COURT OF CHANCERY
OF THE
STATE OF DELAWARE

WILLIAM B. CHANDLER III
CHANCELLOR

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Submitted: October 14, 2005
Decided: December 8, 2005

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Re: *Matthews v. Groove Networks, Inc., et al.*
Civil Action No. 1213-N

Dear Counsel:

The parties in this case disagree about how to interpret the Certificate of Incorporation ("COI") of Groove Networks, Inc. ("Groove Networks"). Plaintiff argues that the liquidation preference in Article IV(B)(3) of the COI (the "Liquidation Preference") does not apply to merger proceeds in the event of a merger. Plaintiff is one of the common stockholders of Groove Networks who, as a result of the Liquidation Preference, received nothing in the March 2005 merger between Groove Networks and Microsoft Corporation ("Microsoft"). The defendants are Groove Networks and individual defendants Raymond Ozzie, James Breyer, and John Stenbit.[1] For the reasons set forth below I grant defendants' motion for summary judgment.

This case arises out of the merger of Groove Networks with Microsoft in March 2005. Before the Merger, the capital structure of Groove Networks consisted of a class of common stock and eight classes of preferred stock. Microsoft was the single largest holder of Groove Network's Senior Preferred stock.

Groove Network's COI creates the Liquidation Preference—a distribution preference in favor of the preferred shareholders. The Liquidation Preference governs the distribution of assets upon the occurrence of any "Liquidation Event."[2] A number of different events qualify as "Liquidation Events," including "any liquidation, dissolution, or winding up" as well as "any reorganization, merger or consolidation" of Groove Networks.[3]

The Liquidation Preference states that, in the event of a merger, the preferred stockholders are to be paid from Groove Networks' "Distributable Assets." The Distributable Assets are defined as the company's assets,

[1] The individual defendants were among the directors of Groove Networks at the time of the merger.
[2] COI Article IV(B)(3)(a).
[3] COI Article IV(B)(3)(d).

"whether from capital, surplus or earnings."[4] The COI clarifies the definition of Distributable Assets in Article IV(B)(3)(d)(i) where the COI states: "In the event of a sale of a Majority of the Assets, the Distributable Assets shall be the net proceeds of such sale." The COI does not contain a corollary statement clarifying what constitutes Distributable Assets in the event of a merger. Based on this bit of silence, plaintiff takes the position that merger consideration was not intended to be part of the assets of the corporation and so the Liquidation Preference does not govern the distribution of merger consideration. I conclude, however, that the COI should be read to provide preferred stockholders with the benefits of the Liquidation Preference in the event of a merger.

The operative sections of the COI are contained in Article IV. Article IV(B) provides that "The Preferred Stock shall have the following rights, preferences, powers, privileges and restrictions, qualifications and limitations." In Article IV(B)(3)(a), entitled "Liquidation, Dissolution, or Winding Up," the COI provides that one of the rights of the preferred stock is that, in the event of a merger of Groove Networks, the assets shall be distributed according to the Liquidation Preference.

[4] COI Article IV(B)3)(a).

Article IV clearly expresses that the Liquidation Preference will apply in the event of a merger. The COI describes only one preference scheme, the one in Article IV(B)(3). If some other preference scheme is meant to apply in the event of a merger, the COI does not describe it. From the fact that there is only one preference scheme in the COI, *i.e.*, the Liquidation Preference in Article IV(B)(3), I infer that it must be the Liquidation Preference that is meant to apply in the event of a merger.

Plaintiff would have me read the COI so that it states that the Liquidation Preference applies in the event of a merger only with respect to the assets owned and controlled by the corporation. I decline to adopt this interpretation because it makes little sense. The assets of the corporation in the sense of capital, surplus and earnings are not distributed to target shareholders in the event of a merger; they are transferred to the acquiring corporation in return for cash or other consideration paid to shareholders. If I were to adopt plaintiff's interpretation, the Liquidation Preference would be interpreted so that it applied in the event of a merger but it would have no effect.

Plaintiff's interpretation fails for another reason: It renders portions of the COI inoperative. Article IV(3)(a)(i) provides that:

> When paid, the Series F Liquidation Preference shall be paid in cash or, at the option of the Corporation … (ii) if the

> Corporation is acquired by a public company, the Corporation may, at its option, pay 100% in registered common stock of the *acquiring* company…. [5]

The COI states in Article IV(3)(a)(i) that the preference scheme can be paid in stock of the acquiring corporation in the event of a merger. The COI must, therefore, have intended that stock of the acquiring corporation be considered one of the "assets of the corporation" available to satisfy the preference scheme. If I adopt plaintiff's reading and read "assets of the corporation" to not include merger consideration, then this portion of the COI would be interpreted so that it was nonsensical.

For the above reasons, I conclude that defendants' interpretation is the correct one. Accordingly, I grant defendants' motion for summary judgment.

IT IS SO ORDERED.

Very truly yours,

William B. Chandler III

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WBCIII:wbg

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[5] Article IV(B)(3)(a)(i). Nearly identical language to the same effect is contained in the second paragraph of Article IV(B)(3)(a)(ii).