EFiled: Feb 28 2013 05:14PM EST
Transaction ID 49860633
Case No. 3940-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE NINE SYSTEMS CORPORATION SHAREHOLDERS LITIGATION	))))	Consol. C.A. No. 3940-VCN

MEMORANDUM OPINION

Date Submitted: October 17, 2012
Date Decided: February 28, 2013

Anne C. Foster, Esquire and Blake Rohrbacher, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware; Lawrence D. Rosenberg, Esquire, Paul V. Lettow, Esquire, James M. Burnham, Esquire, Matthew F. Kuhn, Esquire of Jones Day, Washington, D.C.; and Robert C. Michelletto, Esquire of Jones Day, New York, New York, Attorneys for the Fuchs Plaintiffs.

Richard D. Heins, Esquire, Andrew D. Cordo, Esquire, and Stacy L. Newman, Esquire of Ashby & Geddes, Wilmington, Delaware, and Richard G. Haddad, Esquire, Stanley L. Lane, Jr., Esquire, and Denaka L. Perry, Esquire of Otterbourg, Steindler, Houston & Rosen, P.C., New York, New York, Attorneys for Defendants.

NOBLE, Vice Chancellor

Many shareholders of Nine Systems Corporation, formerly Streaming Media Corporation, (the "Corporation" or "NSC") were surprised to receive notice in 2006 that Akamai Technologies, Inc. ("Akamai") was proposing to acquire the Corporation for $175 million. Those shareholders had heard virtually nothing from NSC during the preceding four years. When last heard from, NSC was in dire financial straits. Those shareholders soon came to appreciate—maybe some had been afforded some timely knowledge—that three large shareholders in late 2001 and 2002 had expropriated much of the minority shareholders' economic interests and voting power. Those shareholders objected to the series of events—the "self-dealing transactions," as they call them—and brought this action well after Akamai completed its acquisition of the Corporation.

Those shareholders—and the Court for that matter—are now confronted with Defendants' summary judgment motion that, if successful, will defeat many of their claims. In addition to several relatively narrow issues, the major questions posed by the pending motion are (1) whether there was a control group that, under the teaching of *Gentile v. Rossette*,[1] would allow those former shareholders to continue to have standing to pursue their claims of dilution that supposedly occurred some four years before the Akamai acquisition; (2) whether various groups of shareholders were not owed fiduciary duties at the time of the self-

[1] 906 A.2d 91 (Del. 2006).

dealing transactions because they either were debt (and not equity) holders or held their interests in the Corporation through yet another entity whose dissolution and subsequent transfer of NSC shares may not have occurred until after those acts; and (3) whether NSC's disclosure of some facts about the dilutive acts provided certain shareholders with enough knowledge to conclude that they were guilty of laches.

I. BACKGROUND[2]

The Plaintiffs are former shareholders of NSC.[3] Some of the Plaintiffs purchased NSC common stock in the spring of 2000. Some invested in NSC through Streaming Media Investment Group, LLC ("SMIG"), which had been established to facilitate investment in NSC.[4] Plaintiffs who invested in 2000 had stock purchase agreements with most-favored nation clauses.[5] In 2001, other

---

[2] Although the critical events took place essentially within no more than a few months, the issues developed over several years and are somewhat complicated factually. This factual background is not intended to be (and it is not) comprehensive. For example, the question (and its relevance, if any) of whether NSC had any hope for survival in the absence of a cash infusion from Defendants is avoided. Summary judgment is not an ideal procedural mechanism for detailing an extensive and frequently conflicting fact pattern. The question is not so much what are the undisputed facts as it should be which inferences may reasonably be drawn. The issues are framed in the sections of this Memorandum Opinion in which they are addressed.

[3] Sheldon Dubroff and Mervyn Klein are plaintiffs in Civil Action No. 3940-VCN. Their claims, except for disclosure claims, have been dismissed. In Civil Action No. 6017-VCN, there are forty-three plaintiffs who are sometimes referred to as the "Fuchs Plaintiffs," a title that traces to the Lead Plaintiff in that group, Morris Fuchs. These actions have been consolidated. *See Dubroff v. Wren Hldgs., LLC*, 2011 WL 5137175 (Del. Ch. Oct. 28, 2011) ("*Dubroff II*").

[4] Transmittal Aff. of Stacy L. Newman in Supp. of Defs.' Mot. for Summ. J. ("Newman Aff.") Ex. 8 (SMIG Subscription Agmt.).

[5] A subsequent investor, one of the Defendants, purchased NSC stock and acquired anti-dilution protection and pre-emptive rights. Thus, the NSC investors at the time with most-favored nation protection received those benefits as well.

Plaintiffs purchased NSC Subordinated Notes with warrants.[6] These were later converted into NSC common stock; they also received anti-dilution protection for their shares.[7] Finally, yet another group of Plaintiffs acquired Senior Secured Notes and Warrants in August 2001.[8] In the spring of 2002, they agreed to surrender the warrants and convert the notes into equity with Preferred A stock issued in August 2002.

The Plaintiffs contend that NSC's three largest shareholders—Defendants Wren Holdings, LLC ("Wren"), Javva Partners, LLC ("Javva"), and Catalyst Investors, L.P. ("Catalyst") (collectively, the "Entity Defendants")—conspired in 2002 to recapitalize the Corporation to the Plaintiffs' detriment. With their ownership of 54.3 percent of NSC, the Entity Defendants designated three of the five members of the board. Defendant Howard Katz served as Javva's managing member and representative on NSC's board. Defendant Christopher Shipman represented Catalyst on the board until 2006 when he was replaced by Tyler Newton. Defendant Dort A. Cameron, III was a co-owner and the board designee of Wren.[9]

The Plaintiffs were generally persuaded to invest in NSC by Abraham Biderman, who then worked for Lipper & Company ("Lipper") and who, on

---

[6] Newman Aff. Ex. 18 (Subordinated Note Term Sheets).
[7] *Id.* at Ex. 23.
[8] *Id.* at Ex. 27 (NSC Credit Agmt.).
[9] Defendant Andrew T. Dwyer beneficially controlled just less than fifty percent of Wren. Defendant Troy Snyder joined NSC's board in May 2002.

June 12, 2001, also became a director of NSC.[10] Some agreed to a collective holding of NSC shares by SMIG, which may have been established under the auspices of Biderman and which was dissolved on April 22, 2002.[11]

NSC had been founded in 1999 to profit from video streaming on the internet. It struggled financially. Javva invested in late 1999 or early 2000.[12] In March and June 2000, Wren invested. It was roughly October 2000 when Catalyst invested.[13] Lipper began working with NSC in March 2000. Many of its investors—some who are Plaintiffs—accepted membership units in SMIG, but others—some also Plaintiffs—chose to be direct stockholders. In December 2000, Lipper assisted NSC in offering Subordinated Notes that were convertible into NSC common stock at $10 per share, a number that could be adjusted, but not below $5 per share.[14]

By the spring of 2001, NSC's financial troubles necessitated additional funding; initially, relatively small loans met its short-term needs. A new round of equity was considered. After some negotiations, Catalyst, Wren, Javva, those Plaintiffs who would eventually acquire Preferred A shares, and others to a lesser degree purchased the Secured Notes, consisting of a senior note and a warrant

---

[10] *Id.* at Ex. 21.
[11] *Id.* at Ex. 38.
[12] *Id.* at Ex. 2.
[13] *Id.* at Ex. 16. (Stock Purchase Agmt.).
[14] *Id.* at Ex. 18.

convertible into common stock.[15] Conversion of the Secured Notes was changed from a floor of $5 per share to $0.50 per share, which also aided those with most-favored nation rights.[16]

Despite turnover in upper management, NSC continued to struggle to pay its bills. A series of board meetings began on December 20, 2001. At that point, the board consisted of Art Williams, NSC's then-new Chief Executive Officer, Katz, Cameron, Shipman, and Biderman. Not only did the board discuss NSC's short-term funding needs during this telephonic meeting, but it also considered a possible route to profitability through acquiring the assets of e-Media, a failing competitor that was approaching bankruptcy, and the streaming division of NaviSite, which was abandoning that aspect of its business. The Plaintiffs claim that the meeting was scheduled for the afternoon (a Friday) that, for religious reasons, made it impossible for Biderman to attend. Defendants contest this claim of motive[17] and assert that Biderman was promptly informed of what occurred at the meeting by the following Monday.[18]

During a meeting on January 7, 2002, Williams pushed the acquisition strategy even though it would require additional funding. All directors, but for Biderman who abstained, voted in favor of the growth effort. The board, on

[15] *Id.* at Exs. 24, 25, 41, 94.
[16] *Id.* at Ex. 23.
[17] Defs.' Opening Br. in Supp of their Mot. for Summ. J. ("NSC Br.") 36.
[18] Biderman frequently asked two colleagues at Lipper, Emily Grad and Patti Koo, to attend meetings on his behalf. It is not clear why they were not asked to attend this meeting.

January 10, 2002, with Biderman as the lone dissenter, agreed to acquire e-Media and the streaming division of NaviSite. Wren and Javva would each loan $2.5 million to finance the transactions. Catalyst did not participate. Biderman's opposition was tied to his perception that, as a consequence of the loans, NSC shareholders' interests would be diluted.

NSC revised its acquisition strategy a week later in response to a change in the terms of the NaviSite transaction that required additional cash. The revised plan for recapitalization (the "Recapitalization") was approved unanimously. Two new series of preferred stock would be issued: Series A would be issued in exchange for the existing secured debt (20 percent) and Series B would be issued for the new money raised for the transaction (seven percent). Also, without a change in control, Biderman would remain a director through 2004, and any subsequent equity issuance, absent unanimous board approval, would allow the Series A Preferred holders to redeem their shares with a 50 percent premium to the face amount. This latter provision was designed to assuage concerns about further dilution.

A board meeting scheduled for February 25, 2002, turned into an informational meeting when a quorum was not achieved.[19] Williams reported that e-Media's integration into NSC was requiring more effort than anticipated, that its

[19] Newman Aff. Ex. 35 (Feb. 25, 2002 meeting minutes).

revenues were less than anticipated, and that the NaviSite transaction was plagued by a shortage of working capital ($1.3 million). Additional funding was already necessary. Wren and Javva agreed to provide about three-quarters of the funds ($900,000), but Catalyst and Lipper both passed on the opportunity.

Grad and Koo, in Biderman's place, attended the next board meeting on March 6, 2002.[20] The NaviSite acquisition's cash shortfall was the primary topic. Outside financing (and financing from Catalyst and Lipper) still had not been obtained. Wren agreed to a significant increase in the amount it would put up, but insisted that its equity be limited. Eventually, Wren loaned $500,000, and Wren's $700,000 and Javva's $100,000 equity contributions would be covered by additional Preferred B-1 shares. There was discussion at the meeting about the need for the holders of the Secured Notes (in part, Plaintiffs) to agree to a debt exchange for Preferred A shares.

The board next met on April 11, 2002,[21] and the meeting addressed several topics that had been considered during a telephonic meeting a few days before but without Biderman as an invitee.[22] Williams was leaving NSC, and certain issues regarding the Recapitalization were discussed. Grad attended the April 11 meeting in Biderman's place. The need to garner the support of all secured debt holders for

---

[20] *Id.* at Ex. 36 (Mar. 6, 2002 meeting minutes).

[21] The parties dispute whether there was an intervening meeting. During this period, a draft term sheet for the Recapitalization was circulated to Wren, Javva, and Catalyst, but, apparently, not to Biderman.

[22] *Id.* at Ex. 37 (Apr. 11, 2002 meeting minutes).

the Recapitalization was recognized, but this was the last time that the Recapitalization was addressed specifically by the board. Apparently, it had been decided during the April 9 telephonic gathering—but not discussed at the April 11 board meeting—that Snyder, who had come to NSC as part of the NaviSite acquisition, would take Williams's place as Chief Executive Officer.[23] Snyder was elected to the board and formally designated as NSC's CEO on May 22, 2002.[24]

Although SMIG's Certification of Cancellation was filed on April 22, 2002, its members did not receive certificates for their NSC shares until at least May 30, 2002.[25] Before then, the SMIG Plaintiffs did not own NSC stock.

In addition, during the same period, additional shares were issued because of most-favored nation provisions, including some about which the Defendants now complain because they claim two Plaintiffs were not parties to any agreement granting most-favored nation status.

The burden of obtaining the consents of the Secured Note holders for the Recapitalization eventually fell to Biderman. On June 18, 2002, he wrote to Plaintiff Herbert Rausman and explained that the Preferred A shares that he and his family would receive upon surrender of their Secured Notes and Warrants would amount to 1.22 percent of NSC's outstanding equity (the "June Update"). One of

---

[23] Aff. of Blake Rohrbacher, Esq. in Supp. of Fuchs Pls.' Br. in Opp'n to Defs.' Mot. for Summ. J. ("Rohrbacher Aff.") Ex. W.
[24] Newman Aff. Ex. 40.
[25] *Id.* at Exs. 41-43 (internal share issuance summary dated May 30, 2002).

the documents supplied by Biderman was an “SMC Update” which, among other items, reported: “Although [NSC] contributed only 15% of the revenues of the combined entity, it is estimated that upon recapitalization, [NSC] shareholders (who did not finance the acquisitions) will own over 30% of the new [combined] company.”[26] The Plaintiffs argue that Rausman could not and did not understand this “confusing sentence.”[27] The sentence informed shareholders that their proportionate interest in NSC had been reduced; it did not, however, inform them who benefited from that dilution or that the Equity Defendants would be providing the new money. A necessary inference from the report is that whoever provided the financing for the two acquisitions would own 70 percent of the combined NSC enterprise (the amalgamation of old NSC, e-Media, and NaviSite). The Secured Note holders eventually executed individually a Preferred A Stockholder Agreement[28] and, in exchange for their Secured Notes and Warrants, received Preferred A shares.

A one-for-twenty reverse stock split, revised from a one-for-ten reverse stock split considered in April 2002, was also approved at this time. Plaintiffs object that after the reverse stock split approved on August 1, 2002,[29] the Entity

---

[26] Newman Aff. Ex. 44.
[27] NSC Br. 17.
[28] Newman Aff. Ex. 53. The agreements were held by Lipper and not released until the end of July.
[29] *Id.* at Ex. 48.

Defendants issued themselves Preferred B-1 shares.[30] Without the change in the reverse split which raised the effective price (from $0.29 to $0.58 per share), the Preferred B-1 issuance, according to the Plaintiffs, would have triggered anti-dilution protections available to many of them.[31] This was all accomplished through written consents of the majority shareholders and did not involve a stockholders meeting.

During August 2002, the board, both through its own actions and through majority shareholder written consents (after consciously eschewing a stockholders meeting) carried out an extensive capital restructuring. Some Plaintiffs had earlier agreed to convert their Senior Notes before this (a necessary precursor to the strategy implemented) but were not afforded an opportunity to participate in the August financing. These Plaintiffs did sign a stockholder agreement dated August 12, 2002.[32] The net effect of all these changes was that the Entity Defendants increased their collective ownership of NSC from roughly 54 percent

---

[30] Rohrbacher Aff. Ex. EEE.

[31] The SMIG Stock Purchase Agreement (Newman Aff. Ex. 9 at § 6) (whether there is a signed version may be yet another question) conferred "most favored nation rights" that required, if better terms were offered in a subsequent investment, that the SMIG members would be "offer[ed] the same terms . . . effective as of the date of this Stock Purchase Agreement." Those most favored nation rights were available for a period of eighteen months from the date of the Stock Purchase Agreement, April 4, 2000. The events of the Recapitalization were more than eighteen months later, but NSC, in late September 2001, issued warrants with anti-dilution provisions (Newman Aff. Ex. 25 at § 3) that had an expiration date of September 2006 (or until a majority of the warrants was no longer outstanding). The questions include whether the SMIG Plaintiffs only had those anti-dilution rights until the expiration of their eighteen-month period or whether they acquired the anti-dilution rights for the duration of the warrants. The parties did not address these questions in detail.

[32] Newman Aff. Ex. 53.

to 85 percent, and perhaps to even slightly more than 90 percent.[33] The corresponding dilution of Plaintiffs' interests forms the core of their claims.

In October 2002, after the now-challenged transactions had been completed, the Defendants sent a "Fall Update" to NSC shareholders.[34] During the more than three years after the update was sent, NSC provided no information to the Plaintiffs.[35] In February 2006, NSC did communicate with its shareholders.[36] A board meeting was convened on November 15, 2006, to consider the Akamai acquisition, something that Biderman, still nominally a board member, had never heard about, even though it had been under consideration for at least six months.[37] Materials sent in late November 2006 to solicit a stockholder vote on the Akamai transaction[38] engendered an unhappy response from the minority shareholders who were disappointed to realize that their holdings in NSC had been diluted. The Akamai acquisition closed on December 13, 2006.

---

[33] *Id.* at Ex. 33; Rohrbacher Aff. Exs. EEE & HHH at 37.
[34] The Complaint in Civil Action No. 3940-VCN stated a claim as to the inadequacies of the disclosures in the Fall Update. *Dubroff v. Wren Hldgs., LLC*, 2009 WL 1478697, at *6 (Del. Ch. May 22, 2009).
[35] Rohrbacher Aff. Ex. G (Horowitz Dep.) at 427.
[36] Newman Aff. Ex. 59.
[37] Rohrbacher Aff. Ex. RRR.
[38] *Id.* at Ex. HHH.

II. THE ISSUES

A. *Summary Judgment Standard*

In order to obtain summary judgment, the moving party must demonstrate "that there is no genuine issue as to any material fact and that [it] is entitled to judgment as a matter of law."[39]

> In deciding a motion for summary judgment, the evidence and the inferences drawn from the evidence are to be viewed in the light most favorable to the nonmoving party and the moving party has the burden of demonstrating that no material question of fact exists.[40]

B. *Gentile Claims*

The Plaintiffs attack the Recapitalization by claiming unfair dilution of equity and voting power.[41] Dilution claims are usually derivative because dilution causes a corporate harm and the corporation is entitled to the remedy.[42] For derivative claims that arise before a merger, shareholders typically lose standing to pursue those claims following a merger because of the "continuous ownership" rule.[43] An exception to that rule may be found in *Gentile* which teaches that a derivative claim may also be a direct claim when a controlling shareholder "extract[s]" or "expropriat[es]" the minority shareholders' economic value and

[39] Ct. Ch. R. 56(c).

[40] *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH.*, 2013 WL 655021, at *8 (Del. Ch. Feb. 22, 2013) (citation omitted).

[41] Fuchs Pls.' Br. in Opp'n to Defs.' Mot. for Summ. J. ("Fuchs Br.") 35.

[42] *Feldman v. Cutaia*, 951 A.2d 727, 732-33 (Del. 2008); *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). The term "dilution" may be too imprecise in some circumstances; it suffices for present purposes.

[43] *In re New Valley Corp. Deriv. Litig.*, 2004 WL 1700530, at *3 (Del. Ch. June 28, 2004).

voting power.[44] The Akamai acquisition occurred roughly four years after the challenged actions,[45] and it could not have been foreseen, and was not foreseen, when those events occurred. Unless the *Gentile* exception applies, the Plaintiffs' dilution claims are solely derivative, and, because of the intervening acquisition, their claims must be dismissed.

Unlike the corporation in *Gentile*, NSC had no majority shareholder. A "control group," however, may be the functional equivalent of a controlling shareholder. The Plaintiffs insist that Wren, Javva, and Catalyst, which collectively owned more than 50 percent of NSC's equity and designated a majority of its board, constituted a control group.

Earlier in these proceedings, the Court addressed the concept of a control group:

> Delaware case law has recognized that a number of shareholders, each of whom individually cannot exert total control over the corporation (either through majority ownership or significant voting power coupled with formidable managerial power), can collectively form a control group where those shareholders are connected in some legally significant way—*e.g.*, by contract, common ownership, agreement, or some other arrangement—to work together toward a shared goal.[46]

Establishing the existence of a control group is not an easy task. All supposed members of the control group here owned less than a majority of shares;

---

[44] *Gentile*, 906 A.2d at 102; *see Dubroff*, 2009 WL 1478697, at *3.
[45] Newman Aff. Ex. 62.
[46] *Dubroff*, 2009 WL 1478697, at *3.

none alone owed fiduciary duties; and each was free to vote in its self-interest. That they signed on to a common objective (*i.e.*, shared parallel interests) is not determinative.[47] Otherwise, every time a majority acts, its participants could be viewed as members of a control group. Resolution of this fact-intensive inquiry on summary judgment is often difficult. As long as the facts of record support a reasonable inference—not necessarily the better inference—that a control group existed, summary judgment is not appropriate.[48]

With their shareholder voting majority allowing them to use written consents to approve changes requiring shareholder consideration and with their majority control of the board, the representatives of the Entity Defendants worked together to accomplish the Recapitalization. There is evidence supporting the Plaintiffs' contentions that details of the plans were developed in advance of meetings and that Biderman was shielded from the discussions. Designees of the Entity Defendants collaborated to develop the structure of the Preferred B-1 shares, which would have the effect of materially diminishing the rights of minority shareholders.

The Defendants emphasize that Catalyst did not acquire any Preferred B-1 shares and argue that this shows that Catalyst did not work toward (or participate

---

[47] *Williamson v. Cox Commc'ns, Inc.*, 2006 WL 1586375, at *6 (Del. Ch. June 5, 2006).

[48] *Bird's Constr. v. Milton Equestrian Ctr.*, 2001 WL 1528956, at *2 (Del. Ch. Nov. 16, 2001) (holding that the Court draws all reasonable "inferences in favor of the non-moving party" on a motion for summary judgment).

in) the common objective.[49] That persuasive fact fails to account for the right held by Catalyst to participate, by way of a 90-day option, on the same terms in the Preferred B-1 issuance.[50] Thus, at the time the strategy was set and carried out, the record suggests that Catalyst had the same incentives and objectives as Wren and Javva. Biderman (and the Plaintiffs) apparently did not know of Catalyst's option and apparently were never offered a comparable opportunity.[51]

Perhaps there was no control group. That, however, is not a conclusion that the Court can reach as a matter of undisputed fact.

In addition, the Defendants attempt to distinguish a *Gentile* claim from "a typical claim of corporate dilution (which is exclusively derivative)"[52] by arguing that a *Gentile* claim requires that "the public shareholders are harmed, uniquely and individually, to the same extent that the controlling shareholder is

---

[49] NSC Br. 38.

[50] The Defendants dispute that there ever was a 90-day option. They characterize the use of the term "option" as equivalent to "choice" or "opportunity." Defs.' Reply Br. in Further Supp. of their Mot. for Summ. J. ("NSC Reply Br."); *see* Newman Aff. Ex. 33. There is no documentation of the board's approval of any stock option. Without the 90-day option sponsored by Plaintiffs, the underpinning of their *Gentile* argument may largely fall away. This is yet another issue of disputed fact.

[51] The parties frequently disagree about whether (and to what extent) participation opportunities were extended to Biderman and the Plaintiffs. Several discussions regarding investment opportunities were held with Biderman (or Grad or Koo) during early 2002. Timing, full knowledge of material information, and the general approach of the supposed control group all affected the reasonableness of the investment opportunities. Also, it appears that the Defendants did not contact the Plaintiffs individually; instead, they implicitly relied upon Biderman to convey to them whatever information he thought appropriate. Whether that reliance was justified is another topic of disagreement.

[52] NSC Br. 40.

(correspondingly) benefited."[53] The inquiry has been described as one about whether "a controller expropriates, from [minority shareholders], a large percentage of the corporation's equity, keeps most of the expropriated equity for itself, and gives a small amount to other people."[54] The Defendants point out that, as part of the Recapitalization, the Series B-2 stock, roughly three percent of NSC's equity, went to e-Media and two percent of NSC's equity was issued to other stockholders.[55] Even though that is accurate, the net effect of the Recapitalization—controlled by the Entity Defendants—cannot be ignored. Their collective holdings grew from roughly 54 percent to 85 percent (or more), while the minority shareholders' holdings dropped from roughly 45 percent to less than 10 percent.[56] That a small amount went to third parties does not preclude a successful *Gentile* claim at this stage.[57]

The Defendants return to the fact that Catalyst did not purchase Series B-1 stock, and, thus, it did not gain from the diminution of the minority shareholders' interests attributed to the efforts of the purported control group. Stated differently, the "benefits" of the Recapitalization went to Wren and Javva which, together, did not hold a majority of NSC's equity. The measure, however, is what was achieved by the control group that included Catalyst, if there was a control group. Here,

[53] *Id.* (quoting *Gentile*, 906 A.2d at 100).
[54] *Dubroff II*, 2011 WL 5137175, at *8.
[55] NSC Reply Br. 18; Newman Aff. Exs. 63 & 94.
[56] Rohrbacher Aff. Ex. EEE (table of percentage ownership after Recapitalization).
[57] *See Dubroff II*, 2011 WL 5137175, at *8.

control group members—at least for purposes of summary judgment—acquired the benefits of a substantial increase in their holdings at the expense of the minority shareholders, and the fact that Catalyst chose not to participate and allowed Wren and Javva to benefit does not alter the effect of the Recapitalization on the minority shareholders. The focus must be on the control group—not on its individual members.

In sum, the Plaintiffs' claims may not, on summary judgment, be denied the status of direct claims, and, accordingly, the continuous ownership rule, applicable to exclusively derivative claims, does not require their dismissal at this point.[58]

C. *The Standing of the SMIG Plaintiffs*

The Defendants argue that those Plaintiffs who acquired their NSC stock as the result of SMIG's dissolution do not have standing to assert dilution claims because the decisions that resulted in the dilution were made before they were owed fiduciary duties.[59] Their shares were not issued until at least May 30, 2002.[60]

As a general matter, when the terms of a transaction are established—not when the transaction is carried out—is the proper time for assessing whether a breach of fiduciary duty occurred.[61] Although the path to the Recapitalization was

---

[58] A corollary conclusion is that the aiding and abetting claims and the unjust enrichment claim (which might otherwise be exclusively direct) are also direct because they are based on the same facts.
[59] NSC Br. 47.
[60] Newman Aff. Exs. 41-43.
[61] *See, e.g.*, *7547 P'rs v. Beck*, 682 A.2d 160, 162-63 (Del. 1996).

established before the SMIG Plaintiffs acquired rights as NSC shareholders, arguably significant terms evidently were not established until August 2002; by then, they were, in fact, shareholders.

They were owed fiduciary duties no later than the end of May, but this is not a matter where events occurring after that date were simply a matter of implementing a transaction with previously fixed terms. The reverse stock split was modified and the terms of the Preferred A and the Preferred B were not finalized.[62] Perhaps the changes were not material, but that is an analysis that should be assisted by a trial record. The board did not formally review or revise the terms of the Recapitalization after mid-April 2002, but it appears that the Entity Defendants (through their representatives) approved various changes. That an informal process seems to have been followed does not defeat the SMIG Plaintiffs' claims. Accordingly, summary judgment on the SMIG Plaintiffs' claims on this ground may not be granted.[63]

---

[62] The percentage of NSC equity allocated to the Preferred B-1 shares increased by approximately 10 percent between May and August 2002.

[63] This also resolves the Defendants' assertion that the SMIG Plaintiffs lack standing to pursue disclosures claims and aiding and abetting claims.

The SMIG Plaintiffs also argue that none of this matters because they acquired their NSC shares by operation of law (on SMIG's dissolution) and did not purchase their shares to "buy into" a derivative suit. *See, e.g.*, *Brown v. Automated Mktg. Sys., Inc.*, 1982 WL 8782, at *2 (Del. Ch. Mar. 22, 1982). The Court does not address this argument.

D . *The Standing of the Preferred A Plaintiffs*[64]

The directors of a Delaware corporation owe fiduciary duties to the corporation and to its stockholders.[65] A claim for breach of fiduciary duty "must be based on an actual, existing fiduciary relationship between the plaintiff and the defendants at the time of the alleged breach."[66] The holders of debentures, bonds, and warrants are not stockholders and are not owed fiduciary duties.[67] The Preferred A Plaintiffs did not acquire their shares until after the Recapitalization—its development, its drafting, or its implementation.[68] In short, they lack standing to challenge the Recapitalization.

The Preferred A Plaintiffs argue that they were owed fiduciary duties because they had contracted to exchange their non-stock interest in NSC for Preferred A shares in May or June 2002 on execution of the Subscription and Surrender Agreements.[69] They assert that, as a result, they acquired an equitable

---

[64] The term "Preferred A Plaintiffs" refers to fifteen holders of Secured Notes and Warrants to purchase NSC common stock. The Secured Notes were eventually exchanged for Preferred A shares in the Recapitalization. The Preferred A Plaintiffs are: Cindy Hassan, Trust FBO Chaim Abikhzer, Trust FBO Naftali Abikhzer, Nathan Hassan, Rachel Hassan, Trust FBO Jacob Rausman, Emil & Joan Rausman Irrevocable Trust, Barry Wien and Eddy Hsu, Susan Rausman Abikhzer, Herbert Rausman, Rivkah Rausman, Trust FBO Barry Rausman, Trust FBO Moishe Abikhzer, and Elie Hassan. Six of them separately held NSC common stock by June 2001.

[65] *In re Answers Corp. S'holder Litig.*, 2012 WL 1253072, at *6 (Del. Ch. Apr. 11, 2012).

[66] *Omnicare, Inc. v. NCS Healthcare, Inc.*, 809 A.2d 1163, 1169 (Del. Ch. 2002), *rev'd on other grounds*, 818 A.2d 914 (Del. 2003).

[67] *See, e.g.*, *Simons v. Cogan*, 549 A.2d 300, 303 (Del. 1988).

[68] The board approved the Preferred A issuance on August 9, 2002, Newman Aff. Ex. 49, and those shares were issued on August 12, 2002, the same day as the issuance of the Preferred B-1 shares. *Id.* at Ex. 50.

[69] Rohrbacher Aff. Ex. Q.

interest in NCS's equity and accepted the economic risks of being a stockholder.[70] They no longer had the protections afforded, for example, creditors. Agreeing to purchase stock does not make one a stockholder, especially if the stock will not even be issued until the consummation of the challenged series of actions.[71] In short, the Preferred A Plaintiffs were not stockholders and they have no standing to pursue dilution claims resulting from the Recapitalization.[72] Similarly, they have no standing to pursue disclosure claims because these claims are tied to the inadequacy of the disclosures relating to the dilution which they have no capacity to challenge. Summary judgment on this claim, therefore, is appropriate.[73]

---

[70] Fuchs Br. 48-49.

[71] *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1172 (Del. 1988) (prospective shareholders owed no fiduciary duties).

[72] The Plaintiffs argue that the Preferred A shares were issued a few days before the Series B-1 shares. Even if that were accurate, there is no evidence that any changes occurred during this brief period or that anything other than purely ministerial steps were taken in implementing the Recapitalization. More importantly, although the Preferred A issuance was approved a few days before the Preferred B issuance, both were issued, according to NSC's stock ledger, on the same day—August 12, 2002. *See* Newman Aff. Ex. 60 at AKAMAI0424, 0426 & *supra* note 68.

[73] To the extent that the Plaintiffs contend that the Preferred A Plaintiffs who were stockholders as of June 2001 were entitled to fiduciary protection with respect to their rights as bondholders and with respect their dilution claims based on that status, that argument is foreclosed by the fundamental nature of corporate securities. The bundle of rights associated with stock ownership is independent of the contractual rights due to debt holders, who are generally owed no fiduciary duty under Delaware law. *See* R. Franklin Balotti & Jesse A. Finkelstein, *1 The Delaware Law of Corporations and Business Organizations* § 5.1, 5-4 & n.7 (2012 Supp.) ("The rights of a security, whether designated debt or equity, will be determined by the terms of the contract.") ("The relative rights of the holders of the securities will be determined by the terms of the certificate of incorporation that Delaware law treats as a contract between the corporation and its stockholders."); *Simons v. Cogan*, 542 A.2d 785, 786 (Del. Ch. 1987), *aff'd*, 549 A.2d 300 (Del. 1988) ("It has now become firmly fixed in our law that among the duties owed by directors of a Delaware corporation to holders of that corporations' debt instruments, there is no duty of the broad and exacting nature characterized as a fiduciary duty."). It follows then that concurrent stock ownership cannot be the basis for a bondholder to obtain rights that were not otherwise contractually bargained for.

The Preferred A Plaintiffs also argue that the Entity Defendants were unjustly enriched at their expense.[74] The Defendants contend that their claims are foreclosed by contract.[75] The Preferred A Plaintiffs' contracts were with NSC—not with the Entity Defendants. Perhaps it is sufficient to reject their claims by noting that in the Complaint, they tied those claims to "illicit conduct in derogation of their fiduciary duties to Plaintiffs."[76] With no fiduciary duties owed to the Preferred A Plaintiffs by the board designees of the Entity Defendants, they could not be victims of the conduct alleged. Moreover, even if their allegations should be read more charitably, the Entity Defendants' board designees may have taken advantage of NSC (and its shareholders at the time), but any harm they may have caused to the Preferred A Plaintiffs was derivative of the impact on the value of NSC stock which they were to receive. Harm to a corporation is, in a sense, harm to its stockholders. Unjust enrichment may provide an equitable remedy where remedies at law are inadequate.[77] It is not a doctrinally appropriate methodology, however, for circumventing the limitations resulting from the fact that the harm caused, if any, was to NSC and not to its debenture holders, or the like, directly. If the Preferred A Plaintiffs were denied value that NSC was contractually obligated to provide, the remedy should have been by way of suit against NSC. Limited

[74] Fuchs Br. 50.
[75] NSC Br. 46-47.
[76] Am. Compl. ¶ 130.
[77] *Addy v. Piedmonte*, 2009 WL 707641, at *22 (Del. Ch. Mar. 18, 2009).

exceptions like *Gentile* exist to protect shareholders who were owed fiduciary duties and to avoid the consequences of the continuous ownership rule; it does not reach the claims of those who were not owed fiduciary duties. Accordingly, the unjust enrichment claims of the Preferred A Plaintiffs must be dismissed.

E. *Cameron Family Partnership, L.P.*

Defendant Cameron Family Partnership, L.P. ("CFP") is alleged to have been unjustly enriched by its receipt, as a result of the Recapitalization, of Preferred B-1 shares.[78] CFP denies that it ever received Preferred B-1 stock.[79] The Plaintiffs point to an exhibit that shows CFP's holding of Preferred B-1 stock.[80] The Plaintiffs' deposition inquiry into this topic was precluded by the Defendants' counsel.[81] This is one of those questions that should be easily answered. The record, however, with its factual disputes, does not afford the Court that opportunity.

F. *Catalyst, Shipman and Self-Dealing*

Catalyst and Shipman, its NSC's board representative, seek summary judgment because they did not engage in self-dealing.[82] In the sense that Catalyst gained no actual financial benefit from the Recapitalization, they are correct. If there was no control group, they would be right about their liability. With the

---

[78] Am. Compl. ¶ 20.
[79] NSC Br. 52.
[80] Newman Aff. Ex. 63.
[81] *See* Rohrbacher Aff. Ex. UU (S. Cameron Dep.) at 21-22.
[82] NSC Br. 55-57.

control group and the opportunity to have participated in the fruits of the fiduciary breach, Catalyst and Shipman cannot use summary judgment to avoid liability. With the 90-day option, they both had reason to issue the Fall Update with its arguably misleading disclosures. Summary judgment is simply not appropriate.[83]

G. *Snyder and Fiduciary Duty*

Snyder owed fiduciary duties both as a director and as an officer of NSC. He was not part of the control group but acquired his significant positions at NSC as of May 22, 2002.[84] Although Snyder assumed fiduciary duties late in the process, he conceded that he participated in the conclusion of the Recapitalization and the issuance of the Fall Update.[85]

The Defendants contend that because Snyder derived no direct benefit from the Recapitalization, he maintains the presumption that he discharged his duties with due care and loyalty. However, Snyder's receipt of options, offered at below market rates, in October 2002—just after the Recapitalization was completed—raises a reasonable inference that he was rewarded for going along with the Recapitalization.[86] The suspicious timing of those options is not fully negated by the fact that the board had planned previously to award NSC's prior CEO

---

[83] That they could have participated in the Recapitalization but that they refrained from accepting the benefits after they helped launch the course of conduct does not relieve either of them of liability for their conduct and its foreseeable consequences.
[84] The minutes of the May 22, 2002 board meeting reflect Snyder's election as President and Chief Executive Officer. Newman Aff. Ex. 40.
[85] Rohrbacher Aff. Ex. QQ (Snyder Dep.) at 90.
[86] *Id.* at Ex. III.

(Williams) a comparable number of options.[87] Whether Snyder, as an officer or as a director, breached a fiduciary duty arising from such conduct is, thus, subject to a dispute of material fact.

Snyder's involvement in the Fall Update is also troubling, but again, there exists a question of material fact. When directors are not seeking shareholder action, a breach of their fiduciary duty may occur if they "knowingly disseminate false information" or deliberately misinform shareholders.[88] On the one hand, Snyder seemed to think that the inclusion of investors and their relative holdings after the Recapitalization was not material. If true, his good faith belief would likely not implicate a fiduciary breach under *Malone*.[89] On the other hand, that the Fall Update did not include a reference to the dilution of non-financing shareholders, which had been provided in the June Update, comports with the Plaintiffs' theory that Snyder and the control group purposefully concealed the dilution from minority stockholders.[90] Moreover, "who benefited from the Recapitalization and what benefits did they achieve" were likely material facts to a

---

[87] *Id*. at Ex. U.

[88] *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998).

[89] *Id*. at 10 (noting that when directors are not seeking shareholder action, the issue "is not whether [the] directors breached their duty of disclosure," rather, it is "whether they breached their more general fiduciary duty of loyalty and good faith by knowingly disseminating to the stockholders false information about the financial condition of the company.").

[90] *See Jackson Nat. Life Ins. Co. v. Kennedy*, 741 A.2d 377, 389 (Del. Ch. 1999) ("[I]t follows from the Court's reasoning [in *Malone*] that one who pleads that directors deliberately omitted information from a communication with . . . stockholders under circumstances that suggest an intent to mislead the stockholders has set forth a violation of the fiduciary duty of loyalty . . . .").

reasonable shareholder.[91] Thus, especially when viewing the facts in the light most favorable to the Plaintiffs, the Court cannot determine as a matter of law that Snyder did not breach his fiduciary duty of loyalty or good faith.[92]

H. *The Fuchs Brothers and Too Many Shares*

The Defendants argue that Plaintiffs Morris Fuchs and Bernard Fuchs were credited with owning too many shares of NSC, and that the excess shares (over what they, in fact, owned) allowed them, through the Akamai transaction, to be paid substantially more than they would have received even if (a) their proper share totals were used and (b) they obtain all the relief they are seeking in this litigation. According to the Defendants, they were overpaid by factors of eight and eighteen, but their diminution in value, alleged in the Complaint, is only by a factor of five or so.[93] If the Defendants are correct about the Fuchs Brothers' share holdings, they may have received all to which they are entitled.

Information regarding the Fuchs Brothers' holdings of NSC stock came from NSC's official stock ledger which creates a rebuttal presumption.[94] The stock

---

[91] *Dubroff*, 2009 WL 1478697, at *5.

[92] In prior opinions the Court did not "delineate the parameters of the disclosure required by § 228(e)." *Id*. at *6. The Court has not made any such delineation here. The record is sufficient for the Court to infer reasonably (and thus preclude summary judgment) either (1) "that the board materially misled shareholders about the Recapitalization" in the context of a request for shareholder action; or (2) "that the board deliberately omitted material information with the goal of misleading the Plaintiffs" in the context where the directors are not seeking shareholder action. *Id*.

[93] Am. Compl. ¶ 114.

[94] 8 *Del. C.* § 219(c); *see also W. Airlines, Inc. v. Kerkorian*, 254 A.2d 240, 241 (Del. 1969).

ledger was reviewed or audited several times between 2002 and 2006,[95] and no reason to doubt the Fuchs Brothers' holdings emerged. Part of the confusion now seems to lie in the debate over whether the Fuchs Brothers signed stock purchase agreements. The evidence tends to suggest that they did not, but Morris Fuchs testified in deposition that he did sign a stock purchase agreement.[96]

It may not be difficult to speculate about the eventual outcome of this debate, but enough doubt about material fact lingers, and, thus, summary judgment on this topic is not appropriate.

I. *Rausman, his Affiliates, and Laches*

On June 18, 2002, Biderman sent to Herbert Rausman information (*i.e.*, the June Update) regarding NSC's request for converting the Secured Notes and Warrants into Preferred A stock. Rausman was a conduit of information not only for the trusts in which he served as trustee, but also for his "affiliates," essentially family members. Rausman was informed that, following the Recapitalization, "[NSC] shareholders (who did not finance the acquisitions) will own over 30 percent of the new [combined] company."[97] Thus, he was on notice that his holdings of NSC (and those of others with whom he worked) of NSC would be diluted. He quibbles that the sentence is confusing, but a reduction in the relative

---

[95] Rohrbacher Aff. Ex. Y.
[96] *Id.* at Ex. XX (M. Fuchs Dep.) at 162; *see also id.* at Ex. WW (B. Fuchs Dep.) at 35 (discussing investment documents for his signature).
[97] Newman Aff. Ex. 44.

interests of non-participating shareholders is not hard to discern, especially given his background knowledge. What is not clear is who would be supplying the new money. The disclosure could be consistent with new money from existing shareholders or new money from outside sources.

If this disclosure adequately put Rausman on notice of the dilution and the surrounding circumstances—to the extent that they may have been material—his claims (and the claims of those with whom he worked) would be barred because no action was brought to recover losses until more than three years later. More specifically, equity would "borrow" the corresponding statute of limitations—three years—and his claim would be barred by laches.[98]

The disclosure did not inform Rausman that the Entity Defendants would provide the new money (and thereby increase their percentage ownership) in a self-dealing transaction. The Court cannot conclude that this self-dealing aspect would not have been material. The Defendants are, of course, correct that, if the source of the new money had been important to him, Rausman could have asked. That approach, if effective, would provide a convenient response to anyone who complains about omitted material facts: they could have asked.

---

[98] *See, e.g.*, *In re Mobilactive Media LLC*, 2013 WL 297950, at *10 (Del. Ch. Jan. 25, 2013) (citation omitted).

Whether Rausman had sufficient contextual knowledge and understanding of NSC's circumstances as of the June communication in order to conclude that he was on notice to a sufficient extent to find him guilty of laches cannot be resolved on summary judgment as a matter of undisputed material fact.

III. CONCLUSION

For the foregoing reasons, the Defendants are granted summary judgment on the Preferred A Plaintiffs' claims. Otherwise, their motion for summary judgment is denied.

An implementing order will be entered.