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IN THE SUPREME COURT OF THE STATE OF DELAWARE

MICROSOFT CORPORATION, a Washington Corporation, Plaintiff Below, Appellant, v. VADEM, LTD., a British Virgin Islands International Business Company; AMPHUS, INC., a Delaware Corporation; ST. CLAIR INTELLECTUAL PROPERTY CONSULTANTS, INC., a Michigan Corporation; and HENRY FUNG, an Individual, Defendants Below, Appellees.	No. 290, 2012 ON APPEAL FROM C.A. NO. 6940-VCP IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE REDACTED VERSION FILED SEPTEMBER 7, 2012

APPELLANT'S OPENING BRIEF

FISH & RICHARDSON P.C.
Cathy L. Reese (DE Bar No. 2838)
Tara D. Elliott (DE Bar No. 4483)
Jeremy D. Anderson (DE Bar No. 4515)
Joseph B. Warden (DE Bar No. 5401)
222 Delaware Avenue, 17th Floor
P.O. Box 1114
Wilmington, DE 19899-1114
(302) 652-5070

OF COUNSEL:

FISH & RICHARDSON P.C.
Lauren A. Degnan
1425 K Street, N.W., 11th Floor
Washington, D.C. 20005
(202) 783-5070

Attorneys for Plaintiff Below-Appellant Microsoft Corporation

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NATURE OF THE PROCEEDINGS

This appeal seeks reversal of the Court of Chancery's April 27, 2012 Memorandum Opinion and Order that dismissed, with prejudice, Plaintiff Below-Appellant Microsoft Corporation's ("Microsoft") direct claims against Defendants Below-Appellees Vadem, Ltd. ("Vadem BVI"), Amphus, Inc., ("Amphus"), St. Clair Intellectual Property Consultants, Inc. ("St. Clair"), and Henry Fung ("Fung"), and Defendant Below Patent Revenue Partners, LLC ("PRP"),[1] on grounds that those claims were time-barred.

In 2000, Fung, a director of Vadem BVI, persuaded the Vadem BVI board to transfer to Amphus certain Vadem BVI patents for only a collective $2, when Fung had a substantial ownership and controlling interest in Amphus. To persuade Vadem BVI to make that transfer, Fung represented to Vadem BVI's board that the patents were worth nothing, while fraudulently concealing that he actually believed the patents to be worth "hundreds of millions of dollars." He then arranged to resell those patents to St. Clair at a substantial profit.

Because Vadem BVI made that transfer as part of the larger disposition of substantially all of Vadem BVI's assets, Vadem BVI's Memorandum of Association (the equivalent of a Certificate of Incorporation) prohibited the transfer from being effected absent the approval of Vadem BVI's preferred shareholders, including Microsoft. No such approval was given and, as a result, the transfer of the patents was an *ultra vires* act that was void *ab initio*.

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[1] Defendant Below PRP was not a named defendant for the claims at issue on appeal, and therefore is not a party to this appeal.

Microsoft, a shareholder in Vadem BVI, brought the action-below on October 14, 2011. The Verified Complaint (the "Complaint") contains eight counts, including derivative claims against Fung for breaches of his fiduciary duties, derivative claims against Amphus, PRP, and St. Clair for conspiring in and aiding and abetting in those breaches, direct claims against Vadem BVI for its *ultra vires* transfer of the patents, in breach of Microsoft's shareholder voting rights, and direct claims against Fung, Amphus, and St. Clair for their complicity in that breach.

On November 17 and 18, 2011, Defendants moved to dismiss the Complaint. After Defendants filed their Joint Opening Brief in Support of Their Motions to Dismiss, Microsoft moved on December 14, 2011 to amend its Complaint pursuant to Court of Chancery Rule 15(aaa) to add Vadem Inc. ("Vadem California") as a named defendant. The court heard oral argument on Defendants' motions to dismiss and on Microsoft's motion for leave to amend on January 4, 2012.

On April 27, 2012, the Court of Chancery issued its decision dismissing all of Microsoft's claims. (Op. at 1.)[2] The court dismissed Microsoft's derivative claims after concluding, as an issue of first impression, that the law of the British Virgin Islands ("BVI") required Microsoft to seek leave of the BVI High Court before filing its derivative complaint against Vadem BVI—a BVI international business company. (Op. at 13-14.) Those claims were dismissed without prejudice to Microsoft's ability to refile after seeking leave

[2] Citations to "Op." are to the Court of Chancery's April 27, 2012 Memorandum Opinion and Order, which is attached as Exhibit A.

from the BVI High Court. (Op. at 15.) On May 23, 2012, Microsoft applied to that court for leave to file its derivative claims, and a hearing on that application is scheduled for November 8, 2012.

The Court of Chancery dismissed Microsoft's direct claims with prejudice because it concluded that those claims were time-barred by the doctrine of laches. (Op. at 25.) In so holding, the Court of Chancery disregarded that notice of the injury, as opposed to mere notice of breach, is essential to commence the running of an otherwise tolled statute of limitations (and analogous laches) period. Instead, the Court of Chancery erroneously found that tolling under the theories of equitable tolling and fraudulent concealment could last only until Microsoft discovered that Vadem BVI had breached Microsoft's voting rights through the *ultra vires* transfer of assets, and that Microsoft's inability to discover its economic injury as a result of those transfers was irrelevant. (Op. at 23-25.)

On May 29, 2012, Microsoft filed its Notice of Appeal, appealing from the Court of Chancery's decision only to the extent it dismissed Microsoft's direct claims.

SUMMARY OF ARGUMENT

1. The Court of Chancery's decision that Microsoft's claims are time-barred was the product of two reversible errors. First, by holding that Microsoft is prohibited from challenging Vadem BVI's *ultra vires* transfer of assets, the Court of Chancery gave legal effect to a void act that cannot be legally enforceable. Courts in Delaware and elsewhere have long recognized that void acts can be challenged at any time because they are legal nullities, and neither a court's authority nor a plaintiff's inaction can breathe life into them. Vadem BVI was prohibited from transferring substantially all of its assets without the affirmative vote of its preferred shareholders, including Microsoft. Because Vadem BVI nonetheless transferred substantially all of its assets without such a vote, that transfer was an *ultra vires* act that was void *ab initio*. As a result, the transfers were never legally enforceable, could not become legally enforceable merely through Microsoft's inaction, and could be challenged at any time.

2. Second, even if some limitations period did apply to Microsoft's direct claims, the Court of Chancery erred by refusing to toll the commencement of that period until Microsoft became aware of its economic injury. That injury was hidden from Microsoft as a result of both Fung's fraudulent concealment and Microsoft's reliance on the good faith of Vadem BVI's directors, in their fiduciary capacities. Microsoft did not know, and could not have known, that Vadem BVI's *ultra vires* transfer resulted in assets perceived as being worth "hundreds of millions," being transferred away for only $2.

Neither Microsoft nor any reasonable party in Microsoft's position could have known that it was in a position to bring a meritorious lawsuit.

3. By holding that Microsoft's lack of notice of its economic injury was "irrelevant" and that Microsoft's claims were, therefore, time-barred, the Court of Chancery's opinion ignores binding case law and creates incentives for parties to bring frivolous lawsuits. The court's opinion requires a plaintiff who, after a reasonable and diligent investigation, concludes that it has suffered no harm from a known breach, to bring a lawsuit nonetheless. Otherwise, that plaintiff would be left without a remedy if it later uncovered a serious injury that had been hidden due to a defendant's fraudulent concealment or the plaintiff's reliance on the good faith of a fiduciary.

4. In light of the inefficient and inequitable results that would flow from such a rule, Delaware courts consistently repeat the standard that beginning of a limitations period should be tolled until a plaintiff discovers its *injury*. Thus, by holding that Microsoft's claims were time-barred based on notice of its breach, without regard to notice of its economic injury, the Court of Chancery's decision is inconsistent with both prior precedent and good policy. Accordingly, this Court should reverse the Court of Chancery's decision, vacate its order of dismissal, and remand for further proceedings.

STATEMENT OF FACTS

A. The Parties

Plaintiff Microsoft is a Washington corporation with its principal place of business at One Microsoft Way, Redmond, Washington, 98052. (App. at A-18, ¶ 3.)

Defendant Vadem BVI is a privately held international business company incorporated in the British Virgin Islands ("BVI") on December 28, 1993. (App. at A-19, ¶ 4.) Vadem BVI maintains its principal place of business at 473 Sapena Court, Suite 5, Santa Clara, California, 95054. (*Id.*)

Defendant Fung is one of the co-founders of Vadem BVI, its former chief technology officer, and its current CEO. (App. at A-19, ¶ 5.) He is one of two current directors on Vadem BVI's board of directors (the "Vadem Board"), having served on the Vadem Board since the company's inception in 1993. (*Id.*) Fung was also a founder, a director, and the CEO of Amphus and a manager of Defendant PRP. (*Id.*) Additionally, Fung is the named inventor of several patents assigned at issuance to Vadem, Inc., a wholly owned California subsidiary of Vadem BVI ("Vadem California"). (*Id.*) Those patents were part of a portfolio of patents held by Vadem BVI and its subsidiaries and described by Fung as "power management patents" (the "Vadem Patents"). (*Id.*) The Vadem Patents were later transferred to Amphus and then to St. Clair. (*Id.*)

Defendant Amphus is a now-dissolved Delaware corporation that maintained its primary place of business at 473 Sapena Court, Suite 5, Santa Clara, CA, 95054. (App. at A-19, ¶ 6.) Vadem BVI spun-off

Amphus on December 8, 1999. (*Id.*) Amphus was dissolved on December 24, 2008, and its remaining assets were repurchased by Vadem BVI. (*Id.*)

Appellee St. Clair is a Michigan corporation with its principal place of business at 16845 Kercheval Avenue, Suite 2, Gross Pointe, Michigan, 48230. (App. at A-19, ¶ 7.) St. Clair is the current, purported owner of the Vadem Patents, some of which it has asserted against Microsoft and others in ongoing litigation pending in the United States District Court for the District of Delaware (the "patent litigation"). (App. at A-19, ¶ 7; A-28, ¶ 28.)

B. Microsoft's Investment in Vadem BVI

Between 1992 and 1999, Microsoft entered into a series of licensing agreements with Vadem BVI and Vadem California, licensing those entities to distribute Microsoft's DOS and Windows CE operating systems, to use those operating systems in their devices, and to use Microsoft's logos on their products. (App. at A-20, ¶ 9.) In 1998, as part of an effort to raise much-needed cash, Vadem BVI sent Microsoft a private placement memorandum soliciting Microsoft's investment. (App. at A-20, ¶ 10; A-22, ¶ 14.) In response to that solicitation, Microsoft eventually purchased 1,554,403 shares of Vadem BVI's Series F Preferred Stock and $10 million in intellectual property assets related to Vadem BVI's handwriting recognition technologies. (App. at A-20-21, ¶¶ 10-11.)

Pursuant to Vadem BVI's Memorandum of Association (the "Memorandum"), Microsoft and the other holders of preferred stock acquired certain voting rights. In particular, the Memorandum

required the affirmative vote of a majority of the preferred stock holders to effectuate any "disposition of all or substantially all of the assets of the Company." (App. at A-21, ¶ 12; A-42-43.) Without that vote, Vadem BVI and its Board were prohibited from "effecting or validating" any such transfer. (App. at A-42-43.)

C. The *Ultra Vires* Disposition of Vadem BVI's Assets

Shortly after Microsoft's investment in Vadem BVI, the Vadem Board began drawing up plans to create four new companies into which Vadem BVI would transfer the business and assets of its four distinct business divisions (the "Operating Companies"). (App. at A-21, ¶ 13; A-25, ¶ 22.) Following the transfer of Vadem BVI's assets to the Operating Companies, Vadem BVI planned to merge into Vadem LLC, a newly formed California company, which would continue as the surviving Vadem entity. (App. at A-25, ¶ 22.) Vadem LLC's assets would consist primarily of stock in the Operating Companies. (*Id.*)

Because the planned asset transfers (the "Asset Transfers") would constitute a "disposition of all or substantially all of the assets of the Company," the Memorandum prohibited the Vadem Board from effecting those transactions without a vote of the majority of shares held by Microsoft and the other holders of Series D, E, and F stock. (App. at A-25:26, ¶ 23.) As a result, in December 1999, the Vadem Board prepared a draft shareholder Information Statement (the "Draft Information Statement"), describing the proposed transactions and informing the shareholders of the Vadem Board's [redacted]

[redacted]

That Draft Information Statement was never sent to Microsoft and the other shareholders. (App. at A-26, ¶ 24.) Instead, the Board began forming the Operating Companies and commenced the Asset Transfers without first informing the shareholders or obtaining the vote required by the Memorandum. (*Id.*) Then, in March 2000, after the Asset Transfers had already begun, the Board sent the shareholders a new Information Statement (the "Final Information Statement"), notifying Microsoft and the other shareholders that the Vadem Board had begun forming the Operating Companies and was already transferring assets to those entities. (*Id.*; App. at A-106-107.) The Final Information Statement did not request any vote or other approval by the shareholders for those Asset Transfers, requesting only their written consent to the proposed merger of Vadem BVI into Vadem LLC. (App. at A-26:27, ¶ 25.) [redacted]

Regardless of the Vadem Board's vacillating position, Vadem BVI disposed of substantially all of its assets—a fact not disputed by Defendants—and did not solicit or receive the required approval of the

shareholders. (*Id.*) [redacted] Nonetheless, because the Memorandum prohibited Vadem BVI from effecting a disposition of substantially all of its assets without the majority vote of the Series D, E, and F shareholders, Vadem BVI was not empowered to transfer those assets and the Asset Transfers were an *ultra vires* act. (*Id.*)

Although the transfer of Vadem BVI's assets to the Operating Companies was completed in 2000, the proposed merger between Vadem BVI and Vadem LLC was never consummated. (App. at A-27, n.4.)

D. The Transfer of the Vadem Patents to Amphus, and Fung's Fraudulent Concealment of Their Value

As part of Vadem BVI's process of transferring its assets to the Operating Companies, during a December 6, 1999 Vadem Board meeting, Fung proposed creating Amphus to receive Vadem BVI's chip products business. (App. at A-21:22, ¶ 13.) Fung further proposed that he would be founder and CEO of Amphus and would own 20 percent of the company—a much larger stake than the 7.9 share he then held in Vadem BVI. (*Id.*) Vadem BVI would own 40 percent of Amphus and the remaining 40 percent would be divided between other founding members and new investors. (*Id.*) Fung also proposed that the Vadem Patents be transferred to Amphus. (App. at A-22, ¶ 14.)

When Fung proposed that he take the Vadem Patents and form Amphus, he believed those patents were worth "hundreds of millions of

dollars."[3] (App. at A-22, ¶ 15.) [redacted] In December 1999, the Vadem Board agreed to Fung's proposal to transfer the Vadem Patents to Amphus. (*Id.*) That decision was effectuated on June 15, 2000, when Vadem BVI

[3] The quoted statements from Fung come from his depositions taken in connection with the patent litigation, portions of which were attached to the Complaint as Exhibit B, and are included in the Appendix at A-47-63. Those depositions were taken in 2011, and, until that time, Microsoft was not aware of any of the facts to which Fung testified regarding his intent to mislead the Vadem Board regarding the value of the Vadem Patents in order to secure those patents for his own company.

caused the Vadem Patents to be assigned from Vadem California to Amphus for only a collective $2. (*Id.*) Because Vadem BVI retained only 40 percent of the equity in Amphus, Vadem BVI did not gain anything in return for the patent assignment, but instead suffered an immediate 60 percent dilution of its interest in the patents. (*Id.*)

Despite Fung's assurances to the Vadem Board that the Vadem Patents were worthless, on June 16, 2000—only one day after Vadem assigned the patents to Amphus—Fung and Amphus sold the same patents to St. Clair for an initial payment of $300,000, plus the first $1,000,000 in licensing revenues received by St. Clair and 50 percent of all licensing revenues received thereafter. (App. at A-23:24, ¶ 18.) Fung believed those revenues could be "hundreds of millions of dollars," (*id.*), and St. Clair is now seeking approximately $1.7 billion in the patent litigation, (App. at A-334).

At no time during the above-described events was Microsoft ever informed of the transfer of the Vadem Patents to Amphus or of the terms of that transfer. (App. at A-27, ¶ 26.) Although the Final Information Statement sent to shareholders stated that certain intellectual property assets were being transferred to the Operating Companies, the Vadem Patents were not identified. (*Id.*) [redacted] and nothing in that statement could have caused the shareholders, including Microsoft, to know or suspect that intellectual property assets worth potentially "hundreds of millions" were being transferred away for nominal consideration. (*Id.*)

E. Microsoft Learns of Fung's Fraudulent Concealment and of the *Ultra Vires* Asset Transfers

Nine years after acquiring the Vadem Patents, St. Clair commenced the patent litigation, bringing suit in the Delaware District Court against various companies it claimed infringed seven of the Vadem Patents. (App. at A-28, ¶¶ 27-28.) In infringement contentions, St. Clair identified functionality in Microsoft Windows as allegedly meeting certain claim elements of four of the seven asserted Vadem Patents and, in response to that claim, Microsoft brought a declaratory judgment action against St. Clair, also in Delaware District Court, seeking a declaration that Microsoft does not infringe those four patents and that those patents are invalid. (App. at A-28, ¶ 28.) It was only during discovery for that patent litigation in 2011 that Microsoft first became aware of the terms of the Vadem Patents' assignment and of Fung's fraudulent concealment of those patents' value. (*Id.*)

ARGUMENT

I. THE TRIAL COURT ERRED BY HOLDING THAT VADEM BVI'S *ULTRA VIRES* ACT, WHICH WAS VOID *AB INITIO*, COULD BE SUBJECT TO ANY LIMITATIONS PERIOD

A. Question Presented

When a corporation performs an *ultra vires* act that is void *ab initio*, can any inaction by plaintiff—including the failure to bring a claim within any potentially applicable limitations period—give legal effect to what is otherwise a legal nullity?

Microsoft preserved the argument that the Asset Transfers were *ultra vires* (and, therefore, void) acts that Vadem BVI and its Board were not empowered to effect at Appendix at A-170, A-180, and A-182. Although Microsoft did not expressly argue before the trial court that these *ultra vires* (and, therefore, void) acts are not subject to laches or the statute of limitations, this Court may consider this question because it is in the interests of justice. Del. Sup. Ct. Rule 8 ("[W]hen the interests of justice so require, the Court may consider and determine any question not [presented to the trial court]."); Del. Sup. Ct. Rule 14(b)(vi)(A)(1) ("Where a party did not preserve the question in the trial court, counsel shall state why the interests of justice exception to Rule 8 may be applicable.") As set forth in detail *infra* Part I(C)(2)-(3), a void act has no legal effect and "[n]o action on the part of plaintiff, nor inaction on the part of the defendant, can invest it with any of the elements of power or of vitality." *Lorenzetti v. Hodges*, 2012 WL 1410103, at *7 (Del. Super.) (internal quotation marks omitted).

The argument that a party cannot waive the right to challenge a void act was previously presented to this Court in *Belfint, Lyons & Shuman, P.A. v. Pevar*, 844 A.2d 991, at *2 (Del. 2004) (table). This Court declined to answer the question at that time, remanding instead to the Superior Court. *Id.* On remand, the Superior Court determined the question was moot. *Belfint, Lyons & Shuman, P.A. v. Pevar*, 862 A.2d 385, at *2 (Del. 2004) (table). Thus, the question remains unresolved in Delaware. Courts in other states, however, have held that a party cannot waive the right to challenge a void act. *Holman v. Family Health Plan*, 596 N.W. 2d 358, 364 (Wis. 1999) ("[A] void judgment cannot be validated by waiver."); *Osage Conservation Club v. Board of Supervisors of Mitchell C'nty.*, 611 N.W. 2d 294, 298 (Iowa 2000) (holding that where a zoning decision was void "plaintiff's failure to raise the issue . . . in district court does not preclude consideration of that issue on appeal"). For the reasons identified more fully below, this Court should now hold that, because a void act is a legal nullity, such an act cannot be given legal force by any inaction or action by a plaintiff, including the omission of an argument in a brief.

B. Scope of Review

This Court reviews the Court of Chancery's decision granting Defendants' motion to dismiss *de novo*. *Sagarra Invesiones, S.L. v. Cementos Portland Valderrivas, S.A.*, 34 A.3d 1074, 1078 (Del. 2011); *CML V, LLC v. Bax*, 28 A.3d 1037, 1040 (Del. 2011). Likewise, "[t]he determination of whether the statute of limitations is applicable is a

question of law subject to *de novo* review by this Court." *Wilmington Trust Co. v. Price*, 692 A.2d 416, at *1 (Del. 1997) (table).

C. Merits of Argument

1. The Asset Transfers were ultra vires *acts that were void* ab initio

Pursuant to the Memorandum, the Vadem Board was prohibited from disposing of all or substantially all of Vadem BVI's assets absent the affirmative vote of Vadem BVI's preferred shareholders. (App. at A-21, ¶12; A-42-43.) The Asset Transfers, which included the transfer of the Vadem Patents to Amphus, were part of the larger disposition of substantially all of Vadem BVI's assets into four newly formed companies, and, consequently, the Board was prohibited from affecting that transfer without a preferred shareholder vote. (App. at A-21, ¶ 12; A-26-27, ¶ 25.) Because no such vote was solicited or received, the Asset Transfers were specifically prohibited by the Memorandum and, consequently, those transfers were *ultra vires* acts. *See, e.g.*, *Solomon v. Armstrong*, 747 A.2d 1098, at 1114 n.45 (Del. Ch. 1999) (explaining that *ultra vires* acts "include[] acts specifically prohibited by the corporation's charter").

Under Delaware law, "void acts[] . . . include[] acts that are *ultra vires*," and such acts are "illegal acts or acts beyond the authority of the corporation and are not ratifiable." *Adams v. Calvarese Farms Maintenance Corp.*, 2010 WL 3944961, at *8 (Del. Ch.)

(internal quotation marks omitted). Consequently, as an *ultra vires* act, the Asset Transfers were void *ab initio*.[4]

2. Void acts are not subject to any limitations period because no inaction on the part of a plaintiff can give legal effect to a legal nullity

Delaware courts have previously held that claims challenging void acts are not subject to limitations periods. Thus, for instance, the Delaware courts have consistently recognized "that 'a void judgment, as distinguished from a voidable judgment, may be collaterally attacked at any time regardless of the running of an otherwise applicable statute of limitations.'" *Lorenzetti*, 2012 WL 1410103 at *6 n.31 (quoting *Husband (G.T.B.) v. Wife (G.R.)*, 424 A.2d 12, 15 (Del. 1980)). That rule also applies to the defense of laches. *E.J. Hollingsworth Co. v. Cesarini*, 129 A.2d 768, 768-69 (Del. Super. 1957) (holding that laches cannot "prevent the vacation of a default judgment which is void for lack of jurisdiction"). This rule ensures that no legal effect is given to void actions, which "never had lawful existence" and cannot be "the foundation of a valid title to property purchased at a sale thereunder." *Lorenzetti*, 2012 WL 1410103 at *7 (internal quotation marks omitted). Accordingly, "[n]o action on the part of plaintiff, nor inaction on the part of defendant, can invest

[4] Void acts also include acts that constitute "waste of corporate assets." *See Adams*, 2010 WL 3944961 at *8 (explaining that void acts include "waste of corporate assets" and unauthorized transactions that were not "in the interest of the corporation"). By transferring the Vadem Patents for $2 only one day before those patents were resold at a substantial profit, Vadem BVI was "caused to effect a transaction on terms that no person of ordinary, sound business judgment could conclude represent a fair exchange." *Steiner v. Meyerson*, 1995 WL 441999, at *1 (Del. Ch.). Accordingly, the transfer of those patents constituted corporate waste, providing an additional reason to consider the transfer void.

it with any of the elements of power or of vitality." *Id.* (internal quotation marks omitted).

Although the cases cited above pertain specifically to void judgments, the rule's reasoning applies equally to void corporate transactions. That is, when a corporation purports to perform transactions that it is not legally empowered to perform, those transactions are "illegal acts or acts beyond the authority of the corporation," and "the corporation cannot, in any case, lawfully accomplish them." *Adams*, 2010 WL 3944961 at *8. As such, like void judgments, those transactions cannot fairly "bar[] nor bind[] anyone" and cannot be "the foundation of a valid title to property." *Lorenzetti*, 2010 WL 1410103 at *7 (internal quotation marks omitted). Consequently, no action or inaction on the part of a plaintiff or defendant "can invest [them] with any of the elements of power or of vitality." *Id.* (internal quotation marks omitted).

Delaware courts have yet to apply this rule to corporate transactions generally, but the Court of Chancery has expressly identified at least some circumstances in which challenges to void corporate transactions cannot be defended by laches. In *Lions Gate Entertainment Corp. v. Image Entertainment Inc.*, the court held that laches—as well as several other equitable defenses—was inapplicable in "circumstances involving void corporate actions" when the application of that defense would require the court to "alter the terms of [the corporation's] bylaws." 2006 WL 1668051, at *10 (Del. Ch.). Thus, the court held that no equitable power would permit the court to recognize a corporation's board as being "classified as of the 2005

meeting" when the governing documents "clearly and unambiguously provide[d] that the board [would] become classified . . . at the 2006 annual meeting." *Id.* at *11. The court so held because "equitable principles cannot be employed to change the terms of authoritatively binding corporate documents." *Id.*

Here, likewise, by applying the equitable defense of laches, the Court of Chancery recognized as legally valid a transaction prohibited by the Memorandum. Such use of laches "change[s] the terms of authoritatively binding corporate documents" by effectively writing-out the Memorandum's provision mandating shareholder vote. As such, the court's application of that equitable defense was error.[5]

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[5] In *Council of South Bethany v. Sandpiper Development Corp.*, 1986 WL 13707 (Del. Ch.), the Court of Chancery addressed a related argument in the context of a void zoning ordinance. The plaintiff there argued that a sixty-day limitations period did not apply to his challenge of a zoning ordinance enacted in violation of statutory procedures because the invalidly enacted ordinance was void *ab initio*. *Id.* at *2. Although the Court of Chancery disagreed, holding that the limitations period was still applicable, *id.* at *2, *Sandpiper* is inapposite for two reasons: First, the limitations period at issue in *Sandpiper*—10 *Del. C.* § 8126—is a statute of repose rather than a statute of limitations. *See, e.g., Sterling Property Holdings, Inc. v. New Castle County*, 2004 WL 1087366, at *3 (Del. Ch.) ("As a statute of repose, the provisions of 10 *Del. C.* § 8126 are jurisdictional and therefore may not be waived."); *Council of Civic Organizations of Brandywine Hundred, Inc. v. New Castle County*, 1993 WL 390543, at *6 (Del. Ch.) ("10 *Del. C.* § 8126 is also a statute of repose."). This Court has explained that while a "statute of limitations is . . . a procedural mechanism, which may be waived, ... a statute of repose is a substantive provision which may not be waived because the time limit expressly qualifies the right which the statute creates." *Cheswold Volunteer Fire Co. v. Lambertson Const. Co.*, 489 A.2d 413, 421 (Del. 1984). Consequently, the limitations period at issue in *Sandpiper* was "jurisdictional and therefore [could] not be waived." *Sterling Property*, 2004 WL 1087366 at *3. No such unwaivable jurisdictional limitation bars Microsoft's claims.

Second, in *Sandpiper*, the court applied the sixty-day limitations period only after concluding that any need for "strict compliance with statutes establishing procedural requirements for enacting local

3. *Courts in several other jurisdictions have held that void acts are not subject to any limitations period*

Recognizing the good public policy of preventing void acts from having legal effect, courts in other jurisdictions have refused to apply statutes of limitation to void acts of many types. *See, e.g., Found. Ventures LLC v. F2G, Ltd.*, 2011 WL 1642245, at *2 (S.D.N.Y.) ("Whether the statute of limitations applies, therefore, depends on a finding that the contract is not void."); *Jersey City v. Roosevelt Stadium Marina*, 509 A.2d 808, at 816 (N.J. Super. A.D. 1986) ("[E]quitable defenses such as estoppel and laches do not apply to contracts which are *ultra vires* and void."). For instance, Washington courts have held repeatedly that "[t]he statute of limitations does not apply where an act or instrument is void at its inception," and have applied that rule across a broad array of circumstances. *Corporate Dissolution of Ocean Shores Park, Inc. v. Rawson-Sweet*, 134 P.3d 1188, 1193 (Wash. App. Div. 2006). For example, the Washington Supreme Court has held that statutes of limitations do not apply to claims challenging void orders by administrative departments, *Marley v. Department of Labor and Industries of State*, 886 P.2d 189, 192 (Wash. 1994), or to claims for annulment of a trust that "was void at its inception," *Colman v. Colman*, 171 P.2d 691, 694 (Wash. 1946). In the corporate context, the Washington Court of Appeals has held that a

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zoning regulations . . . [was] not absolute." 1986 WL 13707 at *2. The court was persuaded that the General Assembly had evidenced a policy that any uncertainty regarding land use should be promptly resolved—as demonstrated by the "extraordinarily brief" sixty-day limitations period. *Id.* The land-use policy considerations at issue in *Sandpiper* are not present here. For both of the above-discussed reasons, *Sandpiper* offers little guidance.

statute of limitations would not bar a claim seeking to void the issuance of corporate shares if the issuance was "void as a matter of public policy." *Ocean Shores Park*, 134 P.3d at 1193.

Because the Asset Transfers were void *ab initio*, those transactions are a "legal nullit[y] incapable of cure." *Apple Computer, Inc. v. Exponential Tech., Inc.*, 1999 WL 39547, at *6 (Del. Ch.). No power of the Court of Chancery or of this Court can breathe life into the transactions, nor can any action or inaction on the part of Microsoft or any other party. As a result, the Court of Chancery erred by holding that Microsoft's claims were barred by laches or an analogous statute of limitations. This Court, therefore, should reverse the Court of Chancery's holding that Microsoft's claims are time-barred, vacate its order of dismissal, and remand for further proceedings.

II. THE TRIAL COURT ERRED BY APPLYING THE WRONG LEGAL STANDARD FOR DETERMINING WHETHER A STATUTE OF LIMITATIONS MAY BE TOLLED BASED ON EQUITABLE TOLLING OR FRAUDULENT CONCEALMENT

A. Question Presented

When a party is on inquiry notice that its rights have been breached, but not on notice that it has suffered any economic injury from that breach, can a statute of limitations be tolled until such time as the party could have reasonably discovered its injury?

This question was preserved before the trial court at Appendix at A-206-207, A-305, and A-341-345.

B. Scope of Review

This Court reviews the Court of Chancery's decision granting Defendants' motion to dismiss *de novo*. *Sagarra Invesiones,* 34 A.3d at 1078; *CML,* 28 A.3d at 1040. Likewise, whether the Court of Chancery applied the correct legal standard in considering the motion to dismiss is reviewed *de novo*. *Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Refining, L.P.*, 777 A.2d 774, 777 (Del. 2001).

A trial court's dismissal should not be affirmed "unless the judge (i) accepts as true all well-pleaded factual allegations, (ii) accepts even vague factual allegations as 'well-pleaded' if they give the opposing party notice of the claim, (iii) draws all reasonable inferences in favor of the non-moving party, and (iv) dismisses the Complaint only if the plaintiff would not be entitled to recover under 'any reasonable conceivable set of circumstances susceptible of proof.'" *CML*, 28 A.3d at 1040 (quoting *In re Gen. Motors S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006)).

C. Merits of Argument

1. The doctrines of equitable tolling and fraudulent concealment toll any limitations period applicable to Microsoft's claims until 2011

Under the doctrine of equitable tolling, a statute of limitations stops "running while a plaintiff has reasonably relied upon the competence and good faith of a fiduciary." *In re Tyson Foods, Inc.*, 919 A.2d 563, 585 (Del. Ch. 2007). The doctrine exists because "even an attentive and diligent investor may rely, in complete propriety, upon the good faith of fiduciaries." *Weiss v. Swanson*, 948 A.2d 433, 451 (Del. Ch. 2008). Under the doctrine of fraudulent concealment, a statute of limitations may be tolled based on "an affirmative act of concealment or 'actual artifice' by a defendant that prevents a plaintiff from gaining knowledge of the facts." *Id.* Under either doctrine, the limitations period is tolled "until a plaintiff discovers, or by exercising reasonable diligence should have discovered, his injury." *Id.*

Both equitable tolling and fraudulent concealment provide a basis for tolling the limitations period on Microsoft's direct claim for breach of contract. Even if Microsoft had been on inquiry notice of the Asset Transfers, that *ultra vires* transaction constituted only a *breach* of the Memorandum—it did not constitute the separate element of injury. Microsoft did not discover, and could not have discovered, the economic *injury* that resulted from that breach until it learned that the Asset Transfers had included the exchange of what Fung considered to be highly valuable patents for only nominal consideration. Microsoft was prevented from discovering that injury

both by its good faith reliance on the Vadem Board's statement that the Asset Transfers were fair and in the best interest of the shareholders (equitable tolling), and by Fung's affirmative act of concealing the value of the patents and his scheme to resell those patents at a profit only a day later (fraudulent concealment). Even if Microsoft had, through an exercise of reasonable diligence, investigated the details of the Asset Transfers, Microsoft would have encountered KPMG's valuation, which assigned no value to the Vadem Patents, based on Fung's misrepresentation to KPMG. Thus, Fung's affirmative act of misleading not only the Vadem Board, but also KPMG, blocked any reasonable means for Microsoft to discover its injury. It was not until 2011, when discovery in the patent litigation led Microsoft to learn the details of the Vadem Patent assignments and of Fung's fraud, that Microsoft could have learned of that harm. Therefore, the limitations period on Microsoft's claims should have been tolled until that time.

2. The Court of Chancery erred by applying the wrong legal standard for determining when any tolling period ceases

Although the Court of Chancery correctly identified the legal standard—stating that the statute of limitations could be tolled until "a plaintiff discovers, or by exercising reasonable diligence should have discovered, his *injury*," (Op. at 23.)—the court applied a different standard. The court stated that because "Microsoft's direct claims stem solely from its allegation that substantially all of Vadem Ltd.'s assets improperly were transferred to other entities . . . . the only relevant inquiry is when Microsoft received inquiry notice

that the asset transfers had occurred." (*Id.*) But the occurrence of the asset transfers was only the breach. *Breach* is not the same as *injury*, which is a separate element of a breach of contract claim. *Great Lakes Chemical Corp. v. Pharmacia Corp.*, 788 A.2d 544, 549 (Del. Ch. 2001) ("An essential element of any claim for breach of contract is cognizable injury.").

There are, of course, sound policy reasons why a statute of limitations should be tolled in situations when a party has become aware of a breach but, as a result of fraudulent concealment or reliance on a fiduciary, has been misled into believing it suffered no injury from that breach. It is unreasonable to expect such a party to file a lawsuit to remedy what it reasonably believes to have been only a harmless breach. As Judge Posner recently explained, "what rational person would [sue for nominal damages]? . . . You can't go into federal court and say you had a contract with X and X broke it and you're really annoyed even though you sustained no injury of any sort . . . so please give me a judgment for $1 that I can pin on my wall." *Apple, Inc. v. Motorola, Inc.*, 2012 WL 2376664, at *6 (N.D. Ill.). Indeed, because "[a]n essential element of any claim for breach of contract is cognizable injury," *Great Lakes*, 788 A.2d at 549, a plaintiff who brought a claim for breach of contract without any basis to believe it was injured could find its claim subject to dismissal pursuant to Rule 12(b)(6). *See id.* at 550. More often than not, a breach that appears to have been harmless will turn out to have, in fact, been harmless, and the law should not create incentives for parties to file lawsuits in those situations. But when a

plaintiff has been erroneously led to believe that a breach is harmless, as a result of fraudulent concealment or the good faith reliance on a fiduciary, the law should provide an avenue for that plaintiff to bring a claim once its injury reasonably could have been discovered.

Tolling the statute of limitations until a plaintiff becomes aware of its economic injury is particularly appropriate in the context of shareholder rights. Rights in stock are comprised of separate voting and financial interests, but it is "important to require an alignment between share voting and the financial interest of the shares." *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 388 (Del. 2010) (quoting Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 Vand. L. Rev. 129, 153 (2009)). That alignment between voting and financial interests is aided by the presumption that stockholders "act in their own best economic interest when they vote," *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 484 (Del. Ch. 2000)(quoting *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1380-81 (Del. 1995)), and "act rationally to maximize the value of their shares," *Kurz v. Holbrook*, 989 A.2d 140, 179 (Del. Ch. 2010). When a breach of a shareholder's voting interests has not caused any harm to its economic interests, no rational shareholder would choose to bring a lawsuit because it would not "maximize the value of their shares." *Id.* Thus, under those circumstances, notice of a breach of voting rights is insufficient to start the clock on a statute of limitations; there must be notice of injury to the economic rights in the stock. Without that notice, a stockholder does not know enough to

seek to exercise the voting rights to protect its economic interest. In sum, for purposes of tolling the statute of limitations, a shareholder is not on inquiry notice until it is on notice that it has suffered an economic injury for which it would then have reason to exercise its voting rights.

It is no surprise, therefore, that numerous Delaware cases state the same rule—that when tolling is available, it continues up until the time that a plaintiff could have reasonably discovered its *injury*. *See, e.g.*, *Ryan v. Gifford*, 918 A.2d 341, 359 (Del. Ch. 2007) ("[T]olling ends where plaintiff discovers, or in the exercise of reasonable diligence should have discovered, his *injury*." (emphasis added)); *Franklin Balance Sheet Inv. Fund v. Crowley*, 2006 WL 3095952, at *7 (Del. Ch.) ("The limitations period will be tolled, however, until such time that persons of ordinary intelligence and prudence would have discovered facts sufficient to put them on inquiry which, if pursued, would lead to the discovery of the *injury*." (emphasis added)); *Wood v. Frank E. Best, Inc.*, 1999 WL 504779, at *2 (Del. Ch.) ("[T]he limitations period should be tolled because the plaintiff through reasonable diligence was unable to discover his *injury*." (emphasis added)); *In re Dean Witter P'Ship Litig.*, 1998 WL 442456, at *6 (Del. Ch.) ("[T]he limitations period is tolled . . . only until the plaintiff discovers (or exercising reasonable diligence should have discovered) his *injury*." (emphasis added and omitted)). Here, Microsoft was not on even inquiry notice of its injury until after Fung testified that he misled the Vadem Board and KPMG by concealing

his belief that the transferred Vadem Patents were worth millions of dollars so that his company, Amphus, could acquire them for $2.

Although many cases articulate the standard that tolling continues until a plaintiff is on inquiry notice of its injury, few cases examine the distinction between inquiry notice of a breach and inquiry notice of an injury. The Court of Chancery's decision in *Pomeranz v. Museum Partners, L.P.*, 2005 WL 217039 (Del. Ch.), is instructive on that point, however. There, plaintiffs brought a claim for breach of contract against a defendant based on the defendant's withdrawal from a limited partnership. *Id.* at *1. Although the withdrawal occurred in February 2000, *id.* at *4, plaintiffs did not bring their breach of contract claim until January 2004. *Id.* at *1. The plaintiffs argued that the three-year statute of limitations should be tolled even though they knew of the defendant's withdrawal in April 2000, because they did not have notice of their injury until March 2001. The withdrawal (i.e., the breach of the agreement) "did not matter to them then [in April 2000] because they were told by [the general partner] that the overall condition of [the partnership] was healthy." *Id.* at *6.

The Court of Chancery concluded that the allegations in plaintiffs' complaint established inquiry notice of the injury as of October 2000—more than three years before filing their claim. *Id.* at *2. Examining the date by which the plaintiffs had inquiry notice of the injury and not just the breach, the court found that the claims were time-barred because plaintiffs were on notice "of *both* the withdrawal of [defendant]"—i.e., the breach—"*and the possibly*

injurious effect of that event"—i.e., the injury—by October 2000. *Id.* (emphasis added).

The court thus considered notice of "the possibly injurious effect" of a breach to be a requirement separate from the breach itself. Furthermore, to determine when the plaintiff was on notice of "the possibly injurious effect" of a breach, the *Pomeranz* court examined when the plaintiff was on inquiry notice of the economic impact of the breach, concluding that plaintiffs "were on inquiry notice as to the economic impact of [defendant's] demand for withdrawal no later than October 2000." *Id.* at *12. Specifically, as of October 2000, the plaintiffs "were on inquiry notice . . . that the withdrawal substantially reduced the capital of the Partnership, and that the Partnership's value had plummeted for no apparent reason as of September 2000"—i.e., the injury. *Id.* at *13. Thus, the *Pomeranz* opinion shows that, where tolling is applicable, the limitations period begins once a plaintiff is on inquiry notice of both the breach and the economic injury resulting from that breach. *Id.*

Any statute of limitations relevant to Microsoft's claims, therefore, should be tolled until Microsoft was on inquiry notice not only that Vadem BVI had breached the Memorandum, but also of "facts sufficient to put [persons of average intelligence and prudence] on inquiry which, *if pursued*, would lead to discovery of the injury", *id.* at *11, or at least to discovery of the "possible injurious effect of that [breach]." *Id.* at *2; *see also Ryan*, 918 A.2d at 359 ("[T]olling ends where plaintiff discovers, or in the exercise of reasonable diligence should have discovered, his *injury*." (emphasis added));

Franklin Balance Sheet, 2006 WL 3095952 at *7 ("The limitations period will be tolled, however, until such time that persons of ordinary intelligence and prudence would have discovered facts sufficient to put them on inquiry which, if pursued, would lead to the discovery of the *injury*." (emphasis added)); *Wood*, 1999 WL 504779 at *2 ("[T]he limitations period should be tolled because the plaintiff through reasonable diligence was unable to discover his *injury*." (emphasis added)); *Dean Witter*, 1998 WL 442456 at *6 ("[T]he limitations period is tolled . . . only until the plaintiff discovers (or exercising reasonable diligence should have discovered) his *injury*." (emphasis added)).

3. By holding that notice of Microsoft's economic injury is irrelevant, the Court of Chancery's opinion promotes unnecessary lawsuits, and rewards fraud and self-dealing

Here, "the injurious effect of [Vadem BVI's breach]," *Pomeranz*, 2005 WL 217039 at *2, was concealed both by Fung's fraud and by Microsoft reasonable reliance on the Vadem Board's statement as fiduciaries that the asset transfers were in the best interest of the shareholders. There were simply no facts known to Microsoft "sufficient to put [persons of average intelligence and prudence] on inquiry which, *if pursued*, would lead to discover of the injury." *Id.* at *11 (quoting *Dean Witter*, 1998 WL 442456 at *7). Even assuming that a person of average intelligence and prudence would not have taken the Vadem Board at its word when that Board reported that the transfers were fair and in the best interest of the shareholders, any investigation into the details of those transactions would have uncovered that KPMG assigned no value to the Vadem Patents. A person

of average intelligence and prudence would have justifiably relied on the valuation of a well-respected firm such as KPMG, and would not have been in a position to know that the valuation was the product of Fung's fraudulent concealment. Thus, the pursuit of any inquiry would not have led Microsoft to discovery of "the possible injurious effect of [Vadem BVI's breach]." *Id.* at *2.

In sum, no "person of average intelligence and prudence" in Microsoft's position as of 2000 would have concluded that it was in a position to bring a fruitful claim. The Court of Chancery's holding, thus, would require Microsoft—and future litigants in Microsoft's position—to act irrationally, and to file lawsuits that could result in nothing more than a judgment to pin on the wall. *Apple*, 2012 WL 2376664 at *6. That result is inconsistent with both precedent and good policy. This Court should hold, therefore, that any limitations period relevant to Microsoft's claim was tolled until 2011, when Microsoft learned the details of the Vadem Patent assignments and of Fung's fraudulent concealment of the value of those patents.

Microsoft brought its claims in October 2011, well within the three-year statute of limitations, and without any unreasonable delay that would warrant a finding of laches. The Court of Chancery therefore erred by holding that Microsoft's claims were barred by the statute of limitations or an analogous laches period. This error provides an alternative reason for this Court to reverse the Court of Chancery's holding, vacate its order of dismissal, and remand for further proceedings.

CONCLUSION

For the above-stated reasons, Microsoft respectfully requests that this Court reverse the trial court's holding that Microsoft's claims are time-barred, vacate its order of dismissal, and remand for further proceedings.

FISH & RICHARDSON P.C.

/s/ Joseph B. Warden

Cathy L. Reese (Bar No. 2838)
Tara D. Elliott (Bar No. 4483)
Jeremy D. Anderson (Bar No. 4515)
Joseph B. Warden (Bar No. 5401)
222 Delaware Avenue, 17th Floor
P.O. Box 1114
Wilmington, Delaware 19899
(302) 652-5070

OF COUNSEL:

FISH & RICHARDSON P.C.
Lauren A. Degnan
1425 K Street, N.W., 11th Floor
Washington, D.C. 20005
(202) 783-5070

Attorneys for Plaintiff Below-Appellant Microsoft Corporation

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