

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

STEPHEN P. LAMB
VICE-CHANCELLOR

COURT HOUSE
WILMINGTON, DELAWARE 19801

Submitted: February 12, 2001
Decided: February 27, 2001

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**RE: Keith Cooper and Robert C. Roeper v. Critical Path, Inc.
C.A. No. 18193**

Dear Counsel:

At the February 12, 2001 hearing, I denied plaintiffs' motion for judgment on the pleadings and reserved decision on their motion to dismiss the counterclaims. For the reasons that follow, I now grant the motion to dismiss the counterclaims.

Background

A brief recitation of the factual and procedural background is in order. In a transaction that closed on December 6, 1999, defendant Critical Path, Inc., a California corporation, acquired by merger NetFax Corporation, a Delaware corporation. The merger agreement provided for a portion of the merger consideration to be placed in escrow subject to the terms of a related escrow agreement. The parties established the escrow to provide a source of indemnification to Critical Path for breach of the NetFax representations and warranties in the merger agreement.¹

Within the six-month period established by the escrow agreement, Critical Path gave notice of a claim. Plaintiffs thereafter filed this action ***seeking, inter alia***, a declaration that Critical Path's claim is defective and an order directing that the **escrowed** property be released to FaxNet's former stockholders. Plaintiffs, Kenneth Cooper and Robert C. Roeper, were appointed to serve as the NetFax stockholders' representatives

¹ For this purpose, the merger agreement also provided for the **survival** of the representations and warranties for a period of 6 months following closing.

pursuant to the terms of the escrow agreement. They bring this suit solely in their representative capacity.

Critical Path counterclaimed, alleging three bases for relief. The first counterclaim is merely a demand for a declaratory judgment to the effect that Critical Path has a valid claim for indemnification against the escrow account. It raises no issues that are not raised by the complaint. This counterclaim must be dismissed because it “relates wholly and completely to the **claim** asserted in the complaint, ” and is “simply a restatement or specification of the answer.”² Such a pleading “does not respond to the purposes of the Declaratory Judgment Act, 10 Del. C. § 6500 *et seq.*”³

The second and third counterclaims also refer to the representations and warranties in the merger agreement, but raise matters beyond the scope of the complaint and the escrow agreement in two ways. First, they rely on legal theories of “unjust enrichment” and “constructive trust” that are not found in the escrow agreement. Second, they introduce additional

² *In re RJR Nabisco, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 10389, Allen, C. (June 12, 1990).

³ *Id.*

factual allegations relating to allegedly false and misleading representations made in the course of negotiations but not found in the merger agreement itself.

The additional factual aspects of these counterclaims focus on a memorandum dated August 1999 (“Descriptive Memorandum”) that was given to Critical Path and others potentially interested in acquiring NetFax and is alleged to have been false and **misleading**.⁴ Cooper, at the time Net Fax’s CEO, plays a central role in the allegations relating to the Descriptive Memorandum. He is alleged to have (i) given it to Critical Path, (ii) known or had reason to know that it was false and misleading, (iii) failed to disclose the true state of facts, (iv) had a duty to disclose the truth to Critical Path, and (v) acted with an intent to induce Critical Path’s reliance on the Descriptive Memorandum. Critical Path also alleges its own reliance and injury.

The second counterclaim then seeks to relate these facts to the escrow fund, claiming that, as a result of Cooper’s misdeeds, Critical Path

⁴ Those alleged representations concern the same subject matter that gives rise to Critical Path’s claim under the escrow agreement.

paid an artificially inflated price to acquire **NetFax** and that the former stockholders of **NetFax** were “unjustly enriched and have enjoyed gain, profit and advantage which they would have not otherwise received. ” The counterclaim concludes as follows:

39. Said shareholders have no right to any unjust gain, profit and advantage resulting from breaches of the representations and warranties in the Merger Agreement and the wrongful acts of Cooper, and they have been unjustly enriched such that the Escrow Amount should be returned to Critical Path.

The thud counterclaim repeats all of the prior allegations and seeks, as a remedy, the imposition of a constructive trust on the escrow fund, as follows:

42. Certain former shareholders of **FaxNet** have wrongfully received rights to the Escrow Amount and have obtained gain, profit, and advantage from the exploitation thereof.
43. By virtue of the breach of the representations and warranties in the Merger Agreement and Cooper’s wrongful acts, said shareholders hold rights to the Escrow Amount, and gain, profit and advantage therefore, as constructive trustees for the benefit of Critical Path.

As can be seen, the second and third counterclaims are alleged to arise both from the representations and warranties contained in the

merger agreement and, independently, from the alleged misdeeds of Cooper and the Descriptive Memorandum.

Discussion

I will first address those aspects of the counterclaims arising out of the Descriptive Memorandum and Cooper's alleged misconduct.

There is a critical procedural defect in this aspect of the second and third counterclaims. First, to the extent that the counterclaims are read as alleging claims against Cooper individually, they are improper. Plaintiffs Cooper and **Roeper** brought their complaint solely in their capacity as stockholders' representatives, and not in their individual capacity. Thus, as a general rule, it would not be appropriate for Critical Path to assert counterclaims against them as individuals, as they are not "opposing" parties within the meaning of Court of Chancery Rule 13.⁵ Critical Path concedes this point in its answering brief, but states that it "alleges its counterclaims against the Representatives solely in their representative capacity. "

⁵ See, generally, *In re Arthur Treacher's Fish & Chips, etc.*, Del. Ch., 386 A.2d 1162, 1164-65 (1978).

This leads to the second point. In this case, the “representative capacity” of Cooper and **Roeper** has a specific meaning, defined by paragraph S(a) of the escrow agreement. It is as follows:

The Representatives shall have full power and authority to represent all of the Stockholders and their successors with respect to all matters arising under the Escrow Agreement and all actions taken by the Representatives hereunder shall be binding upon all such Stockholders and their successors as if expressly confirmed and ratified in writing by each of them.

Plainly, this grant of authority does not extend to matters arising out of the Descriptive Memorandum or Cooper’s alleged misdeeds, none of which have anything to do with the escrow agreement. Thus, I am unable to understand how Critical Path can sue either Cooper or **Roeper** “in their representative capacity” for those matters. Neither is alleged to have any the authority to represent or act for the other stockholders generally or, more specifically, even with respect to claims made against the escrow fund that do not arise out of the escrow agreement.

This brings me to those aspects of the second and third counterclaims that purport to arise out of the representations and warranties in the merger agreement itself.

Those claims, at least, bear some factual relationship to the escrow agreement, since the purpose of the escrow is to provide a source of indemnification for Critical Path for breach of one or more of those same representations or warranties. Nevertheless, those claims also cannot be said to **arise under** the escrow agreement and, thus, are not within Cooper and **Roeper's** representative capacity.

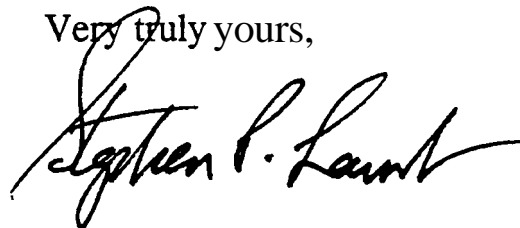
The escrow was created for the purpose of providing compensation to Critical Path in certain limited and defined circumstances. The procedure for making a claim against the escrow was spelled out and subject to rigid, relatively short, time.constraints. The escrow agreement does not provide to Critical Path a contractual right to make a claim for unjust enrichment. Nor does it provide any contractual mechanism for resolving a **claim** for the imposition of a constructive trust on the escrow fund. Indeed, Critical Path does not contend otherwise, as evidenced by the fact that the claim it filed under the escrow agreement makes no mention of either such theory of recovery.

Because these claims do not arise under the escrow agreement, it follows that that Cooper and **Roeper** have no authority to represent the

other stockholders in relation thereto. Thus, they are not proper counterclaim defendants as to such claims.⁶

For these reasons, I have today entered an order dismissing the counterclaims, a copy of which is enclosed.

Very truly yours,

A handwritten signature in black ink, appearing to read "Stephen P. Lamb". The signature is written in a cursive style with a large initial "S".

SPL/caj
Enclosure

oc: Register in Chancery

⁶ See n.2, *supra*.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

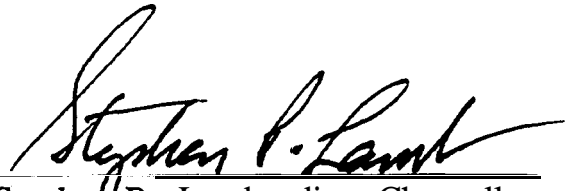
KEITH COOPER and ROBERT C. ROEPER,)
in their representative capacity,)
)
Plaintiffs,)
)
v.)
)
CRITICAL PATH, INC.,)
a California corporation,)
)
Defendant.)

CA. No. 18193

ORDER

For the reasons set forth in the Court's letter opinion of February 27, 2001,
the Counterclaims are hereby dismissed.

IT IS SO ORDERED.


Stephen P. Lamb, Vice Chancellor