IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

C. ROBERT COATES,	)	
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
NETRO CORPORATION, a Delaware corporation, NETRO CORPORATION, a California corporation, GIDEON BEN-EFRAIM, RICHARD M. MOLEY, ROBERT J. WYNNE, SANFORD ROBERTSON, IRWIN FEDERMAN and THOMAS R. BARUCH,	)	Civil Action No. 19154
	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: August 6, 2002
Date Decided: September 11, 2002

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Allen M. Terrell, Jr., Gregory P. Williams and Thad J. Bracegirdle, of RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; OF COUNSEL: Dennis E. Glazer, John J. Clarke, Jr., and David B. Toscano, of DAVIS POLK & WARDWELL, New York, New York, Attorneys for Defendants.

CHANDLER, Chancellor

This case involves a redomestication merger of a California corporation into a Delaware corporation, and the subsequent adoption of a poison pill rights plan. The defendants-the board of directors and the corporation-filed a motion to dismiss. The plaintiff shareholder alleges various breaches of disclosure and fiduciary duties. None of the allegations, however, state a claim upon which relief can be granted. The plaintiff also failed to make a demand on the board under the second count of the complaint, which is a derivative claim. Therefore, on these grounds, I grant defendants' motion to dismiss.

I. BACKGROUND FACTS

Netro Corporation was a California Corporation ('Netro California"). The board of directors for Netro California decided that redomestication to Delaware would best serve the interests of the corporation. The board planned to accomplish the redomestication by merging into a wholly owned subsidiary incorporated in Delaware. The resulting company ("Netro") is now a Delaware corporation. Netro has about 202 shareholders, the largest of which is Telecom, a 15% shareholder.

On April 26, 2001, the board disseminated a proxy statement to the shareholders with a proposal outlining the merger plan and discussing the differences between Delaware and California corporate law. The board of directors included a disclaimer that their recommendation should be tempered

based on the fact that Delaware law provided more protections for the board. The board also attached a copy of the resulting Certificate of Incorporation ("Certificate") and a copy of the by-laws that would survive after the merger.

The annual meeting was held on May 3 1,200 1. The meeting was adjourned overnight and reconvened on June 1, 200 1. It is alleged that the polls were held open through June 1, 2001. The Form 1 OQ filed on August 14, 2001, stated that 50.44%' of the outstanding shares voted in favor of the merger. After the merger, on July 19, 2001, Netro's board of directors approved a rights plan, or "poison pill."

The plaintiff filed this action on October 5, 200 1, alleging that the redomestication merger and the related anti-takeover devices are invalid. The plaintiff also alleges that the poison pill is invalid. The plaintiff is a holder of 986,500 shares of Netro common stock. The defendants filed a motion to dismiss under Court of Chancery Rule 12(b)(6) on November 30, 2001. After briefing and oral argument, this is the Court's decision in that motion.

II. STANDARD OF REVIEW

The standard governing a Rule 12(b)(6) motion to dismiss is well established. A party is entitled to dismissal of the complaint only where it is clear

[1] 26,283,352 shares out of 52,103,464 outstanding shares voted in favor of the transaction. See Compl. ¶ 33.

from its allegations that the plaintiff would not be entitled to relief under any set of facts that could be proven to support the claim. Moreover, the Court is required to accept all of plaintiffs factual allegations as true and give plaintiff the benefit of all inferences that may be drawn from the facts. Disrnissal is appropriate under Rule 12(b)(6) only where it appears with a reasonable certainty that a plaintiff would not be entitled to the relief sought under any set of facts that could be proven to support the action.

III. ANALYSIS

Plaintiff alleges two causes of action in his complaint. Neither cause of action states a claim upon which relief can be granted.

A. Count I—The Redomestication Merger and Related Anti-Takeover Devices

Plaintiffs first count involves seven allegations of irregularities affecting his voting and contractual rights.

1. "[B]ecause invalid proxies were counted, the Redomestication Merger did not receive sufficient valid votes to be approved under applicable law."[2]

[2] Compl. ¶ 48.

The final vote on the Redomestication Merger resulted in 50.44% of the shareholders voting in favor of the merger.[3] Plaintiff alleges that this is not enough because "[t]he error rate for proxies in an uncontested proxy count *would likely be* higher than 1%,"[4] and "[i]t is *highly unlikely* that in a public corporation with thousands of stockholders . . . there would not have been a significant number of invalid proxies submitted."[5] These are unsupported, conclusory allegations.

Nothing is alleged in the complaint to show that any of the proxies were invalid; nor can any inference reasonably be drawn from the mere statement that the existence of invalid proxies is *likely*. No effort was made by the plaintiff to challenge the vote count or to use any remedy provided by California law[6].

California law states that the "report or certificate made by the inspectors of election is prima facie evidence of the facts stated therein."[7] The plaintiffs allegations do not overcome the presumption that the results were correct. The proper way to challenge the result was by following California law, which the plaintiff failed to do. These allegations do not support a claim upon which relief can be granted.

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[3] Compl. ¶ 33.
[4] Id. (emphasis added).
[5] Id. (emphasis added).
[6] California law governs the vote on the Redomestication Merger. The corporation was not yet a Delaware Corporation, so Delaware law does not apply.
[7] CAL. CORP. CODE § 707 (Deering 2002).

2. "[K]eeping the polls open for the purpose of sweeping the street to find sufficient votes to approve the anti-takeover merger constituted a breach of fiduciary duty by the directors."[8]

First, California law applies to this allegation, since this is about the California corporation. California law allows adjournments of meetings, allows inspectors of elections to determine when the polls should close, and suggests that this determination should be given broad latitude and reviewed only for abuse of discretion.[9] No violation of California corporate law was plead.

Second, even if Delaware law applied, the plaintiff does not show "that the primary purpose of the board's action was to interfere with or impede exercise of the shareholder franchise."[10] Therefore, the adjournment receives the benefit of the business judgment presumption. Defendants' action survives under the business judgment rule, because they adjourned the meeting for just one day and received sufficient votes to approve the merger. The plaintiffs only allegation is that all of the proxies were not valid. That conclusory statement has already been dealt with and dismissed. Therefore, regardless of which law applies, there is no cognizable claim resulting from this allegation.

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[8] Compl. ¶ 48.
[9] *See Clopton v. Chandler,* 150 P. 1012 (Cal. Ct. App. 1915).
[10] *State of Wisconsin Inv. Bd. v. Peerless Sys. Corp., 2000* Del. Ch. LEXIS 170 at *32 (Del. Ch.).

3. "[T]he Merger and anti-takeover certificate provisions were not validly effected in accordance with applicable law and the anti-takeover provisions were inserted into Netro's certificate in violation of law and the Merger Agreement."[11]

First, the merger needed to comply with California law. There is no allegation that it did not comply with applicable California law; nor is there an allegation that the Delaware corporation did not comply with § 252 of the Delaware General Corporate Law ("DGCL"). The only allegation is that the California corporation did not follow Delaware law. It was not supposed to, thus this allegation fails to state a claim.

Second, as to the certificate amendment, the shareholders approved the proxy statement with the amended certificate of incorporation attached to the statement. When the merger was completed, the certificate matched the one attached to the proxy statement. Had it not, the plaintiff could assert a breach of the duty of disclosure. The shareholders, however, received what they voted for. There thus was no breach of the duty of disclosure.

[11] Compl. ¶ 48.

4. "[T]he stockholder vote on the Redomestication Merger was not fully informed because material information was misstated or withheld from the stockholders."[12]

The disclosure allegations here are several and weak. None of them constitute a claim for relief. The proxy statement has a fifteen page point-by-point comparison of Delaware and California law. That entire discussion is qualified in its entirety by reference to the actual Certificate and bylaws, which are attached to the proxy statement. Nevertheless, the plaintiff raises eight disclosure issues.

First, plaintiff says the defendants needed to include evidence, explanations, and examples to support statements about the differences between California and Delaware law, rather than merely describing those differences. That is not required. If the differences described by the defendants were incorrect, I am certain the plaintiff would raise that issue loudly and vigorously. Requiring the defendants to back up the statements with the evidence needed to win at trial would be immaterial, unnecessary and overly confusing to the shareholders.

Second, plaintiff says that defendants should have disclosed the threat they were responding to by redomesticating and adding defenses. The defendants claim there was no specific threat. The threat identified by the plaintiff that Telecom was trying to take over Netro, is contradicted by the same Telecom SEC filings

[12] Compl. ¶ 48.

relied on by the plaintiff. Those filings expressly disclaim any intention to seek control of Netro. No threat need be disclosed if no threat exists. It was reasonable for the. defendants to take Telecom at its word, so nothing existed to disclose. Therefore, this allegation fails as a matter of law.

Third, plaintiff states that the defendants did not correctly describe the significance of changing the board from two equally sized classes to three classes. Such a description would be immaterial. The alleged significance of this, according to the plaintiff, was that the change would "insure that it would take at least two proxy contests and two annual meetings in order to change a majority of the board."[13] That statement is true, but was also true under the makeup of the board prior to the change. Thus, there was no significant difference for the defendants to discuss.

Fourth, the plaintiff alleges that the proxy statement indicated that shareholders could call a special meeting and bring business before the meeting, but that the by-laws removed that right and only allowed the board to bring business before the meeting. That is a misreading of the by-laws. The by-law allows both the person calling the meeting and the board to bring business before

[13] Compl. ¶ 20.

the meeting.[14] That is not any different from the language quoted from the proxy statement. Thus, no disclosure violation occurred.

Fifth, plaintiff contends that the proxy statement is defective because it says that a few provisions-about special meetings, removal of directors, and filling of vacancies on the board-are in the bylaws when those provisions are actually in both the bylaws and the Certificate of Incorporation. Plaintiff alleges the proxy statement was "misleadingly incomplete"[15] because it failed to reveal that those provisions could only be amended with approval of both the board and the stockholders.

The Certificate was attached to the proxy statement. All discussions of the Certificate and the by-laws were qualified in their entirety by reference to the attached documents. The proxy statement was complete. All the necessary information was available to the shareholders, and the shareholders were directed to refer to those documents. Nothing was omitted or misrepresented and, thus, no breach of disclosure occurred.

Sixth, the plaintiff alleges that the proxy statement misled the shareholders by stating that indemnification was required under Delaware law. This is also a misreading of the proxy statement. The proxy statement lists nine bullet points

[14] Compl. ¶ 21.
[15] Compl. ¶ 22.

correctly characterizing Delaware indemnification law. The statement that is allegedly misleading merely states that the by-laws will reflect the required aspects of Delaware law with respect to indemnification. That is a statement ensuring the shareholders that the board is complying with all requirements of Delaware law. This is not misleading, nor is it a breach of disclosure.

Seventh, plaintiff states that the defendants did not disclose their intention to adopt a poison pill. There was no evidence alleging that the defendants intended to adopt a pill at that time, but, even so, the merger had nothing to do with the poison pill. Defendants could have adopted a pill any time, either before or after the merger. No disclosure was necessary, nor was any reason for disclosure alleged in the complaint.

Finally, plaintiff states that defendants should have described how $203 of the DGCL would have affected Telecom, Netro's largest shareholder. This information is not material to a shareholder voting on whether to approve a redomestication merger, especially when § 203 is described in great detail in the proxy statement. Therefore, this allegation is not material and does not state a claim.

None of the above allegations, individually or collectively, state a claim for breach of the duty of disclosure. Accordingly, all of these allegations are dismissed.

5. "[T]he defendant directors breached their fiduciary duties in approving and recommending the Redomestication Merger."[16]

No allegations to support this statement are developed in the complaint. A mere conclusory statement that the defendants breached their fiduciary duties is not enough to survive a motion to dismiss. The defendants, in fact, were clear in the proxy statement that a possible conflict of interest may arise from the greater protections afforded directors under Delaware law. The defendants emphasized that conflict to temper their recommendation to the shareholders.[17] This is the only evidence of any conflict, and it is specifically stated to warn the shareholders in evaluating the board's recommendation. Thus, no cognizable breach has been alleged.

6. "[D]efendants are estopped from maintaining the anti-takeover provisions."[18]

No explanation is made, in the complaint or in plaintiffs brief filed with the Court, for why the defendants should be estopped. The defendants never stated that they would not implement anti-takeover provisions. The anti-takeover provisions as implemented are not alleged to violate California or Delaware law.

[16] Compl. ¶ 48.
[17] See Proxy Statement p.24.
[18] Compl. ¶ 48.

Thus, there is no reason why defendants should be estopped from maintaining the anti-takeover provisions.

7. "[C]ertain of the measures contained in Netro's certificate and by-laws are invalid under Delaware law."[19]

The complaint fails to allege which measures are invalid or why. All of the defensive measures adopted by the defendants are permitted under Delaware law. The measures include a classified board, § 203, limits on shareholder action, and the poison pill. These are not invalid by virtue of plaintiff alleging them to be invalid. This allegation of the complaint fails to state a claim.

All seven of the allegations in Count I of the complaint fail to state a claim upon which relief can be granted. Therefore, the motion to dismiss Count I of the complaint is granted.

B. Count II-The Poison Pill

The second count of the complaint alleges that the adoption of the poison pill was a breach of the defendants' fiduciary duties because it was not a reasonable response to any perceived threat. Thus, the plaintiff wants the poison pill rights plan declared invalid.[20] This count fails in two ways. First, it is a derivative claim and no demand was made on the Board, nor was the futility of

[19] Compl. ¶ 48.
[20] Compl. ¶ 50.

such demand shown. Second, the count fails to state a claim upon which relief can be granted.

1. Plaintiffs failure to make demand.

The complaint characterized the claim as a direct one. The distinction between derivative and direct claims can be hazy, but this claim is clearly derivative.

The standard for distinguishing direct and derivative claims was established in ***Moran v. Household Int'l, Inc.***[21] ***Moran*** involved the adoption of a poison pill rights plan, and certain shareholders brought direct claims based upon violations of their contractual rights. Then-Vice Chancellor Walsh determined that, since the shareholders suffered no distinct injury, "such an action must be brought derivatively on behalf of the corporation."[22]

The situation is no different here. The allegation is that the Board breached its fiduciary duties by adopting the poison pill rights plan. No distinct injury was alleged. Therefore, the claim must be brought on behalf of the corporation. Since it is a derivative claim, demand must be made on the board, or excused based upon futility.[23] Failure to make demand results in dismissal of the complaint.[24]

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[21] See 490 A.2d 1059 (Del. Ch. 1985).
[22] Id. at 1070.
[23] See Court of Chancery Rule 23.1.
[24] *See id.*

Demand, however, may be excused if facts are alleged showing that demand would be futile. To determine "demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[25] No facts were alleged, or can even remotely be inferred, that futility of demand was present here. Therefore, Count II is dismissed for failure to make demand upon the Board.

2. Plaintiffs failure to state a claim.

Even if the plaintiff properly showed demand futility, the complaint still fails to state a claim upon which relief can be granted.

It is true that the adoption of a precautionary defensive measure does require the board to justify its action.[26] The adoption of a precautionary defensive device, however, does not automatically mean that the complaint will survive a motion to dismiss.[27]

The complaint does not allege any legally cognizable harm to the corporation or the shareholders. The complaint only alleges the possibility that the board could later deploy the poison pill to deter an unwanted threat. That

[25] *Aronson v. Lewis, 473* A.2d 805, 814 (Del. 1984).
[26] *See Moran v. Household Int'l, Inc.,* 5A.2d1346, 1356 (Del. 1985).
[27] *See Chrysogelos v. London,* 1992 Del. Ch. LEXIS 61 at *12-*18 (Del. Ch.).

"possibility-presently abstract and divorced from any actual or threatened use against a specific, impending proposal-does not give rise to an actionable claim."[28] Since the plaintiff fails to allege any specific threat or show any harm by the adoption of the poison pill rights plan, Count II must be dismissed for failure to state a claim.

IV. CONCLUSION

The plaintiff fails to state any claims upon which relief can granted. As to the second count of the complaint, the plaintiff failed to make demand upon the Board or to show the futility of such a request. Therefore, I grant the defendants' motion to dismiss.[29]

IT IS SO ORDERED.

[28] Id. at *13.

[29] After the motion to dismiss was fully briefed (and on the eve of oral argument), plaintiff moved to supplement the complaint. The proposed supplemental complaint includes allegations regarding certain recent events that occurred after the present complaint was filed. It would appear that these new allegations would more properly be asserted in a new filing against defendants. Counsel, however, should advise the Court how they wish to proceed after receiving this decision.