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November 21, 2005

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Re: Gentile, et al. v. Rossette, et al.  
C.A. No. 20213-NC  
Date Submitted: November 10, 2005

Dear Counsel:

Plaintiffs seek certification of an interlocutory appeal of a portion of the Court's order (the "Order") of October 20, 2005, which granted partial summary judgment to Defendants with respect to a claim that the Defendants breached their

fiduciary duties as directors of SinglePoint Financial, Inc. (“SinglePoint”) when they authorized the issuance of a substantial number of shares of SinglePoint to Defendant Pasquale David Rossette (“Rossette”) at a price substantially below its fair value. Rossette acquired his shares for \$0.05 each even though, just a few weeks before, he had recognized a fair price of \$0.50 per share.<sup>1</sup> Although Rossette was the majority shareholder of SinglePoint at the time of the challenged transaction, he increased his voting control of SinglePoint from approximately 61% to approximately 93%. The Plaintiffs claim that issuance of these additional shares diluted their voting rights in SinglePoint.

SinglePoint merged into a subsidiary of Cofiniti, Inc. some six months after the challenged transaction, but the Plaintiffs have not demonstrated that the issuance of additional shares was part of a scheme linked up to (or a part of) the merger process.

The Court, as set forth in its memorandum opinion (the “Opinion”) accompanying the Order, concluded that the Plaintiffs, as former shareholders of SinglePoint, lost standing to pursue their claims upon the merger of SinglePoint.

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<sup>1</sup> Rossette acquired the shares, not for a payment of cash, but, instead, pursuant to a conversion of debt.

As derivative claims, they passed to the acquiring corporation upon completion of the merger. The Plaintiffs, however, contend that their share dilution claim is a direct claim and, thus, survives the merger.

The determination of whether a claim is derivative or direct is guided by the seminal decision of *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,<sup>2</sup> which sets forth a seemingly straightforward inquiry:

[A] court should look to the nature of the wrong and to whom the relief should go. The stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.<sup>3</sup>

*Tooley's* application to shareholder dilution claims, however, may be vexing because the issuance of stock for no (or grossly insufficient) consideration has two distinct consequences. First, the issuance of stock for insufficient consideration is generally viewed as a waste of corporate assets.<sup>4</sup> Second, by improperly issuing

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<sup>2</sup> 845 A.2d 1031 (Del. 2004).

<sup>3</sup> *Id.* at 1039.

<sup>4</sup> The view that issuing stock for grossly insufficient consideration states a waste claim reflects an understanding that stock to be issued is, in substance, an asset of the corporation. Implicitly rejected is the notion that such a transaction should be subject to challenge by the affected shareholders directly on the grounds that it necessarily reduces the percentage equity interest held by the nonparticipating shareholders and the value of their holdings without the receipt by the corporation of assets commensurate with the value of the stock that is issued.

additional shares for insufficient consideration, the voting power of the other stockholders and their relative equity holdings are diminished. The Plaintiffs now focus on the impact to their voting rights.

The question posed by the Plaintiffs is whether they can obtain any remedy for the issuance of stock for little or no value when that transaction is followed by a merger that precludes pursuit of a derivative claim. The waste claim passes to the acquiring corporation. Their stockholder dilution claim, based on the Order,<sup>5</sup> has escaped any judicial review.<sup>6</sup> Ultimately, the Plaintiffs, in the Court's view, were unable to demonstrate that they can "prevail without showing an injury to the corporation," because their dilution claim cannot exist independently of the harm suffered by SinglePoint.

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<sup>5</sup> This case does not present a question involving a material change in voting power, such as an increase in the insider's holdings from less than 50% to more than 50% (or increasing the holdings above some supermajority shareholder vote threshold). Here, Rossette's holdings were increased substantially as a percentage of outstanding shares, but his voting power (*i.e.*, the power to control the outcome of any shareholder vote) and the voting power of the minority shareholders did not change materially.

<sup>6</sup> See *Gentile v. SinglePoint Fin., Inc.*, 2003 WL 1240504, at \*5, n.36 (Del. Ch. Mar. 5, 2003) (related appraisal action in which the Court speculated that "no forum may be available for injured shareholders [in this context] to assert their dilution claims").

Applications for interlocutory review, governed by Supreme Court Rule 42, require the exercise of the Court's discretion and "are granted only in exceptional circumstances."<sup>7</sup> A party seeking certification of interlocutory appeal must provide satisfactory answers to three questions: First, did the Order determine a substantial issue; second, did it establish a legal right; and third, has the party satisfied any of the other itemized criteria of Supreme Court Rule 42(b), ranging from the criteria for a certified question of law to whether "a review of the interlocutory order may terminate the litigation or may otherwise serve considerations of justice"? The Plaintiffs can easily satisfy the first two prongs of this test; the third is more problematic.

Because the Order resolved a substantive legal issue (whether the Plaintiffs have standing to pursue their share dilution claim), the Order resolved a substantial issue. Furthermore, by concluding that the Defendants are entitled to judgment in their favor with respect to the question of whether the Plaintiffs have standing to pursue the shared dilution claim, the Order and Opinion also established a legal

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<sup>7</sup> *Duthie v. Kohls*, 2000 WL 1589799 (Del. Aug. 29, 2000).

right in the Defendants (the right to be free from the claim of shareholder dilution).<sup>8</sup>

Although not free from doubt, considerations of justice, within the meaning of Supreme Court Rule 42(b)(v), will be served by appellate review of that portion of the Order dismissing the Plaintiffs' share dilution claim now instead of at a later date, when the balance of the litigation is resolved. It may be, as argued by the Defendants, that with limited effort they will be able to supplement their previous summary judgment application with respect to the Plaintiffs' remaining claims and prevail, but that is, for present purposes, speculative. Instead, if this matter is to be tried, it would be more efficient if the trial could address all claims properly asserted by the Plaintiffs, including perhaps those claims which the Court has precluded because of its view that they are derivative and not direct. Thus, an interlocutory appeal would serve the beneficial purposes of allowing for a more efficient trial preparation effort and avoiding the risk of a need for two trials.<sup>9</sup>

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<sup>8</sup> See generally DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY §14-4[a]-14-4[b] (2005).

<sup>9</sup> The Plaintiffs also contend that certification is appropriate because the Opinion conflicts with other decisions of both this Court and the Delaware Supreme Court. The Court does not reach this ground for certification.

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Accordingly, an order granting leave to the Plaintiffs to appeal the Order on an interlocutory basis will be granted.<sup>10</sup>

Very truly yours,

*/s/ John W. Noble*

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cc: Register in Chancery-NC

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<sup>10</sup> The Defendants have also sought leave to appeal from that portion of the Order which denied their motion for summary judgment with respect to the claim associated with the merger. That claim is separate and distinct from the shareholder dilution claim for which the Plaintiffs seek an interlocutory appeal. Moreover, that aspect of the Court's decision was premised primarily upon the Court's perception that there are disputed questions of material fact. Under these conditions, an interlocutory appeal is particularly unhelpful, and that is why denials of summary judgment are rarely subject to interlocutory appeal. More specifically, the Defendants cannot demonstrate that the Order, to the extent that they seek to challenge it, determined a substantial issue or established a legal right.