was any omission to disclose any plan to do so. Rather, the stockholder claims that, in deciding whether or not to exercise the right of first refusal and in requesting that extra shares be made available for purchase, the corporate insiders should have but did not disclose the asset sale.

The performance of a stockholder agreement giving corporations or corporate insiders rights of first refusal over other stockholders' shares is not governed by any generalized fiduciary duty of disclosure like that known to exist when a corporation asks its stockholders to engage in some discretionary action (such as granting a proxy, voting, or tendering shares). Nor is such performance governed by any generalized application of the duty of loyalty. Instead, the contours of such an insider's duty to the selling stockholder is defined by the terms of the agreement itself and the normal prohibitions against fraud. In contrast, where transactions are made outside the confines of such an agreement, insiders should expect to observe the normal obligations of fiduciaries not to engage in transactions with stockholders while in the possession of material information known to be unavailable to the sellers. Because the complaint adequately pleads that certain portions of the second sales transactions fall outside of the four corners of the agreement, the court will not dismiss the claims for breach of the duty of loyalty and fraud arising out of those transactions.

I.

A. The Parties[1]

Plaintiff Brett Stewart is a founder, the founding CEO, and a former board member of Wayport, Inc., and at all relevant times was a record and beneficial owner of shares of the company's common stock. He is also the inventor of much of the contents of Wayport's patent portfolio. Stewart served as CEO of the company from 1996 to 2000 and as a director from 1996 until December 2001. Plaintiff Latesco, L.P. was also at all relevant times a beneficial owner of Wayport common stock. Although the exact relationship between Stewart and Latesco is unclear, it appears that Latesco is a vehicle through which Stewart and his wife

---

[1] The facts in this opinion, which must be treated as true for the purpose of this motion to dismiss, are drawn from the well pleaded allegations of the amended complaint and the exhibits attached thereto. *See, e.g., In re Tyson Foods, Inc.*, 919 A.2d 563, 571 (Del. Ch. 2007). The plaintiffs assert that the court should convert this motion to dismiss into a motion for summary judgment due to the additional documents introduced by the defendants. The court will not do so. While matters outside the pleadings should not generally be considered in ruling on a motion to dismiss, the court may properly consider documents "integral to a plaintiff's claim and incorporated in the complaint." *In re Santa Fe Pacific Corp. S'holder Litig.,* 669 A.2d 59, 69 (Del. 1995). The only documents outside of the amended complaint that the court relies on in this motion to dismiss are the right of first refusal agreement at issue and an email chain between a managing partner at Trellis and Stewart. A portion of that email chain is quoted in the amended complaint. The plaintiffs' fraudulent misrepresentation claim rests on the quoted email and the court must view the quote in context to properly examine whether the plaintiffs allege a valid claim. The right of first refusal agreement is repeatedly cited in the amended complaint and is also integral to the plaintiffs' case because it allegedly governs certain aspects of the stock sales at issue in this case.

claim to have been beneficial owners of some additional amount of Wayport stock. References herein to Stewart will include both the Stewarts and Latesco, unless the context otherwise requires.

Defendant Wayport, Inc. is a Delaware corporation and is now a wholly owned subsidiary of AT&T. Wayport designs and develops various products related to carrier-grade Wi-Fi networks, and holds numerous related patents. During the relevant time period (prior to its acquisition by AT&T), Wayport's common stock was not publicly traded.

Defendants Trellis Partners Opportunity Fund, LP and two affiliates of New Enterprise Associates–New Enterprise Associates VIII LP and New Enterprise Associates 8A, LP (collectively with New Enterprise Associates, "NEA")–are all Delaware entities and were major investors in Wayport during the relevant time period. Trellis at all relevant times had the right to appoint one director to the Wayport board of directors. Similarly, at all relevant times, NEA had the right to appoint an observer to Wayport's board.

Defendants John Long, Dave Vucina, Kate Mitchell, Jackie Kimzey, John Evans, Larry Katzen, and Doug McCormick were or are directors of Wayport at relevant times. Defendant Chuck Williams was Wayport's Senior Vice President, General Counsel and Corporate Secretary at relevant times. Williams was

Stewart's primary contact for information during the stock sale transactions at issue.

B. <u>The Facts</u>

1. <u>The Right Of First Refusal Agreement</u>

In 2000, Stewart and his wife, along with the other Wayport founders, entered into an agreement with Wayport, Trellis, NEA, and several other investors who held shares of Wayport Series A Preferred Stock, known as the Third Amended and Restated Right of First Refusal and Co-Sale Agreement ("Agreement"). The overall effect of this contract was to restrict the transfer of all shares of Wayport common stock held by Stewart and the other signing founders and to make those shares subject to a right of first refusal for the benefit of Wayport and, to the extent Wayport chose not to exercise that right, the other investors. The other investors also obtained certain co-sale rights that are not involved in this lawsuit. The Agreement was later amended, but Stewart and his wife never signed any later version and deny that any later version is binding on them.

The Agreement is a fully integrated contract. None of its terms address the subject of Stewart's right to access to Wayport information in connection with any proposed sale of shares of stock owned by him.

2. The Stock Sale Transactions

In early 2006, Millennium Technology Ventures Partners, L.P. ("MTVP") offered Stewart and other founders of Wayport $3 per share for a portion of their shares. After he determined that the MTVP offer was acceptable, Stewart had an obligation, under the Agreement, to offer to the other parties thereto (Wayport, Trellis, and NEA) any shares he proposed to sell to MTVP. Accordingly, Stewart gave notice of the potential transaction to the holders of these first refusal rights.[2] The holders all chose not to exercise their rights of first refusal, and Stewart sold 300,000 shares of Wayport common stock to MTVP for $3 per share.

During the early stages of this transaction, Stewart asked Wayport to provided information regarding the company.[3] To a limited extent, Wayport complied, making available information about its financial results. The complaint does not allege that the information furnished contained any material misstatements or misrepresentations. The complaint does allege that the information disclosed did not contain material information regarding the market value of the Wayport patent portfolio. Stewart alleges that one of the reasons he

---

[2] The defendants contend that the Eighth Amended and Restated Right of First Refusal and Co-Sale Agreement, which contained additional signatories, was the agreement that should have governed. Stewart contends that the Agreement governed, because it was the last such agreement that he signed. Solely for the purposes of this motion to dismiss, the court will grant the plaintiffs the reasonable inference that the Agreement governed. The parties obtained a waiver of notice prior to the stock sale transactions so as to avoid the issue as to whether the third or eighth version of the agreement controlled.

[3] The defendants provided the plaintiffs with financial information only after the plaintiffs threatened to file suit under 8 *Del. C.* § 220.

sold a significant number of his shares was because of his concern that there were no transactions on the horizon that would allow him to monetize his Wayport shares.

In late 2006 and early 2007, Stewart and MTVP began talking about a second set of sales transactions. Originally MTVP discussed purchasing 300,000 shares from Stewart at $3 per share, but lowered its offer to $2.50 per share after receiving Wayport's updated financial information. No disclosure of any pending material transaction was made by Wayport at that time. During the late 2006 and early 2007 time period, Williams asked Stewart to make more shares available for sale to company insiders.[4] Ultimately, Wayport's directors did not purchase shares from Stewart. Trellis and NEA did purchase from Stewart about 148,000 shares and 350,000 shares, respectively, in six different sales transactions between May 21, 2007 and October 1, 2007.[5] During the relevant time period, both Trellis and NEA potentially had access to Wayport inside information through their board representatives.[6] In the course of discussions leading up to these sales, Stewart allegedly made clear to Williams that he was relying on the fact that the purchasers

---

[4] This request appears to have arisen out of a desire by Williams to accommodate all of the parties to the Eighth Co-Sale Agreement without having to resolve the dispute between Wayport and the plaintiffs about whether the Third Co-Sale Agreement or the Eighth Co-Sale Agreement applied to the plaintiffs.

[5] MTVP also purchased shares in the second sales transactions.

[6] John Long was Trellis's board representative. It is unclear whether NEA actually had a board observer.

owed fiduciary duties to the sellers and sought a representation that the purchasers did not have possession of material information not available to Stewart. No specific representation to that effect was made or included in the written sales contracts.

During negotiations regarding the second sales transactions, Stewart emailed Alex Broeker, a managing partner at Trellis, to address a concern that the parties were not on a level playing field regarding access to information about Wayport's business. Broeker responded in a June 8, 2007 email to Stewart, stating that "[w]e are not aware of any bluebirds of happiness in the Wayport world right now and have graciously offered to rep that."[7] Stewart sought stronger representations from Trellis, but Broeker expressed concern that contract language proposed by Stewart could lead to a breach by Trellis if a company entered negotiations to sell Wayport *after* the second sales transactions closed. Ultimately, nothing similar to the representation Broeker offered to make was included in the documents governing the second sales transactions.

3. <u>Stewart Discovers The Cisco Transaction</u>

Meanwhile, Stewart alleges that Wayport formed a patent monetization committee sometime during the summer of 2005, a fact Stewart claims he did not become aware of until after the sale of his stock. At some time prior to May 2007,

---

[7] Am. Comp. ¶ 43.

Wayport and its board became aware of Cisco Systems Inc.'s interest in buying at least one of its patents (representing approximately 117 of the 1,595 claims in Wayport's total portfolio) for $9.5 million.[8] Stewart alleges that this transaction was near closing or had already closed at the time of Broeker's email disclaiming any knowledge of any "bluebirds of happiness."[9] According to Stewart, the patents sold in the Cisco transaction were among the least valuable in Wayport's portfolio. Stewart claims that, had he known the market value of the patent sold in the Cisco transaction (as measured by the transaction price itself), he would have recognized that the remaining Wayport patents were significantly more valuable. Stewart thus contends that if the patent sale had been made known to him prior to the second sales transactions, it would have provided valuable insight into the market value of Wayport as a whole.[10]

On or about October 30, 2007, a month after the closing of the last of the second sales transactions, Stewart received Wayport's audited financial statements for the period ending June 30, 2007. Those financial statements contained a reference, in a footnote, to a sale of certain patent(s). It is this footnote which first alerted Stewart to the existence of the Cisco transaction. After informal attempts to

---

[8] The defendants do not admit that Cisco was the buyer, but Stewart has inferred that Cisco was the buyer from a USPTO filing by Cisco.
[9] Am. Comp. ¶ 43.
[10] The defendants did not provide Stewart with any information regarding the Cisco transaction until after the stock sale transactions closed.

obtain information from Wayport regarding the Cisco transaction, Stewart made a formal demand for books and records pursuant to 8 *Del. C.* § 220. In response, Wayport provided Stewart with limited additional information.

4. AT&T's Purchase Of Wayport

On November 6, 2008, Wayport announced that it had reached an agreement to sell the company to AT&T for $328 million, or approximately $6.43 per common share. The sale consideration also included a $0.25 per common share pre-merger dividend and the right to receive a further "remainder dividend" approximately 18 months after the transaction closed. There is no allegation that any of the defendants were aware of an impending transaction with AT&T at the time of the first or second sales transactions. Stewart merely pleads that the "price paid by AT&T necessarily values the intellectual property of Wayport materially in excess of the value that plaintiffs attributed to it in agreeing to the Stock Sale Transactions."[11]

5. Procedural History

On November 17, 2008, the complaint was filed in this action. Shortly thereafter the defendants moved to dismiss. On February 26, 2009, an amended complaint was filed in response to the motions to dismiss. The amended complaint claims breach of the fiduciary duty of disclosure (Count I), breach of the fiduciary

[11] Am. Comp. ¶ 63.

duty of loyalty (Count II), fraudulent misrepresentation (Count III), civil conspiracy (Count IV), aiding and abetting breaches of fiduciary duty (Count V), unjust enrichment (Count VI), and breach of contract (Count VII). On March 12, 2009, the defendants renewed their motions to dismiss. On June 11, 2009, the court heard oral argument on the motions.

II.

The defendants move to dismiss the amended complaint pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted and Rule 9(b) for failure to plead fraud with particularity.

The Rule 12(b)(6) standard is familiar: if "it appears with reasonable certainty that the plaintiff cannot prevail on any set of facts that can be inferred from the pleadings" the court will grant the motions to dismiss.[12] For the purpose of these motions, the court will, as it must, grant the plaintiffs all reasonable inferences that may be drawn from the complaint.[13] The court, however, "is required to accept only those reasonable inferences that logically flow from the face of the complaint and is not required to accept every strained interpretation of the allegations proposed by the plaintiff."[14] Moreover, conclusory allegations

---

[12] *Romero v. Career Educ. Corp.*, 2005 WL 1798042, at *2 (Del. Ch. July 19, 2005); *accord Malpiede v. Townson*, 780 A.2d 1075, 1082-83 (Del. 2001).
[13] *Malpiede*, 780 A.2d at 1083.
[14] *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (citations and quotations omitted).

unsupported by facts contained in a complaint will not be accepted as true.[15] Rule 9(b) additionally requires that the circumstances constituting fraud be stated with particularity.

III.

Stewart, certain that he had been wronged but searching for a theory of recovery, alleges a variety of claims sounding variously in fiduciary duty, contract, fraud, and restitution. The defendants move to dismiss, urging the court to regard the case as involving only a series of voluntary sales of stock initiated by Stewart and priced as the result of negotiations between Stewart and MTVP. The defendants claim their involvement in the transactions was governed by the contractual terms of the right of first refusal agreement. Thus, they say, they were under no general fiduciary duty-based disclosure obligation and were free to exercise the right of first refusal without disclosing information about the Cisco asset sale.

The court is not able, at this stage of the proceedings, to regard all of the defendants' conduct as falling entirely within the scope of the right of first refusal agreement. Instead, there are well pleaded allegations of fact that the second sales transactions involved more. For example, Williams asked Stewart to make a large number of additional shares available for sale to insiders, including the Wayport

---

[15] *See, e.g., Solomon v. Pathe Commc'n Corp.*, 672 A.2d 35, 38 (Del. 1996).

directors, some of whom do not appear to have had any right of first refusal. Stewart acceded to this request, which led to the purchase of those shares by Trellis and NEA when the directors decided not to purchase shares. For the purposes of the motion to dismiss, the court concludes that the inclusion of those additional shares can be seen as placing the entire second series of sales outside the analytical framework of the right of first refusal agreement. Thus, in deciding these motions, the defendants' liability will be evaluated under the normal standard of fraud, as applied to transactions between corporate insiders[16] and minority stockholders. This is a scienter-based standard that, in the case of a fiduciary, may include a duty to speak when, in purchasing or selling stock, the fiduciary is aware that material information is known to him but not to the counter party to the transaction.[17]

---

[16] By insider, here the court means a stockholder-party that, by virtue of board representation or observers, possesses additional information about the fortunes of the company beyond that generally made available by corporate management to the stockholders.

[17] *See In re Am. Intern. Grp., Inc.*, 965 A.2d 763, 805 (Del. Ch. 2009); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *7 (Del. Ch. Aug. 26, 2005) ("[W]here there is a fiduciary relationship, fraud may also occur through deliberate concealment of material facts, or by silence in the face of a duty to speak."); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) (holding that because "the duty of candor is one of the elementary principles of fair dealing, Delaware law imposes this unremitting obligation not only on officers and directors, but also upon those who are privy to material information obtained in the course of representing corporate interests"). This is in contrast to the affirmative-misrepresentation or intentional concealment species of fraud (that is, the forms of fraud that do not require a duty to speak) which Stewart would be restricted to pleading if the stock sales fell within the scope of the right of first refusal agreement.

This standard is not an instance of the fiduciary duty of disclosure that results from a call for stockholder action.[18] The rule requiring calls for stockholder action to be accompanied by full and fair disclosure of all material information regarding the decision presented to the stockholders is premised on the collective action problem that stockholders, in the aggregate, are faced with when asked to vote or tender their shares. In such a situation, it would be impractical, if not impossible, for each stockholder to ask and have answered by the corporation its own set of questions regarding the decision presented for consideration. In the absence of a fiduciary duty by the corporation and its directors to engage in full and fair disclosure, stockholders would thus be forced to make a decision in an

---

[18] The duty of disclosure arises when a board asks the stockholders to make a discretionary decision, "such as whether to grant a proxy, to vote yes or no on a particular matter, or to seek appraisal or accept merger consideration." *Metro Commc'ns Corp. BVI v. Advanced MobileComm Tech. Inc.*, 854 A.2d 121, 156 (Del. Ch. 2004); *accord Gantler v. Stephens*, 965 A.2d 695, 710 (Del. 2009) ("It is well-settled law that directors of Delaware corporations have a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action." (quoting *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992)) (internal quotations omitted)); *Loudon v. Archer-Daniels-Midland Co.,* 700 A.2d 135, 137 (Del. 1997) ("Delaware law of the fiduciary duties of directors . . . establishes a general duty of directors to disclose to stockholders all material information reasonably available when seeking stockholder action."); *cf. Sims v. Tezak*, 694 N.E.2d 1015, 1018-19 (Ill. App. Ct. 1998) (surveying Delaware cases regarding the duty of disclosure and concluding that an offer by the corporation to buy an individual shareholder's shares did not implicate the duty of disclosure because such an offer did not constitute a call for shareholder action as contemplated by Delaware case law). Thus, for the duty of disclosure to be implicated, it is necessary as a threshold matter to conclude that the board was seeking "shareholder action" as contemplated by *Gantler* and *Metro Communications*. *See Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998) ("In the absence of a request for stockholder action, the Delaware General Corporation Law does not require directors to provide shareholders with information concerning the finances or affairs of the corporation."). This court agrees with the Illinois court in *Sims* that a call for an individual stockholder to sell his shares does not, without more, qualify as a call for stockholder action.

information vacuum. These same factors do not, however, come into play when the corporation asks a stockholder as an individual to enter into a purchase or sale. There, the stockholder may refuse to do so until he is satisfied the corporation has given him sufficient information to evaluate the decision presented to him.[19]

The general fraud standard the court will apply is not directly derived from the fiduciary duty of loyalty, upon which Count II of the complaint rests, although the duty of loyalty may give rise to a duty to speak as discussed above. In his answering brief, Stewart defends Count II by arguing that he has both properly alleged a fiduciary insider trading claim under *Brophy v. Cities Service Co.*[20] and that the directors improperly favored Trellis and NEA over him by permitting the second sales transactions to occur when they knew Trellis and NEA possessed an informational advantage. Neither of these arguments is persuasive. A *Brophy* claim is fundamentally derivative in nature, because it arises out of the misuse of corporate property–that is, confidential information–by a fiduciary of the corporation, for the benefit of the fiduciary and to the detriment of the

---

[19] The corporation and its officers and directors are, of course, subject to the underlying duty of loyalty not to make false statements or otherwise materially misrepresent the facts in such a way as to defraud the stockholder in any such negotiation. *See Malone*, 722 A.2d at 10 ("[W]hen directors communicate publicly or directly with shareholders about corporate matters the *sine qua non* of directors' fiduciary duty to shareholders is honesty."). Stewart pleads no facts whatsoever to suggest that the company, or its directors or officers, made any knowingly false statements to him. In fact, the complaint does not adequately allege any false statements made by the company or any of the individual defendants, knowingly or otherwise.
[20] 70 A.2d 5 (Del. Ch. 1949).

corporation.[21] The claim essentially arises out of agency law, which holds that an agent may not acquire a material benefit (other than from his principal) in connection with his position as agent.[22] Stewart makes no attempt to plead this claim derivatively or to explain why such a claim exists in the context of a right of first refusal agreement. Moreover, Delaware fiduciary duty law does not guarantee all stockholders identical rights to corporate information; nor does it impose any obligation on directors to make sure that all stockholders have access to identical information at all times. To do so would be impractical, invalidate numerous negotiated agreements between companies and their private equity investors regarding informational rights, and render invalid common distinguishing features of varied classes of stock. Such a result is neither desirable nor required by Delaware law; nor is it supported by the broad, general statements of equal treatment cited by Stewart.[23]

---

[21] *Id.* at 7-8.

[22] *See* RESTATEMENT (THIRD) OF AGENCY § 8.06 ("An agent has a duty (1) not to use property of the principal for the agent's own purposes or those of a third party; and (2) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party."); RESTATEMENT (THIRD) OF AGENCY § 8.02 ("An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent's use of the agent's position.").

[23] For example, Stewart cites the incontrovertible statement found in 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS §4.16[E][5] (3d ed. 2009 Supp.) to the effect that the duty of loyalty "generally requires directors to treat stockholders equally." This entirely sensible statement is followed by examples concerning the payment of dividends and the extraction of benefits by a controller to the exclusion of the other stockholders. Nothing suggests the extension of this general observation to the equalization of access to information within the corporation.

If the court were to ignore the extra shares or otherwise regard the second sales transactions as governed by the contract, the question then becomes what, if any, disclosures might an insider who is party to a right of first refusal agreement be required to make to an outsider when exercising such a right. This appears to be a matter of first impression both in Delaware courts, and, to the best of the court's research, elsewhere. Courts have addressed the similar, but not entirely analogous, issues that arise when corporations act to exercise contractual repurchase rights triggered by death or termination of employment, but it is hard to discern any general rule.[24] Perhaps the most closely analogous case is *Kerrigan v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* involving the exercise of a fixed price option to repurchase shares from the estate of a deceased partner pursuant to a written agreement. Applying Delaware law, the court dismissed a claim alleging that the corporation had breached a duty when it failed to disclose to the deceased partner's estate information that might have implied a higher value than was fixed by agreement. The court stated:

> Under Delaware law, Merrill Lynch had a right to exercise the valid option to repurchase Kerrigan's shares from his estate. For this reason, whatever deficiencies, if any, there were in disclosure did not

---

[24] *See Gallagher v. Lambert*, 549 N.E.2d 136, 137-38 (N.Y. 1989); *Kerrigan v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 450 F. Supp. 639 (S.D.N.Y. 1978); *Guy v. Duff & Phelps, Inc.*, 672 F. Supp. 1086 (N.D. Ill. 1987). *See generally* 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE, § 7:12 (3d ed. 2007) (discussing fiduciary duty as a limit on transfer restrictions and buyout agreements).

> and could not have affected plaintiffs, for they had the legal obligation to sell the shares at the predetermined price.[25]

It is similarly possible to view the rights of first refusal in this case as appropriately giving insiders such as Trellis and NEA the unconstrained right to buy shares when a notice of an intent to sell is given. Many factors beyond the mere existence of a contract distinguish the exercise of a right of first refusal from situations in which the law imposes strict fiduciary fidelity. First, it must be said that the exercise of a right of first refusal does not involve the fiduciary in soliciting sales or even offers to sell; on the contrary, the impetus for the transaction comes from the selling stockholder who has already arranged a separate sale requiring performance under the right of first refusal. Second, the fiduciary is not involved in any price negotiation with the selling stockholder; instead, the pertinent price negotiation is between the selling stockholder and the purchaser. Third, as is true in this case, the selling stockholder often signs a right of first refusal agreement that contains no contractual right to information; thus, he has reason to know that any decision he makes to sell once he is no longer an insider will be made without access to the broad scope of information available to insiders. These factors all suggest the justice of enforcing a right of first refusal according to its terms.

---

[25] *Kerrigan*, 450 F. Supp. at 646.

In this regard, it must also be observed that any broad rule of fiduciary disclosure would almost certainly disrupt the intended operation of any right of first refusal given to a corporation or one of its insiders. Such rights generally operate on tight time schedules and certainly do not contemplate price renegotiation between the selling stockholder and any other party to the agreement. Thus, any requirement of proxy statement-type information in this context would be wholly impracticable and would, in any event, serve only to cause either the selling stockholder or the third-party purchaser to rethink the transaction. Moreover, the law would need to determine whether such a rule should operate even where no one holding a right of first refusal elected to exercise it. That is, would the law imply a broader duty requiring the corporation or other fiduciary to affirmatively give notice or some form of warning to a stockholder proposing to sell if, for example, the fiduciary knew that a premium sale of the corporation was imminent? If so, where does this duty come from and what are its limits?[26]

Obviously, contractual rights of this sort inhabit an interesting intersection of contract, fiduciary duty, and fraud. It may become necessary to resolve these or similar questions at some later stage of these proceedings. For the purposes of these motions, however, the court need not do so since the request for extra shares

---

[26] At oral argument, counsel for the company and certain of the individual defendants suggested, without conceding the point, that the implied covenant of good faith and fair dealing might be the source of such a duty, where there is actual knowledge that the price proposed in the sale notice is grossly unfair due to some major undisclosed corporate development. Tr. 22-24.

is presumed, for current purposes, to distinguish the case from one involving purely contract issues.

For the foregoing reasons, the breach of fiduciary duty of disclosure claim (Count I) must be dismissed. With respect to the duty of loyalty, for the purposes of the motions to dismiss, the complaint pleads sufficient facts to support a claim that Trellis and NEA traded with Stewart in the second sales transactions while in the possession of undisclosed material inside information.[27] Because the second sales transactions are not well cabined within the four corners of the Agreement, general fiduciary principles apply. Thus, the duty of loyalty claim against Trellis and NEA cannot be dismissed. Similarly, the complaint adequately pleads that Williams (possibly on behalf of Wayport, whose officer and agent he was) induced the plaintiffs to offer additional shares for sale beyond those MTVP was prepared to buy, and that Williams may have been in possession of undisclosed material inside information at the time he did so. The claim for breach of the duty of loyalty against Williams and Wayport therefore cannot be dismissed. As for the remaining individual defendants, all of whom are claimed to have been directors of Wayport during the relevant period, there is no well pleaded allegation (or in fact, any allegation at all) that they acted in any way in the second sales transactions

[27] The complaint supports no allegations of wrongdoing whatsoever with respect to the first sales transaction. Therefore, the claims that are not dismissed are sustained only with respect to allegations relating to the second sales transactions.

pursuant to their roles as directors of Wayport (other than, perhaps, in causing the company to elect not to exercise its right of first refusal under the Agreement). Because there is no allegation of board action that implicates the duty of loyalty, and none of the directors ultimately purchased any stock in the second sales transactions, no claim for breach of the duty of loyalty can be maintained against them. Thus, Count II must be dismissed against the director defendants.

IV.

The complaint alleges a claim for fraud or fraudulent misrepresentation. The elements of common law fraud are :

> 1) a false representation, usually one of fact, made by the defendant; 2) the defendant's knowledge or belief that the representation was false, or was made with reckless indifference to the truth; 3) an intent to induce the plaintiff to act or to refrain from acting; 4) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and 5) damage to the plaintiff as a result of such reliance.[28]

Moreover, a positive misrepresentation is not required. Rather, a "claim of common law fraud can arise from three types of conduct: (1) a representation of false statements as true; (2) active concealment of facts that prevents their

---

[28] *Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1074 (Del. 1983) (listing the elements of a cause of action for common law fraud). As a threshold matter, to state a claim for fraud an alleged misrepresentation must be material. The test for materiality with regard to uncertain corporate events has been stated in *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (holding that materiality will "depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity" (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)). Because this is necessarily a fact intensive inquiry, it is beyond the scope of the court's inquiry at the motion to dismiss stage.

discovery; or (3) remaining silent in the face of a duty to speak."[29] The second of these types of conduct is not alleged here. Instead, the complaint attempts to allege the first type with respect to Trellis,[30] and the third with respect to Trellis, NEA, Williams, and Wayport.[31]

The court has already determined that no duty of disclosure existed under which the corporation or its directors were bound to provide full and fair information to the seller-plaintiffs here. However, that determination is not the same as one that Trellis, NEA, Williams, and Wayport (the "Remaining Defendants"), were not subject to a duty to speak arising from their positions as fiduciaries of the plaintiffs.[32] Because the court has found that the complaint succeeds in stating a claim for a breach of the duty of loyalty by the Remaining

---

[29] *Corporate Prop. Assocs. 14 Inc. v. CHR Holding Corp.*, 2008 WL 963048, at *6 (Del. Ch. Apr. 10, 2008) (citing *Metro Commc'ns*, 854 A.2d at 143; *Stephenson*, 462 A.2d at 1074).

[30] Trellis, unlike NEA, during a negotiation over the sale agreement stated (through Broeker) that they were aware of no "bluebirds of happiness" in Wayport's vicinity.

[31] Although the plaintiffs attempt to plead a claim for fraud against all defendants, the court has already determined that the director defendants did not have an obligation to speak in this context. Thus, given the the individual defendants' absence of false statement, a claim for common law fraud cannot be made to lie against them.

[32] The court assumes here, without deciding, that Trellis and NEA were aware, by virtue of their board representation/observer, of the Cisco transactions at the time that they entered into the second sales transactions, and that by virtue of the possession of such inside information they constituted constructive insiders with concomitant fiduciary duties. Granting the plaintiffs all reasonable inferences, the court here again assumes that Trellis and NEA knew of the Cisco transaction at the time of the second sales transactions, and thus knew that their failure to speak would imply a false representation, satisfying the *scienter* element for pleading purposes. *See H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 145-46 (Del. Ch. 2003) (holding that the Rule 9(b) requirement that fraud be pleaded with particularity does not extend to requiring particularized pleading of the defendant's fraudulent knowledge or intent). The plaintiffs have thus so far succeeded in pleading the first two elements of fraud.

Defendants as a result of their alleged lack of candor surrounding the second sales transactions, the court likewise concludes that the Remaining Defendants can be said for the purposes of these motions to have been subject to a duty to speak which made silence about the material inside information they possessed impermissible.

With respect to the third element of common law fraud, it is clear from the pleadings what the plaintiffs allege the defendants sought to induce them to do–to sell at a lower price than they otherwise would have if apprised of the facts which the defendants failed to disclose. With regard to the fourth element, Trellis makes much of the fact that even though it offered to make a representation regarding no "bluebirds of happiness," the ultimate sales agreement contained no such representation. If, however, the plaintiffs are ultimately able to succeed on a failure to speak theory, the lack of such a representation will be immaterial. More generally, with respect to reliance, the better view would appear to be that, at the motion to dismiss stage, a seller is entitled to rely in general on statements (or the lack thereof) made by a fiduciary of his.

Lastly, with regard to damages, although how damages would be measured should the plaintiffs prevail is unclear, all that the plaintiffs need to plead at this stage is that they were harmed by the fraudulent conduct. This is well pleaded by the complaint, which alleges that the plaintiffs would not have sold or would have only sold at a higher price had they known of the information about the Cisco transaction at the time of the second sales transactions.

Thus, a claim for common law fraud is adequately pleaded against defendants Trellis, NEA, Wayport, and Williams.

V.

The complaint also contains a claim for aiding and abetting a breach of fiduciary duty against NEA, Trellis, and Wayport.[33] To succeed on an aiding and

---

[33] The complaint makes three additional claims which are without merit: 1) civil conspiracy, 2) breach of contract via the duty of good faith and fair dealing with respect to the Agreement, and 3) unjust enrichment. Conspiracy to defraud must itself be pleaded with particularity, as with the underlying fraud claim. *See Atlantis Plastics Corp. v. Sammons*, 558 A.2d 1062, 1066 (Del. Ch. 1989) ("A complaint alleging conspiracy must allege facts which, if true, show the formation and operation of a conspiracy, the wrongful act or acts done pursuant thereto, and the damages resulting from such acts. Facts, not legal conclusions, must be pled . . . ."). The first element has not been adequately pleaded by the complaint. That is, there are no well pleaded allegations relating to an explicit agreement among any of the defendants to engage in tortious activity. Thus, the civil conspiracy count must be dismissed as to all defendants.

The complaint also alleges that Trellis, NEA, and Wayport breached the implied covenant of good faith and fair dealing under the Third Co-Sale Agreement by failing to inform the plaintiffs about material inside information. The Third Co-Sale Agreement does not give the plaintiffs information rights. Such rights are routinely negotiated for, and are not a proper subject for a claim of breach of the covenant of good faith and fair dealing. Absent contractual information rights, the stockholder must rely on 8 *Del. C.* § 220 as a basis for rights to certain information. The covenant of good faith and fair dealing does not expand those rights. Rather, the court has explicitly held above that if the second sales transactions had fallen within the four corners of the Agreement, the only claim that could lie against any of the defendants would be affirmative fraud–that is, fraud involving an actual misrepresentation or *active* concealment of facts. Thus, it is only because the complaint succeeds in pleading that the second sales transactions fall outside the bounds of the Agreement (and therefore outside of the reach of the implied covenant of good faith thereunder) that the duty of loyalty claims and "fiduciary fraud" claims stand. The breach of contract claim therefore must be dismissed.

Lastly, the unjust enrichment claim fails because the complaint does not adequately plead the enrichment of any defendant at the expense of the plaintiffs that was not justified. *See Addy v. Piedmonte*, 2009 WL 707641, at *22 (Del. Ch. Mar. 18, 2009) (stating that unjust enrichment requires "(1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification, and (5) the absence of a remedy provided by abetting claim, the plaintiffs must establish "'(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, . . . (3) knowing participation in that breach by the defendants,' and (4) damages proximately caused by the breach."[34] The aiding and abetting claim against NEA and Trellis is predicated on breaches of the duty of loyalty by the director defendants. Because the court has already determined that the plaintiffs have failed to state a claim for breach of fiduciary duty by the director defendants, it is impossible to state a claim for aiding and abetting a breach of fiduciary duty predicated on any such breach. The aiding and abetting claim against Trellis and NEA must therefore be dismissed. In contrast, the aiding and abetting claim against Wayport is predicated on fiduciary duty breaches by Trellis and NEA. Because the actions of Williams in requesting

---

law"). Unjust enrichment is a restitutionary claim, which arises in circumstances in which it would be inequitable to allow a party to retain a benefit which has been conferred on him by another. *See* RESTATEMENT (FIRST) OF RESTITUTION § 1 (1937) ("A person who has been unjustly enriched at the expense of another is required to make restitution to the other."); *see also* RESTATEMENT (THIRD) OF RESTITUTION § 1 cmt. b (Discussion Draft, 2008) ("Unjustified enrichment is enrichment that lacks an adequate legal basis: it results from a transfer that the law treats as ineffective to work a conclusive alteration in ownership rights. Because the legal basis that makes a transfer effective is ordinarily a consensual exchange, a valid gift, or a legal duty (such as a liability in tort or an obligation to pay taxes), the concern of restitution is predictably with those anomalous transfers that cannot be justified by the terms of a valid and enforceable exchange transactions; by the intention of the transferor to make a gift; or by the existence of a legal duty to the transferee."). It is not, however, a means by which a party who later regrets a legally contracted sale as being for insufficient price can recover value he claims he failed to capture in the sale. Thus, if Stewart can succeed on the other claims, the unjust enrichment claim will be superfluous. If he cannot prevail on those claims, he will have no basis upon which to claim unjust enrichment by the defendants. Thus, the unjust enrichment claim must be dismissed.

[34] *Malpiede*, 780 A.2d at 1096 (quoting *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972)).

the offer of additional shares for sale can, at least at this stage, be attributed to Wayport as well, the aiding and abetting claim against Wayport cannot be dismissed.

VI.

For the foregoing reasons, the motions to dismiss of the defendants are GRANTED IN PART and DENIED IN PART. The defendants are directed to submit an order implementing this opinion on or before August 7, 2009.