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Re: Caravias v. Interpath Communications, Inc.
C.A. No. 3301-VCN
Date Submitted: February 11, 2008

Dear Counsel:

Plaintiff George Caravias (“Caravias”) brings this action against Defendant Interpath Communications, Inc. (“Interpath” or the “Company”), a Delaware corporation, seeking various forms of equitable relief or damages stemming from an alleged breach of a stock purchase agreement.¹ Interpath has moved to dismiss

¹ No specific date for the breach is alleged in the complaint.

under Court of Chancery Rule 12(b)(6) on the ground that, among others, Caravias' claim is barred by the doctrine of laches. Given Caravias' artful pleading of his complaint and the procedural limitations of a motion to dismiss, Interpath's motion must be denied. Even from this limited record, however, one can surmise Caravias' claims may have come too late. Therefore, the Court will permit the parties to take limited discovery to develop the facts necessary for the Court to resolve the laches defense under the summary judgment standard. All other discovery shall be stayed pending resolution of that question.

I. BACKGROUND²

A. *General Background*

At all times relevant to this action, Caravias was the controlling shareholder³ of Alta Pty Ltd. ("Alta Pty"), an Australian company.⁴ Alta Pty served as trustee for the Caravias Family Trust (the "Trust"), an Australian revocable trust⁵ of which Caravias was the trustor and principal beneficiary.⁶ Caravias was also a founder and

² The facts are drawn from the well-pleaded allegations of Caravias' complaint ("Compl.").

³ Caravias does not specify his percentage of ownership of Alta Pty, except to say the he is the "controlling shareholder."

⁴ Compl. ¶ 5. "Pty Ltd." designates a "proprietary limited company" under Australian law.

⁵ *Id.* ¶ 4.

⁶ *Id.* ¶¶ 5, 72.

43% shareholder of Alta Internet Business Centres Pty Ltd. (“Alta IBC”), an Australian company engaged in the business of providing managed Internet hosting and network application services.⁷ Caravias’ Alta IBC shares were part of the corpus of the Trust and registered in the name of Alta Pty, as trustee.⁸

B. *Bain Capital Gains Control of Interpath, Recapitalizes the Company, and Causes Interpath to Acquire Alta IBC*

In or about June 2000, Bain Capital, LLC and its various affiliates (collectively “Bain”) acquired a majority of the common stock of Interpath,⁹ which also was engaged in the business of providing managed Internet hosting and network application services.¹⁰ Bain and other investors then agreed to recapitalize the Company through two \$50 million investment tranches in exchange for Interpath equity securities.¹¹ The first \$50 million recapitalization investment was received by Interpath some time between June and August of 2000 (the “\$50M Pre-Closing Capitalization”).¹² Upon receipt of the \$50M Pre-Closing Capitalization, Interpath

⁷ *Id.* ¶¶ 6, 7.

⁸ *Id.* ¶ 7.

⁹ *Id.* ¶ 12.

¹⁰ Compl. ¶ 12.

¹¹ *Id.* ¶ 12.

¹² *Id.* Although Caravias does not plead a specific date for Interpath’s receipt of the \$50M Pre-Closing Capitalization, it must have been received between Bain’s acquisition of control of

issued 10,000,000 Class A shares and 1,111,111 Class L shares to Bain and other investors;¹³ those were the only issued and outstanding shares of Interpath's capital stock.¹⁴

In or about that same time period, Interpath, at Bain's behest, also sought to acquire Alta IBC in a stock-for-stock transaction whereby the Alta IBC shareholders would receive a mix of Interpath Class A and Class L shares approximately equal to a 3% equity stake in Interpath;¹⁵ in addition, because of the ongoing planned recapitalization of the Company, Interpath offered the Alta IBC shareholders anti-dilution protection pending receipt of the second \$50 million recapitalization investment (the "\$50M Post-Closing Capitalization").¹⁶ The Alta IBC shareholders, including Caravias, who was acting on behalf of Alta Pty, as trustee for the Trust, approved the transaction, and the parties entered into a stock purchase agreement

Interpath in June 2000 and the closing of the Alta IBC acquisition, discussed immediately below, in early August 2000.

¹³ *Id.* ¶ 23. Interpath had two classes of common stock: Class A and Class L. Investors apparently received both Class A and Class L shares in a ratio of 9:1. *Id.* ¶ 19.

¹⁴ *Id.* ¶ 24. At the time, Interpath had a total authorized capital stock consisting of 62,000,000 shares of Class A and 3,000,000 shares of Class L. *Id.*

¹⁵ Compl. ¶ 13.

¹⁶ *Id.* ¶ 14.

memorializing the terms of the transaction on or about August 4, 2000 (the “Alta Stock Purchase Agreement” or the “Agreement”).¹⁷

The issuance of the Interpath shares to the Alta IBC shareholders under the Alta Stock Purchase Agreement was tied to Interpath’s receipt of the recapitalization investments.¹⁸ Schedule 2.1 of the Agreement specified the number of shares to be issued to each Alta IBC shareholder immediately upon execution of the Agreement (the “Initial Buyer Shares”)¹⁹ and an anti-dilution multiplier that would be used to determine the number of shares to be issued upon Interpath’s receipt of the \$50M Post-Closing Capitalization (the “Adjustment Buyer Shares”).²⁰ Thus, at closing, Interpath issued a total of 300,000 Class A Initial Buyer Shares²¹ and 33,333 Class L Initial Buyer Shares²² to the Alta IBC shareholders, representing an aggregate 3% stake in the Company. In consideration of Caravias’ 43% ownership interest in Alta

¹⁷ *Id.* ¶ 15.

¹⁸ *Id.* ¶ 18.

¹⁹ The number of shares specified as Initial Buyer Shares was calculated based upon the number shares issued to Bain and other investors in exchange for the \$50M Pre-Closing Capitalization (*i.e.*, 10,000,000 Class A shares and 1,111,111 Class L shares). *Id.* ¶ 27.

²⁰ *Id.* ¶ 41.

²¹ Compl. ¶ 27 ((10,000,000 Class A shares issued and outstanding) x (3%) = 300,000 Class A Initial Buyer Shares to the Alta IBC shareholders).

²² *Id.* ((1,111,111 Class L shares issued and outstanding) x (3%) = 33,333 Class L Initial Buyer Shares to the Alta Pty shareholders).

IBC, and consistent with Schedule 2.1, Caravias (through Alta Pty, as trustee for the Trust) acquired a 1.291% stake in Interpath (*i.e.*, 129,100 shares of Class A²³ and 14,344 shares of Class L²⁴) in exchange for his Alta IBC shares;²⁵ additionally, in order to maintain his position in the Company, Caravias (through Alta Pty, as trustee for the Trust) was slated to receive Adjustment Buyer Shares equal to 1.291% of any additional shares issued by Interpath upon receipt of the \$50M Post-Closing Capitalization.²⁶

²³ *Id.* ¶ 29 ((300,000 Class A Initial Buyer Shares) x (43% Caravias Alta IBC Interest) = 129,100 Class A Initial Buyer Shares to Alta Pty, as trustee for the Trust).

²⁴ *Id.* ¶ 29 ((33,333 Class L Initial Buyer Shares) x (43% Caravias Alta IBC Interest) = 14,344 Class L Initial Buyer Shares to Alta Pty, as trustee for the Trust).

²⁵ The number of shares of Interpath Class A and Class L received by Alta Pty, as trustee for the Trust, was consistent with the 9:1 ratio of Class A to Class L at that time. *Id.* ¶ 31.

²⁶ *Id.* ¶ 46. Caravias attached a copy of Schedule 2.1 as an exhibit to his complaint. In support of its motion to dismiss, Interpath attached a complete copy of the Alta Stock Purchase Agreement, which includes a copy of Schedule 2.1, as an exhibit to its opening brief. Curiously, the two drafts of Schedule 2.1, although largely consistent, differ with respect to the anti-dilution multiplier for the Class L Adjustment Buyer Shares; Caravias' version of the document, as noted, specifies an anti-dilution multiplier for the Class L Adjustment Buyer Shares of 0.012910; Interpath's version, on the other hand, specifies an anti-dilution multiplier of 0.0014344. The parties have not yet offered an explanation for the dueling versions of Schedule 2.1. For purposes of this motion, the Court must accept as true Caravias' version of Schedule 2.1 and the Class L anti-dilution multiplier.

C. *Interpath Allegedly Breaches the Alta Stock Purchase Agreement and Dilutes Caravias and Alta Pty's Class L Interest*

Upon receipt of the \$50M Post-Closing Capitalization, Interpath issued an additional 19,999,997 shares of Class A²⁷ and 1,111,111 shares of Class L²⁸ to Bain and other recapitalization investors.²⁹ In accordance with the Alta Stock Purchase Agreement, it also issued Adjustment Buyer Shares to the Alta IBC shareholders, including Alta Pty. Accordingly, Caravias (through Alta Pty, as trustee for the Trust) received an additional 258,200 shares of Class A³⁰ and an additional 1,594 shares of Class L.³¹ Caravias acknowledges that he received the correct number of Class A Adjustment Buyer Shares,³² but he contends that he should have received

²⁷ Compl. ¶ 50.

²⁸ *Id.* ¶ 53.

²⁹ At some point prior to Interpath's receipt of the \$50M Post-Closing Capitalization, the Company declared a two for one stock split of its Class A shares; consequently, the ratio of Class A to Class L increased to 18:1. *Id.* ¶¶ 32, 33.

³⁰ *Id.* ¶ 51 ((19,999,997 newly issued shares of Class A) x (0.012910 anti-dilution multiplier) = 258,200 Class A Adjustment Buyer Shares to Alta Pty as trustee for the Trust).

³¹ *Id.* ¶ 56. The number of Class L Adjustment Buyer Shares actually issued to Alta Pty, evidently, was calculated by multiplying the number newly issued Class L shares by the anti-dilution multiplier specified in Interpath's version of Schedule 2.1 to the Alta Stock Purchase Agreement. Thus, the number of Class L Adjustment Buyer Shares actually issued to Alta Pty is derived as follows: (1,111,111 newly issued shares of Class L) x (0.0014344 Interpath anti-dilution multiplier) = 1,594 Class L Adjustment Buyer Shares to Alta Pty, as trustee for the Trust.

³² *Id.* ¶¶ 50-52.

14,344 Class L Adjustment Buyer Shares in accordance with the anti-dilution multiplier specified in Schedule 2.1 of the Alta Stock Purchase Agreement.³³ Thus, he claims a resulting deficiency in his Class L holdings of 12,750 shares (the “Deficiency Shares”).³⁴

D. *Caravias Dissolves the Trust and “Discovers” the Alleged Deficiency in his Interpath Class L Holdings*

In October 2004, Caravias, the trustor, caused the Trust to be dissolved.³⁵ The corpus of the Trust, including the Interpath shares, was transferred to Caravias.³⁶ As a result, Caravias succeeded to the interests of Alta Pty in the Interpath stockholdings and under the Alta Stock Purchase Agreement.³⁷ On or about October 18, 2004, Interpath reissued the Alta Pty shares in Caravias’ name.³⁸

³³ Compl. ¶ 55 ((1,111,111 newly issued shares of Class L) x (0.012910 Caravias anti-dilution multiplier) = 14,344 Class L Adjustment Buyer Shares).

³⁴ *Id.* ¶ 57 ((14,344 Class L Adjustment Buyer Shares per Caravias anti-dilution multiplier) – (1,594 Class L Adjustment Buyer Shares per Interpath anti-dilution multiplier) = 12,750 Deficiency Shares). Caravias also represents that his calculation of the number of Class L Adjustment Buyer Shares would be consistent with the then-applicable 18:1 ratio of Class A to Class L. As it stands, Interpath’s issuance of 1,594 Class L Adjustment Buyer Shares to Caravias (a Class A to Class L ratio of 162:1) effectively diluted his Class L ownership interest by a factor of nine to the benefit of the other Interpath shareholders generally, and to the benefit of Bain, in particular. *Id.* ¶ 63-69.

³⁵ *Id.* ¶ 73.

³⁶ *Id.*

³⁷ *Id.* ¶ 74.

³⁸ Compl. ¶ 75.

At that point, or some time thereafter, Caravias claims to have “discovered” the alleged shortfall in his Interpath Class L holdings.³⁹ Caravias sought issuance of the Deficiency Shares from the Company, but Interpath refused his requests.⁴⁰ Caravias took no legal action to remedy the deficiency.

E. *AT&T Acquires Interpath and Caravias Tenders His Interpath Shares*

In 2006, AT&T Corporation (“AT&T”), through a wholly-owned subsidiary, acquired Interpath in a cash-out merger which Bain negotiated on behalf of the Interpath shareholders.⁴¹ Caravias tendered all of his documented Interpath holdings through a “Transmittal of Tender” dated October 27, 2006.⁴² At or about the same time, he also tendered an “Error Description Letter” and an “Affidavit of Lost, Missing or Destroyed Certificate(s)” regarding the Deficiency Shares.⁴³ On or about October 27, 2006, the exchange agent paid Caravias merger consideration (as defined by the merger agreement) in the amount of \$1,376,306.88 for his documented Class A and Class L shares⁴⁴ but rejected his claim for the

³⁹ *Id.* ¶ 76.

⁴⁰ *Id.* ¶ 77-80.

⁴¹ *Id.* ¶ 81, 82.

⁴² *Id.* ¶ 87.

⁴³ *Id.* ¶ 88.

⁴⁴ Compl. ¶ 91.

undocumented Deficiency Shares.⁴⁵ Caravias took no further action until October 16, 2007, when he filed this action.

II. THE PARTIES' CONTENTIONS

Caravias asserts five claims against Interpath, all stemming from the alleged breach of the Alta Stock Purchase Agreement with respect to the Deficiency Shares. First, he seeks a declaratory judgment as to the number of Class L shares to which he is entitled under the Alta Stock Purchase Agreement. Second, he seeks an order compelling Interpath to issue the Deficiency Shares in accordance with the requirements of 8 *Del. C.* § 158. Third, he seeks an order compelling Interpath to accept his tender of the Deficiency Shares and to issue merger consideration for those shares. Fourth, he seeks an order compelling Interpath to perform under the Alta Stock Purchase Agreement to issue the Deficiency Shares. Finally, Caravias also seeks damages for Interpath's breach of the implied covenant of good faith and fair dealing.

Interpath has moved to dismiss under Court of Chancery Rule 12(b)(6) on several grounds. First, Interpath asserts that Caravias released and waived his claims relating to the Deficiency Shares when he tendered his Interpath holdings in

⁴⁵ *Id.* ¶ 93.

the AT&T merger and, therefore, that he ought now to be estopped from asserting those claims. In support of this defense, Interpath maintains that Caravias' purported effort to tender an affidavit evidencing his "lost" Deficiency Shares was an invalid tender under the procedures established for the AT&T merger; moreover, the valid tender of his documented Interpath shares constituted a release and waiver of the Deficiency Shares claim under the boilerplate release language of the form letter of transmittal. Second, Interpath contends that because the breach of the Alta Stock Purchase Agreement occurred some time before the Interpath shares were issued in Caravias' individual name in 2004, his claim is time-barred by laches and by 10 *Del. C.* § 8106, the three-year statute of limitations for contract claims. Finally, Interpath argues that Caravias lacks standing to assert a claim arising under the Alta Stock Purchase Agreement because he was neither a party to the Agreement, nor an intended third-party beneficiary, nor the successor to Alta Pty under the Agreement.

III. ANALYSIS

A. *The 12(b)(6) Standard*

On a motion to dismiss pursuant to Court of Chancery Rule 12(b)(6), the Court is required to accept as true all well-pleaded allegations in the complaint;⁴⁶ unsupported and conclusory allegations, however, will not be credited.⁴⁷ The Court also must draw all reasonable inferences in favor of Caravias, the non-moving party.⁴⁸ Essentially, the Court must be convinced that there is no set of facts to be inferred from the complaint upon which Caravias might prevail on his claims. In addition, where, as here, a party asserts affirmative defenses, such as waiver, estoppel, or laches, in support of its motion to dismiss, the facts of the complaint must incontrovertibly establish the defense.⁴⁹

⁴⁶ *Globis Partners, L.P. v. Plumtree Software, Inc.*, 2007 WL 4292024, at *4 (Del. Ch. Nov. 30, 2007).

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Apple Computer, Inc. v. Exponential Tech., Inc.*, 1999 WL 39547, at *9 (Del. Ch. Jan. 21, 1999).

B. *Interpath's Laches Defense*⁵⁰

⁵⁰ Given Interpath's time-bar defenses, it is not necessary to engage in an extensive analysis of Interpath's other affirmative defenses of waiver and estoppel. In short, it should suffice that those defenses are too fact-intensive for adjudication on a motion to dismiss. Nevertheless, a brief digression on Interpath's waiver argument is warranted.

Interpath contends that the form letter of transmittal submitted by Caravias with his certificated Interpath shares in connection with the AT&T merger contained waiver provisions that released any and all claims he might have had against the Company with respect to the Deficiency Shares. Interpath further contends that the "second" form letter of transmittal submitted by Caravias along with his affidavit attesting to his entitlement to the Deficiency Shares was invalid and barred by the "first" letter of transmittal which waived any claims against the Company, including those referenced by the "second" letter of transmittal. In other words, Interpath views the two letters of transmittal as distinct and makes a technical argument that because the Deficiency Shares were not referenced in the "first" letter of transmittal, and because the "first" letter of transmittal contained a release and waiver of all other claims, the "second" letter of transmittal is not only invalid because it sought merger consideration for uncertificated shares but also (and, more importantly) it pertains to a claim against the Company that technically was released in the "first" letter of transmittal. Caravias counters, in an affidavit that is beyond the scope of the present motion, that although he submitted two letters of transmittal—one covering the certificated shares and the other an affidavit attesting to the Deficiency Shares—both letters were received by the transfer agent at the same time and in the same UPS envelope. Thus, he argues, that there is no merit to Interpath's argument that the "first" letter of transmittal trumps the "second" and constitutes a waiver of his Deficiency Shares claim; instead, he suggests that the two letters of transmittal were a single tender because they arrived simultaneously in the same envelope.

Although Caravias makes reference to the two letters of transmittal in his complaint, and, therefore, the Court may consider them and their waiver provisions on a motion to dismiss, the resolution of the waiver defense in this case requires the Court to look beyond the four corners of the complaint and the documents incorporated by reference. It is possible to infer from the allegations in the complaint that the two letters of transmittal were a single tender and not two distinct transmittals such that one might trump the other; on a motion to dismiss, at least, the Court must make that inference. Thus, although Interpath's argument may ultimately prevail, there is enough factual ambiguity in the complaint to prevent the Court from reaching it at this stage of the proceedings.

Similarly, the Court does not deem it necessary to consider Interpath's standing defense in any detail; one may fairly infer from the allegations in the complaint that Caravias succeeded to all of the rights of Alta Pty upon dissolution of the Trust in October 2004 and, therefore, that he has standing to assert these claims. *See, e.g.*, Compl. ¶ 74.

The timing of Caravias' complaint appears to be problematic, but his skillful pleading precludes (barely) that conclusion as a matter of fact and law. Caravias' most salient problem is that the breach of the Alta Stock Purchase Agreement probably occurred outside the three-year limitation period prescribed by 10 *Del. C.* § 8106; indeed, one can infer that fact from the complaint. Furthermore, it also is a reasonable inference that Caravias knew or should have known about the breach of the Agreement when it occurred, either because he can be charged with personal knowledge through his actions on behalf of Alta Pty, as trustee for the Trust, or because he should have been on inquiry notice as the beneficiary of the Trust. The factual pleadings in the complaint, however, do not inexorably bear out the exclusive inferences necessary for the Court to draw those conclusions in this context.

A second laches problem confronting Caravias is his baffling delay in otherwise asserting these claims. The record shows that he had numerous opportunities to assert his claims in a timely manner and that time and again he chose not to do so. For example, he contacted Interpath regarding the Deficiency Shares some time after October 18, 2004 and the Company ignored his complaint;

yet, he took no legal action to vindicate his rights. He also attempted to rectify the problem through his tender in the AT&T merger; that claim was summarily rejected by the exchange agent, but, again, Caravias did nothing for nearly a year to address the situation. On a more developed factual record, those facts alone could prove fatal to Caravias' claims, but, again, the confines of a motion to dismiss preclude the Court from drawing a definitive conclusion.⁵¹

In short, despite the significant laches problems lurking in Caravias' complaint, with the limited range of facts available to the Court on a motion to dismiss and with its plaintiff-friendly standard of review, the Court cannot escape the possible (although not very likely) scenario in which Caravias did not, in fact, discover, or have reason to discover, his claim until October 18, 2004 or some time thereafter; accordingly, it is possible that his claim, which was filed on October 16, 2007, is not subject to a time-bar defense, and, therefore, Interpath's motion must be denied.

⁵¹ The Court also hesitates to find that Caravias' claims are barred by laches on a period of time that is shorter than the analogous three-year statute of limitations for a breach of contract claim on a motion to dismiss, particularly where there is no readily identifiable detriment or harm to Interpath (except, ultimately, the payment of money damages) resulting from the delay.

IV. MANAGEMENT OF DISCOVERY

As noted above, with a more developed factual record, there is a likelihood that Interpath will be able to prevail on a time-bar defense. Therefore, in accordance with Court of Chancery Rule 26, and in the interests of economy and efficiency, the Court will stay discovery in this matter, except discovery relating to Interpath's time-bar defenses, pending consideration of that issue under a summary judgment standard.⁵² Under the circumstances, it would be a waste of resources and unduly burdensome to allow Caravias to proceed with discovery on his substantive claims until the Court has had an opportunity to address the time-bar defense on a more fully developed record.

V. CONCLUSION

For the foregoing reasons, Interpath's motion to dismiss under Court of Chancery Rule 12(b)(6) is denied. Discovery shall proceed as described above and shall otherwise be stayed pending the opportunity to focus on Interpath's time-bar defenses on summary judgment.

⁵² Ct. Ch. R. 26(b)(1); *cf.* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 6-3, at 6-10.1 (2007) (Where a case dispositive motion, such as a motion to dismiss, is pending before the Court, "it has long been recognized that a trial court has the power to stay or limit the scope of discovery as part of its overall discretion to control and supervise the discovery process.").

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IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap

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