IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JOHN A. GENTILE, VICTORIA S. CASHMAN, BRADLEY T. MARTIN, JOHN KNIGHT, and DYAD PARTNERS, LLC,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 20213-NC**
PASQUALE DAVID ROSSETTE, DOUGLAS W. BACHELOR, and LEASENET GROUP, INC., an Ohio corporation, as successor by merger to LeaseNet Group, Inc., a Delaware corporation,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: June 2, 2005
Date Decided: October 20, 2005

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Jesse A. Finkelstein, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware, J. Travis Laster, Esquire of Abrams & Laster, LLP, Wilmington, Delaware, and Shawn T. Carnathan, Esquire and Alan J. Langton, Esquire of Quigley, O'Connor & Carnathan LLC, Burlington, Massachusetts, Attorneys for Defendants.

NOBLE, Vice Chancellor

SinglePoint Financial, Inc. ("SinglePoint" or the "Company") was a software development company that never produced a commercially viable product and never generated a sustained revenue stream.[1] It survived only because Defendant Pasquale David Rossette ("Rossette"), its majority shareholder, regularly provided desperately needed infusions of cash to meet operating obligations.[2] The Plaintiffs, former shareholders of SinglePoint,[3] which merged into a subsidiary of Cofiniti, Inc. in 2000,[4] bring this action for breach of fiduciary duty against its two directors, Rossette and Defendant Douglas W. Bachelor ("Bachelor"). They challenge, as an unwarranted dilution of their equity interests and voting power in SinglePoint, the conversion of some of the debt held by Rossette into SinglePoint common stock at an unfairly and unreasonably low conversion rate. They also challenge special benefits that Rossette received as part of the merger—additional consideration upon which he conditioned his approval of the merger.

[1] Affidavit of Douglas Bachelor ("Bachelor Aff.") ¶¶ 3, 8.
[2] *Id.* ¶ 3.
[3] The Plaintiffs are John A. Gentile, Victoria S. Cashman, Bradley T. Martin, John Knight, and Dyad Partners, LLC (collectively, the "Plaintiffs").
[4] Affidavit of James B. Radebaugh ("Radebaugh Aff.") Ex. 23 (Agreement and Plan of Reorganization by and among MarketKnowledge, Inc. Cosmo Merger Corp., and SinglePoint Financial, Inc., Sept. 15, 2000 (the "Merger Agreement")). MarketKnowledge adopted the Cofiniti name shortly before consummation of the merger.

Rossette and Bachelor now seek summary judgment. First, they claim that the Plaintiffs' claims are all derivative in nature and, thus, the Plaintiffs lost standing to pursue their claims upon completion of the merger. Second, they assert that they are entitled to judgment as a matter of law on the merits of the Plaintiffs' substantive claims as well. For the reasons set forth below, the Plaintiffs' claims of dilution are derivative in nature and must be dismissed. Whether the claims premised upon the separate consideration received by Rossette as part of the merger are direct claims cannot be resolved on the current record, and the Defendants have not demonstrated that, on the undisputed facts, they are entitled to judgment as a matter of law.

I. BACKGROUND

A. *The Company*

In 1995, Plaintiff Gentile and Defendant Bachelor, who were acquaintances and co-workers, discussed forming a new software company together.[5] Later that year, Gentile and Bachelor presented their idea to Rossette, a childhood friend of Gentile, who agreed to provide an initial investment.[6] As a result of their agreement, on March 19, 1996, Gentile, Rossette, and Bachelor formed the company that would come to be known

[5] Bachelor Aff. ¶ 4.
[6] *Id*. ¶ 5; Deposition of David Pasquale Rossette ("Rossette Dep.") at 17.

as SinglePoint,[7] a "high technology financial services company" that "support[ed] financial advisors and their clients with the ability to manage assets online."[8] The Company failed to develop a commercially viable product and to produce significant revenues.[9] Faced with tremendous financial difficulties throughout its existence (1996-2000), the Company turned to Rossette—who was SinglePoint's sole source of additional funds—several times for financial assistance.[10]

Gentile, Rossette, and Bachelor served as the initial directors of the Company.[11] Gentile was the first President and Chief Executive Officer ("CEO") and Bachelor was the Chief Technology Officer.[12] When the Company encountered difficulties, it relied, as was its practice, upon Rossette for more funding.[13] After having to make several additional cash infusions in 1998, Rossette insisted that Gentile be replaced as President

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[7] Bachelor Aff. ¶ 6. The Company, a Delaware corporation originally called New Horizons Technology, changed its name to OpTeamaSoft in June 1997, and finally in 1999, to SinglePoint Financial, Inc. *Id.*; Bachelor Dep. at 7-8; Radebaugh Aff., Ex. 14 (Board Minutes, July 26, 1999).

[8] Affidavit of Joelle E. Polesky ("Polesky Aff."), Ex. 16 (SinglePoint Financial, Inc. Information Statement, Oct. 13, 2000 (the "Information Statement")) at 2.

[9] Bachelor Aff. ¶ 3.

[10] *Id*.

[11] *Id*. ¶ 7; Rossette Dep. at 19-20.

[12] Bachelor Aff. ¶ 7. Bachelor initially served in a part-time capacity. *Id*. He was named Chief Technology Officer in June 1997. *Id*. ¶ 2.

[13] *Id*. ¶ 3.

before Rossette would make any more funds available.[14] Gentile's replacement, Christopher McGrath, resigned less than one year later, and Bachelor became the new CEO.[15] The Company continued to struggle though, and in April 1999, Rossette decided to take over as CEO, a position that he held throughout the balance of SinglePoint's existence.[16]

B. *The Debt Conversion*

As of March 2000, Rossette had advanced more than $3 million to the Company.[17] In consideration of this financing, Rossette had received promissory notes that were convertible into shares of SinglePoint common stock.[18] The initial conversion rate was $1.33 per share.[19] On November 1, 1997, the rate was dropped to $0.75 per share,[20] and, on October 23, 1999, the rate was lowered once more to $0.50 per share.[21]

SinglePoint's capital structure, before March 27, 2000, principally consisted of almost 6,000,000 outstanding shares of common stock and debt

[14] Bachelor Aff. ¶¶ 11-13. During the months of June and July 1999, Gentile was terminated as an officer and removed from the Board of Directors. *Id.* ¶ 25. With Gentile gone, Rossette and Bachelor comprised the Board in its entirety. *See* Radebaugh Aff., Ex. 14 (Board Minutes, July 26, 1999).
[15] Affidavit of Christopher McGrath ("McGrath Aff.") ¶ 1; Bachelor Aff. ¶ 19.
[16] Bachelor Aff. ¶ 21; Rossette Dep. at 23.
[17] Radebaugh Aff., Ex. 18 (Board Minutes, Mar. 27, 2000).
[18] Poleksy Aff. Ex. 1 (Stock Purchase Agreement, June 7, 1997).
[19] *Id*.
[20] Poleksy Aff., Ex. 2 (Stock Purchase Agreement, Nov. 1, 1997). In 1999, SinglePoint converted $460,620 of the debt owed to Rossette at a rate of $0.75 per share. Radebaugh Aff., Ex. 11 (Debt Conversion Agreement, Jan. 13, 1999) at A 0843-46.
[21] Polesky Aff., Ex. 4 (Amended Loan Agreement, Oct. 23, 1999).

payable to Rossette. Rossette believed that the large amount of debt owed SinglePoint deterred investment by third parties.[22] To ameliorate this problem, Rossette decided to exercise his option under the promissory notes to convert a substantial portion of his debt holdings into equity holdings in the Company.[23] Instead of employing the contractually agreed upon conversion rate of $0.50 per share, Rossette and Bachelor agreed to a substantially lower rate of $0.05 per share.[24]

Rossette and Bachelor, the sole directors at that time,[25] convened a meeting of the Board at which it was agreed that more than $2.2 million of Rossette's debt would be converted into SinglePoint equity at a conversion rate of $0.05 per share.[26] As a result, the debt would be exchanged for 44,419,020 shares of SinglePoint common stock, instead of the

[22] Bachelor Aff. ¶ 40.
[23] *Id*.; Rossette Dep. at 128-29.
[24] Rossette Dep. at 128-33; Bachelor Aff. ¶ 42. Rossette personally retained The Harman Group Corporate Finance, Inc. (the "Harman Group") to render a fairness opinion regarding whether the new debt conversion ratio was fair to SinglePoint. Rossette Dep. at 157. The Harman Group concluded that the fair value of SinglePoint common stock was $0.04 per share. Polesky Aff., Ex. 10 (The Harman Group Fairness Opinion, Mar. 27, 2000) at 3. Plaintiffs challenge the independence of the experts chosen by Rossette and put forth facts that call into question the accuracy of such a conclusion. For example, Rossette and Bachelor voted to increase the exercise price of employee stock options from $0.50 per share to $0.75 per share just 17 days before approving the $0.05 per share rate for Rossette's debt conversion. Rossette Dep. at 110-11 and Ex. 11 (Board Minutes, Mar 10, 2000). The employee stock option plan required that the exercise price for certain options be priced at fair market value. Polesky Aff., Ex. 5 (1997 Stock Option Plan § VII, ¶ 6.1). Thus, the inference is that Rossette and Bachelor believed that the fair market value per share of SinglePoint common stock was $0.75.
[25] Radebaugh Aff., Ex. 14.
[26] Polesky Aff., Ex. 8 (Board Minutes, Mar. 27, 2000).

approximately 4.4 million shares that Rossette would have received at the $0.50 per share conversion rate.[27]

Rossette's debt holdings, however, would convert into more shares of common stock than were then authorized; thus, an amendment to the SinglePoint certificate of incorporation was needed.[28] Accordingly, at a Special Shareholders Meeting on March 27, 2000, the number of authorized shares was increased from 10,000,000 to 60,000,000.[29] Thereafter, under a new Debt Conversion Agreement, all but $1 million in principal of Rossette's debt holdings were converted into shares of common stock at a rate of one common share for every $0.05 of debt.[30] Before the conversion, Rossette held approximately 61.19% of SinglePoint's equity; after the conversion, he held 93.49% of SinglePoint's then issued and outstanding stock.[31]

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[27] *Id.* Later, there would be a 1-for-10 reverse stock split.

[28] Rossette Dep., Ex. 9 (Board Minutes, Mar. 10, 2000).

[29] *Id.* Plaintiffs challenge the validity of this meeting and subsequent vote. Plaintiffs contend that the shareholders "received no notice of the dilution" because, although the shareholders were asked to vote on the authorization of additional shares, the underlying purpose of the authorization—the debt conversion—was not disclosed. Pls.' Answering Br. at 16.

[30] Radebaugh Aff., Ex. 18. As a result of the Debt Conversion Agreement, SinglePoint further restructured its remaining obligations to Rossette and negotiated an additional $500,000 in credit with him. *Id.* The Board also executed a contract to provide Rossette $327,450 in compensation, should the Company experience a change in control. *Id.*

[31] Radebaugh Aff., Ex. 19 (Board of Directors' Stock Analysis, Mar. 10, 2000 and Mar. 27, 2000).

C. *The Merger*

After the conversion, SinglePoint began looking for a possible acquiror.[32] As the result of negotiations with Rossette,[33] Cofiniti, SinglePoint's only direct competitor,[34] offered approximately $14 million of its stock for the Company's stock.[35] On September 15, 2000, SinglePoint entered into an Agreement and Plan of Reorganization pursuant to which Cosmo Merger Corp., a Delaware corporation wholly-owned by Cofiniti, was to merge into SinglePoint, with SinglePoint, the surviving entity, thus becoming a wholly-owned subsidiary of Cofiniti.[36] As consideration, SinglePoint shareholders would receive approximately 0.49 shares of Cofiniti common stock for each share of SinglePoint common stock.[37]

In order to secure Rosette's approval of the Merger, Cofiniti offered Rossette benefits that were not shared with the other shareholders. These benefits included a "put," whereby Cofiniti, *inter alia*, was required to repurchase, in no later than one year, 360,000 shares of the Cofiniti stock

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[32] Rossette Aff. ¶ 3.
[33] Bachelor Aff. ¶ 49.
[34] Affidavit of Thomas Loch ("Loch Aff.") ¶ 10.
[35] Bachelor played a minimal role in the negation process between Cofiniti and SinglePoint; Rossette stated that he handled all of the "material" negotiations himself. Rossette Dep. at 177-78.
[36] Merger Agreement at A1312.
[37] *Id.* This had an approximate value of $2.46 per share, based on Cofiniti's apparent market value of $5 per share. Information Statement at C-02364.

Rossette received in the merger at a price of $5 per share, for a total of $1.8 million.[38] Because Cofiniti shares were not publicly traded,[39] thereby making it difficult for the minority shareholders to liquidate their shares, the put was a substantial benefit to Rossette.

On October 13, 2000, SinglePoint issued an Information Statement regarding the Merger to its shareholders. The shareholders were told that, "approval of the merger is assumed because several of [the] large stockholders, representing in the aggregate approximately 96.8% of [the] outstanding common stock, have agreed to vote their shares in favor of the merger."[40] The Information Statement explained that Rossette had obtained certain benefits not shared with the other stockholders as a result of the Merger. The Information Statement, however, failed to disclose specifically that Rossette had conditioned his approval of the Merger on his receipt of the put agreement with Cofiniti, which entitled Rossette to receive $1.8 million in one year. It also failed to disclose that Rossette had obtained the put agreement. The Merger was approved by a majority of the minority

[38] Rossette Dep., Ex. 30 (Agreement for the Sale and Purchase of Stock, Sept. 15, 2000, the "Repurchase Agreement").
[39] Information Statement at C-02364.
[40] *Id.*

shareholders.[41] The Plaintiffs neither consented to, nor voted their shares in favor of, the Merger.

D. *Post-Merger Events*

After the Merger, Cofiniti encountered many of the same problems that had thwarted SinglePoint's efforts. Within 18 months, Cofiniti had filed for bankruptcy and was later liquidated.[42] Rossette's put agreement, upon which the Plaintiffs have focused, was canceled. As a result of his efforts to support SinglePoint and Cofiniti, Rossette may have lost as much as $6 million.[43]

II. CONTENTIONS

The Defendants' motion for summary judgment attacks Plaintiffs' claims for breach of fiduciary duties in connection with the Debt Conversion (Count I) and the Merger (Count II). Defendants assert that these claims are derivative in nature and, because of the Cofiniti merger, Plaintiffs lost standing to pursue them on behalf of SinglePoint. If either Count I or Count II is properly viewed as derivative in nature, it must be dismissed as a matter of law.

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[41] Bachelor Aff. ¶ 53.
[42] On March 11, 2002, Cofiniti filed a Chapter 7 bankruptcy petition. Rossette Aff. ¶ 8.
[43] *Id*. ¶ 6.

Defendants also assert that, regardless of whether the claims are derivative or direct, they are nonetheless entitled to summary judgment because the Plaintiffs have not advanced any viable claim for breach of fiduciary duty. Additionally, Defendants argue that an exculpation provision in SinglePoint's charter bars recovery for any breach of the duty of care. Finally, Defendants contend that they are entitled to summary judgment because the Plaintiffs have suffered no cognizable damages.

III. APPLICABLE STANDARD

Under Court of Chancery Rule 56, summary judgment may be granted only when there are no issues of material fact in dispute and the moving party is entitled to judgment as a matter of law.[44] The Court must view the facts 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."[45] A party opposing summary judgment, however, "may not rest upon the mere allegations or denials of [his] pleading, but . . . must set forth specific facts showing that there is a genuine issue for trial. If [he] does not so respond, summary judgment, if appropriate, shall be entered against

[44] Del. Ch. Ct. R. 56(c); *Motorola, Inc. v. Amkor Tech., Inc.*, 849 A.2d 931, 935 (Del. 2004).

[45] *Cochran v. Stifel Fin. Corp.*, 2000 WL 1847676, at *4 (Del. Ch. Dec. 13, 2000), *aff'd in part, rev'd in part on other grounds*, 809 A.2d 555 (Del. 2002).

[him]."[46] The Court "also maintains the discretion to deny summary judgment if it decides that a more thorough development of the record would clarify the law or its application."[47]

IV. ANALYSIS

A. *Distinguishing Between Direct and Derivative Claims*

The direct/derivative distinction is critical because, by reason of the Merger with Cofiniti, the Plaintiffs are no longer SinglePoint shareholders. Thus, they lack standing to bring a derivative claim on behalf of the Company.[48] On the other hand,

> [a] direct action may be brought in the name and right of a holder to redress an injury sustained by, or enforce a duty owed to, the holder [of stock in the company at the time of the transaction]. An action in which the holder can prevail without showing an injury or breach of duty to the corporation . . . may be maintained by the holder in an individual capacity.[49]

Whether a claim is derivative or direct depends "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit

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[46] Del. Ch. Ct. R. 56(e).

[47] *Cooke v. Oolie*, 2000 WL 710199, at *11 (Del. Ch. May 24, 2000).

[48] *See, e.g., In re Syncor Int'l Corp. S'holders Litig.*, 857 A.2d 994, 998 (Del. Ch. 2004) ("[A] merger which eliminates a shareholder's ownership of stock in a corporation also eliminates his or her status to bring a derivative suit on behalf of the corporation, on the theory that upon the merger the derivative rights pass to the surviving corporation which then has the sole right or standing to prosecute the action.") (citing *Lewis v. Anderson*, 477 A.2d 1040, 1045-46 (Del. 1984)).

[49] *Syncor*, 857 A.2d at 997 (quoting 2 A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE, ANALYSIS & RECOMMENDATIONS § 7.02(b) at 17).

of any recovery or other remedy (the corporation or the stockholders, individually)?"[50] In answering these questions, the Court is to look beyond the words of complaint, into the "nature of the wrong alleged,"[51] and after considering all of the facts, "determine for itself whether a direct claim exists."[52]

1. <u>The Debt Conversion and Share Dilution</u>

Plaintiffs allege that the Debt Conversion, by which the SinglePoint board authorized the issuance of additional shares of the Company's common stock in order to convert into equity part of the debt owed to Rossette, "result[ed] in a massive dilution of the minority stockholders' interests."[53] Plaintiffs argue that the conversion rate ($0.05 per share) was inadequate and caused SinglePoint to issue "vastly more stock than it should have."[54]

The Plaintiffs' contention that they were directly harmed by the alleged dilution fails as a matter of law. When a "board of directors authorizes the issuance of stock for no or grossly inadequate consideration,

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[50] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004) (emphasis in original).
[51] *In re J.P. Morgan Chase & Co. S'holders Litig.*, 2005 WL 1076069, at *5 (Del. Ch. Apr. 29, 2005) (quoting *Syncor*, 857 A.2d at 997).
[52] *In re J.P. Morgan Chase*, 2005 WL 1076069, at *5 (quoting *Dieterich v. Harrer*, 857 A.2d 1017, 1027 (Del. Ch. 2004)).
[53] Pls.' Opening Br. at 12.
[54] *Id.* at 33.

the corporation is directly injured and shareholders are injured derivatively . . . [and] mere claims of dilution, *without more*, cannot convert a claim traditionally understood as derivative, into a direct one."[55] A dilution claim may be direct, however, if voting rights are harmed.[56] Stock dilution may produce a direct claim:

> where a significant stockholder sells its assets to the corporation in exchange for the corporation's stock, and influences the transaction terms so that the result is (i) a decrease (or 'dilution') of the asset value *and* voting power of the stock held by the public stockholders and (ii) a corresponding increase (or benefit) to the shares held by the significant stockholder.[57]

Here, however, the minority shareholders' voting power was not materially decreased.[58] Rossette owned a controlling interest both before (61%), and after (93%), the challenged Debt Conversion.[59] As minority shareholders to begin with, Plaintiffs' voting power was not materially changed.[60]

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[55] *J.P. Morgan Chase*, 2005 WL 1076069, at *6 (internal quotations and citations omitted) (emphasis added). *See also Gatz v. Ponsoldt*, 2004 WL 3029868 (Del. Ch. Nov. 5, 2004).

[56] *See, e.g.*, *Oliver v. Boston Univ.*, 2000 WL 1091480 (Del. Ch. July 18, 2000).

[57] *In re Paxson Comnc'n. Corp. S'holders Litig.*, 2001 WL 812028, at *5 (Del. Ch. July 12, 2001) (emphasis added).

[58] In contrast, dilution claims emphasizing the diminishment of voting power have been categorized as direct claims. *See, e.g.*, *Oliver*, 2000 WL 1091480, at *6.

[59] The Plaintiffs have not argued that the Debt Conversion impacted voting rights because a corporate parent (of course, not the circumstances here at the time) controlling at least 90% of shares can use a short-form merger to divest the minority shareholders of their equity interest without any shareholder vote. *See* 8 *Del.C.* § 253.

[60] *See, e.g.*, *Agostino v. Hicks*, 845 A.2d 1110, 1124 (Del. Ch. 2004) (finding no cognizable loss of voting power where the plaintiffs held only a minority interest before the challenged transaction).

The issuance of additional stock necessarily reduces the proportional voting power of those shareholders who do not maintain their same percentage of the total number of outstanding shares. Thus, dilution typically is a consequence of any effort to raise funds through the issuance of new shares. It may be done for good purposes or for bad purposes. Here, by selling its shares too cheaply—the core of Plaintiffs' attack—SinglePoint lost—perhaps only theoretically in light of its unhappy fiscal condition—the ability to sell those shares for a better price. That loss, while hurting the shareholders in the sense that any corporate loss hurts shareholders, was the Company's loss; the remedy would be either to cancel the shares (thereby affording the Company the opportunity to sell the shares for fair value) or to require the acquirer to pay fair value (thereby conferring a financial benefit on the Company). Thus, this is an instance where the Company suffered the harm and any remedy would be for the benefit of the Company. As such, under *Tooley*, the claim is derivative.[61]

[61] The Plaintiffs view the exchange of debt for stock as a recapitalization. After all, they argue, stock was issued, but no cash was received. Pls.' Answering Br. at 33. There are, of course, instances where a recapitalization can give rise to direct claims. *See, e.g.*, *Acker v. Transurgical, Inc.*, 2004 WL 1230945 (Del. Ch. Apr. 22, 2004), because it will reallocate rights among shareholders without causing any consequences to the corporation. The debt conversion in this instance, if one accepts Plaintiffs' allegations, did cause harm to the Company and, if the Company sold those share too cheaply, whether payment was through debt cancellation or the receipt of cash makes no difference for these purposes.

Because the Plaintiffs' challenge to the Debt Conversion may only be brought derivatively by the Company's shareholders, the Plaintiffs lost standing to pursue that claim upon completion of the Merger. Accordingly, the Defendants are entitled to summary judgment dismissing Count I of the Complaint.

2. The Merger

The Plaintiffs also challenge the stock-for-stock merger of SinglePoint and Cofiniti. They contend that Rossette conditioned his approval of the Merger on receipt of special benefits, not available to the other shareholders, and that, because of his conduct, the Merger process was unfair and the consideration which they received from the Merger was also unfair. The focus is on the put provided by the Repurchase Agreement.[62] The Plaintiffs point out that a reallocation of the Merger proceeds would benefit

[62] The Plaintiffs also complain about the handling of SinglePoint's indebtedness to Rossette. For example, Rossette, with consummation of the Merger, was repaid some $355,000 for sums which he advanced to SinglePoint after the Merger Agreement had been executed. Merger Agreement at A1362, A1371; Rossette Dep. at 198. Without these funds, SinglePoint could not have continued in business through closing. SinglePoint's other debt to Rossette was assumed by Cofiniti. The Plaintiffs do not dispute that Rossette's loans to SinglePoint were critical to its survival and they offer no viable reason for why Rossette, simply because of his status as a director and majority shareholder of SinglePoint, should have been expected to forego a commitment for repayment of duly incurred indebtedness.

them directly. The parties' debate revolves around *Parnes*[63] and *Kramer*.[64] In both *Kramer* and *Parnes*, the shareholders alleged that they suffered a direct injury as a result of unfair transactions that occurred in connection with a merger.[65] The cases had strikingly different outcomes.

In *Kramer*, the stockholders challenged the decision by the board of directors to grant stock options and golden parachutes to management six months before a merger. The stockholders argued that the claim was direct because their share of the merger proceeds was reduced by the cost of the options and golden parachutes. The Court concluded that the claim was essentially for "waste of corporate assets"[66] and, therefore, derivative in nature because it did not "allege something other than an injury resulting from a wrong to the corporation."[67]

As did the shareholders in *Kramer*, the shareholders in *Parnes* alleged that their share of merger proceeds had been unfairly reduced. Unlike the *Kramer* case, however, the gravamen of the plaintiffs' complaint

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[63] *Parnes v. Bally Entm't Corp.*, 722 A.2d 1243 (Del. 1999) (applying motion to dismiss standard).
[64] *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348 (Del. 1988). *Tooley* confirms that the conclusions in both *Parnes* and *Kramer* resulted from the proper analysis. 845 A.2d at 1039. The Defendants, perhaps recognizing the similarities between this case and *Parnes*, contend that the *Tooley* Court, although it approved the test applied in *Parnes*, did not necessarily approve the result in *Parnes*. Defs.' Reply Br. at 8 n.4.
[65] *See Kramer*, 546 A.2d at 349; *Parnes*, 722 A.2d at 1244.
[66] *Kramer*, 546 A.2d at 355.
[67] *Tooley*, 845 A.2d at 1038 (discussing *Kramer*).

in *Parnes* was not based on benefits granted before the merger. Instead, the reduction in their share of the proceeds, the *Parnes* shareholders contended, was caused by the board chairman's insistence that he receive special payments before he would consent to the merger. Unlike in *Kramer*, this claim was held to be direct. The critical distinction was that because of the board chairman's alleged conduct, the entire merger process had been tainted by unfair dealing with a resulting material, adverse impact on price. In contrast, *Kramer* did not involve an allegation that the merger price was unfair, or that the merger was obtained through unfair dealing. In *Kramer*, the plaintiffs complained that the value of the corporation itself had been reduced by the cost of the options and golden parachutes that had been granted prior to the merger—"a classic derivative claim" because the corporation alone directly suffered the harm.[68]

Thus, the shareholder-plaintiff who seeks to bring a direct action must tie her claim to the price and process of the merger.

> [A] direct attack on the fairness or validity of a merger can be maintained as an individual or direct action. . . . In order to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price.[69]

[68] *See Parnes*, 722 A.2d at 1245 (discussing *Kramer*).
[69] *Dieterich*, 857 A.2d at 1029 (quoting *Parnes*, 722 A.2d at 1245).

Here, Plaintiffs allege that the directors breached their fiduciary duties by engaging in unfair dealing during the merger process. Specifically, Plaintiffs allege that in order to secure Rossette's approval of the Merger, the Board (or Rossette with the passive and poorly informed acquiescence of Bachelor) unfairly shifted merger consideration from the minority shareholders to Rossette. In the Plaintiffs' view, Cofiniti had a finite amount it was willing to pay for SinglePoint, and Rossette misused his directorship position to usurp a portion of the available bounty for his own personal benefit. The side benefits to Rosette included the right (and obligation) to sell, at some future time, the Cofiniti shares he received in the Merger back to Cofiniti at an agreed upon price—a benefit that no other shareholder was offered. In support of this allegation, Plaintiffs offer Rossette's own deposition testimony that he needed personal "inducements" in order to approve the Merger.[70] Taking the facts in a light most favorable to the Plaintiffs, Rossette's conduct may be viewed as similar to the conduct alleged in *Parnes*.

Defendants argue that *Kramer* is dispositive of this case because the challenged side benefits to Rossette, comparable to the options and golden parachutes in *Kramer*, are essentially examples of alleged corporate waste.

[70] Rossette Dep. at 208-09.

Defendants contend that the challenged benefits to Rossette were not part of the merger consideration, but were conferred upon Rossette as a SinglePoint creditor. But, as *Parnes* confirms, *Kramer* does not stand for the proposition that all side payments made in connection with a merger are derivative in nature. The Court stressed the timing of the side payments in *Kramer*, pointing out that the "conduct extend[ed] over a period of six months or more," and was "largely unrelated to the [merger]."[71] Because the benefits in *Kramer* were not cotemporaneous with the merger, the Court determined that the shareholders' claims did not "implicate the fairness of the merger terms," and therefore, "[did] not directly challenge the merger as resulting from a breach of fiduciary duty."[72] In contrast, here the challenged side benefits were (as Plaintiffs allege) entirely related to the merger—consummation of the merger was actually conditioned upon Rossette's receipt of some "inducement." Rossette's insistence that he receive a personal benefit in order to approve the Merger distinguishes this case from *Kramer*. The Merger, and its allocation of proceeds, is alleged to have resulted from a breach of fiduciary duty and the shareholders' complaint directly attacks the merger process and its consequences for them.

[71] *Kramer*, 546 A.2d at 352.
[72] *Id*. at 354.

In the post-merger fallout, according to *Dieterich*, “a shareholder makes a direct claim by alleging that director conduct in a transaction that eliminates shareholders is so egregious as to materially affect the price paid in that transaction.”[73] This suggests that the question of whether a claim is direct or derivative requires consideration of whether the alleged conduct caused a material impact on the price received by the shareholders. Accordingly, the value of the put as the separate consideration flowing to Rossette as part of the Merger, must be assessed.

The value of the put as of the time of the Merger has not been established. The Plaintiffs prefer the simple approach of multiplying 360,000 shares by the put price of $5 per share to reach $1.8 million. The proper value would seem to be significantly less than that, whether because of the time value of money (depending upon the circumstances, the agreement may be viewed as one requiring a payment at the end of one year) or the difference between market price and the exercise price of the put (at the time of the Merger, one would have assumed that Cofiniti would have had some value a year later). The Defendants argue that the value of the put is inherently speculative and difficult to ascertain. They are correct that the

[73] 857 A.2d at 1027 (relying upon *Golaine v. Edwards*, 1999 WL 1271882 (Del. Ch. Dec. 21. 1999)).

valuation of contractual rights of this nature is difficult,[74] but that does not lead to the conclusion, especially in the context of a motion for summary judgment where inferences are to be drawn in favor of the nonmoving party, that the put was of no or *de minimis* value. Rossette insisted upon the put and it was material to him.[75] Thus, he—or so one can reasonably infer—thought that it had material value. The Court in these circumstances should not attempt to calculate the value of the put because that is essentially a fact-finding exercise, one usually performed with the help or hindrance of expert witnesses. If the value of the put approaches the $1.8 million ascribed to it by Plaintiffs, then it would likely be viewed as material when measured against the $14 million Merger consideration allocated among all of SinglePoint's shareholders. Conversely, if the value of the put tends toward the *de minimis* valuation advanced by the Defendants, its materiality, or, more specifically, its impact on the fair price aspect of the Merger, is subject to substantial doubt.[76]

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[74] *See, e.g.*, *Lewis v. Vogelstein*, 699 A.2d 327, 331-33 (Del. Ch. 1997).

[75] Rossette Dep. at 208-09.

[76] The proper classification of the put agreement is also in dispute. Rossette argues that it was provided to him because of his status as creditor; the Repurchase Agreement recites that it was an inducement to him as the controlling shareholder. The Plaintiffs view it as a benefit acquired, at least in substantial part, by virtue of his status of director. If the benefits of the put agreement are properly characterized as merger consideration in which, but for the directors' unfair dealing, the shareholders would have participated, the shareholders may have presented a direct claim. On the other hand, if the benefits were granted to Rossette—a SinglePoint creditor—for reasons independent of the Merger, the

In short, the Court's inquiry as to whether the Plaintiffs' claims regarding the Merger are direct must also focus on whether Rossette's diversion of the value of the put from the other shareholders resulted in an unfair price.[77] Because this question cannot be resolved on the existing summary judgment record, the Court cannot now conclude that the Plaintiffs' Merger claim is derivative.[78]

B. *Defendants' Fiduciary Duties and the Merger*

The Court in its review of the Defendants' summary judgment challenge to the Plaintiffs' claims under the Merger now turns to whether, assuming for these purposes that those claims are direct, they would nonetheless fail as a matter of law based on the undisputed material facts. The Defendants' arguments can be grouped as follows: (1) the Plaintiffs have not brought an action that requires evaluation of the Defendants' conduct under the entire fairness standard; (2) the Merger was approved by a disinterested and independent Bachelor, who constituted one-half of the

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shareholders suffered no direct harm because they had no individual entitlement to proceeds that Cofiniti offered to a creditor outside the scope of the merger consideration.

[77] This is not to exclude the unfair process aspect of the Plaintiffs' challenge. Fairness of price and process, in the final analysis, calls for an integrated review. *See, e.g.*, *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1163 (Del. 1995) ("The test for fairness is not a bifurcated one as between fair dealing and fair price. All aspects of the issue must be examined in whole since the question is one of entire fairness.").

[78] Alternatively, this is one of those instances where the Court may deny summary judgment in the expectation that the factual record will be enhanced and provide a more solid foundation for its analysis. *See, e.g., Cooke*, 2000 WL 710199, at *11.

Board, and ratified by a majority of the minority shareholders; (3) even if Rossette is unsuccessful in his effort to earn summary judgment, Bachelor, because of his limited, independent and disinterested role, is entitled to summary judgment; (4) the exculpatory clause in SinglePoint's charter, adopted under 8 *Del.C.* § 102(b)(7), relieves the Defendants of any liability for the monetary damages now sought by the Plaintiffs; and (5) the Plaintiffs have not shown that the Defendants' actions caused them cognizable and calculable damages.

1. <u>Entire Fairness Standard</u>

Rossette received a personal benefit, the put agreement, that was not available to the other shareholders. Although there are substantial questions as to the value of the put, one cannot conclude as a matter of undisputed fact, that it was not material either to Rossette or to the other shareholders. Thus, for Rossette, the Merger was a self-interested transaction.[79] Unless otherwise relieved of the burden, it falls upon the Defendants to show that the transaction was "entirely fair." The Defendants, however, cannot

[79] *See Orman v. Cullman*, 794 A.2d 5, 29 (Del. Ch. 2002). "[A] director is considered interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders.") (internal quotations and citations omitted); *Chaffin v. GNI Group, Inc.*, 1999 WL 721569, at *5 (Del. Ch. Sept. 3, 1999) ("To be considered disinterested, the director's decision must be based entirely on the corporate merits of the transaction and not be influenced by personal or extraneous considerations. Thus, a director who stands to receive a substantial benefit in a transaction that he votes to approve, cannot objectively be viewed as disinterested.") (internal citations and quotations omitted).

"demonstrate that the record evidence, viewed in the light most favorable to the [P]laintiffs, including all reasonable inferences, compels a conclusion that the transaction was entirely fair."[80]

2. Approval of the Merger by Bachelor and the Minority Shareholders

Defendants insist that, because the Merger was approved by an independent director, Bachelor, and a majority of the minority shareholders, they need not demonstrate that the Merger was entirely fair. At the time of the Merger, SinglePoint's board consisted only of Rossette and Bachelor. Assuming, as is reasonable, that Bachelor was independent and disinterested, he was only one half of an evenly divided board—not a majority. His approval of the Merger is insufficient to validate Rossette's self-interested transaction.[81]

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[80] *Seagraves v. Urstadt Prop. Co., Inc.*, 1996 WL 159026, at *4 (Del. Ch. Apr. 1, 1996) (stating that when a "merger [is] a self-dealing transaction, the burden of proving entire fairness rests on the defendants.").

[81] *See In re Oracle Corp., Deriv. Litig.*, 824 A.2d 917, 944 (Del. Ch. 2003); *Chaffin*, 1999 WL 712569 at *4-6. In addition, Bachelor apparently had no independent sources of assistance (legal or financial) to assist him. Because of Rossette's status—controlling shareholder, director, creditor—the ability of Bachelor alone to preserve the interests of the minority shareholders was limited. Moreover, even if Rossette extracted unfair consideration from the Merger, Bachelor might have readily concluded that the Merger was nonetheless in the best interests of the minority shareholders. Without a combination with another entity or a substantial infusion of capital, SinglePoint could have failed and then the shareholders would have had nothing. Indeed, SinglePoint's ability to stay in business until consummation of the Merger appears to have been in doubt. That the merger with Cofiniti was in the best interests of the shareholders may have explained Bachelor's support for the Merger even though the allocation of consideration from the Merger may have been both inequitable and actionable.

Nor does the shareholder vote ratify the interested transaction because the Information Statement failed to provide adequate disclosure to the shareholders. Rossette's approval of the Merger was conditioned upon his receipt of the certain "inducements," which included the put agreement with Cofiniti. Omission of the fact that Rossette was to receive this benefit in connection to the Merger "raise[s] a question as to the judgment and care of the defendant directors regarding their . . . disclosure decisions connected with the merger."[82] Moreover, if the put agreement conferred a material benefit upon Rossette,[83] the failure to disclose it to the shareholders leads to the conclusion that they were not fully informed. Shareholder ratification of an interested transaction can only occur if the shareholders are fully informed.[84]

3. <u>Bachelor's Role</u>

Bachelor seeks to extricate himself from this litigation by pointing out that the Plaintiffs have made no significant effort to demonstrate that he was

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[82] *Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 (Del. 1999) (internal quotations omitted).

[83] As addressed above, whether it was material cannot be determined from the record for summary judgment purposes.

[84] *See, e.g., In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *36 (Del. Ch. May 3, 2004).

beholden to Rossette or that he was interested in the Merger.[85] Bachelor approved the Merger as one of two directors, but he did so without ever inquiring of either Rossette or Cofiniti whether Rossette was receiving any special consideration even though Rossette negotiated the terms of the Merger with Cofiniti.[86] In the context of a motion for summary judgment, it is a reasonable inference that the Court may draw, for these purposes, that Bachelor failed to discharge his duties with due care and loyalty (or in good faith). The shareholders had every right to expect him to ascertain (or at least attempt to ascertain) whether Rossette had negotiated any significant specific favorable terms for his exclusive benefit. Bachelor's abject failure to take any steps to meet this expectation precludes summary judgment.[87]

4. Exculpation Provision in SinglePoint's Charter

SinglePoint's certificate of incorporation contained a typical exculpation provision adopted in accordance with 8 *Del. C.* § 102(b)(7). Under Section 102(b)(7), directors may be exculpated from personal liability for monetary damages arising out of their breach of their duty of care. If the loyalty or good faith of a director is in doubt, however, the protection of Section 102(b)(7) is not available.

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[85] Bachelor did secure employment with Cofiniti following the Merger, but the Plaintiffs have not suggested that his employment alone, in this context, would compromise the exercise of his business judgment.
[86] Bachelor Dep. at 58-59.
[87] *See, e.g.*, *Emerald Partners*, 726 A.2d at 1222-24.

Based upon the current record, Rossette's loyalty (because of his interest in the put agreement) and Bachelor's good faith are at issue, and, thus, the Court cannot conclude that only a duty of care claim remains.[88] Therefore, consideration of the effect of the exculpatory provision, at this point, is premature.[89]

5. Damages

Finally, Defendants argue that the Plaintiffs' claims fail because they have no cognizable damages. In light of Cofiniti's financial demise after the Merger, Defendants assert that even if "Plaintiffs would have received more shares of Cofiniti stock in the merger but for the purported wrongdoing by Rossette, those shares would have been valueless."[90] The Court's calculation of any damages must be based on conditions as of the merger date, i.e., what the "shares would have been worth at the time of the Merger if [Rossette and Bachelor] had not breached [their] fiduciary duties."[91] That the shares and the put agreement may have *eventually* become worthless does not change this analysis. In addition, as set forth above, the questions

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[88] *See, e.g., Orman*, 794 A.2d at 41.

[89] *See Emerald Partners v. Berlin*, 787 A.2d 85, 95 (Del. 2000) (stating that "[a] judicial determination on the issue of entire fairness is a condition precedent to any consideration of damages" and, therefore, any consideration of an affirmative Section 102(b)(7) defense).

[90] Defs.' Opening Br. at 47.

[91] *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 440-441 (Del. 2000)

of material fact concerning the value of the put agreement preclude summary judgment on this basis as well.

V. CONCLUSION

For the foregoing reasons, summary judgment will be granted to the Defendants with respect to Count I (Debt Conversion and Share Dilution) of the Complaint. The Court concludes that Count I states a derivative, and not a direct, claim. Defendants' motion for summary judgment will be denied with respect to Count II (Merger) of the Complaint. Rossette undertook a self-interested transaction in which he received benefits not shared with those to whom he owed fiduciary duties. Based on the record, whether Plaintiffs' claim is direct or derivative cannot be resolved on summary judgment. Similarly, the record does allow for the conclusion, at this stage, that the Merger was entirely fair or that any of the Defendants' other contentions prevail.

An order will be entered to implement this memorandum opinion.