Cover Page revised 10/1/12

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SHOCKING TECHNOLOGIES, INC.,	:	
	:	
Plaintiff,	:	
	:	
v.	:	**C.A. No. 7164-VCN**
	:	
SIMON J. MICHAEL, BALCH HILL PARTNERS L.P., and BALCH HILL CAPITAL, LLC,	:	
	:	
Defendants.	:	
---	---	---
SIMON J. MICHAEL,	:	
	:	
Counterclaim-Plaintiff,	:	
	:	
v.	:	
	:	
LEX KOSOWSKY, GARY KENNEDY, and JAMES HOGAN,	:	
	:	
Third-Party Defendants,	:	
	:	
and	:	
	:	
SHOCKING TECHNOLOGIES, INC.,	:	
	:	
Nominal Third-Party Defendant.	:	

MEMORANDUM OPINION

Date Submitted: June 29, 2012
Date Decided: September 28, 2012
Date Revised: October 1, 2012

Kevin G. Abrams, Esquire of Abrams & Bayliss LLP, Wilmington, Delaware and Patrick E. Gibbs, Esquire, Matthew Rawlinson, Esquire, and Andrew M. Farthing, Esquire of Latham & Watkins LLP, Menlo Park, California, Attorneys for Plaintiff.

Daniel A. Dreisbach, Esquire, Blake Rohrbacher, Esquire, Lisa M. Pietrzak, Esquire, and Robert L. Burns, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware and Robert Charles Ward, Esquire of Shartsis Friese LLP, San Francisco, California, Attorneys for Defendants.

NOBLE, Vice Chancellor

Plaintiff Shocking Technologies, Inc. ("Shocking" or the "Company") has accused one of its directors, Defendant Simon J. Michael ("Michael"), of breach of his fiduciary duty of loyalty.[1] As part of his strategy to gain an additional board seat for a group of investors with which he believed he shared common objectives, Michael, who understood that the Company was in dire financial condition, sought to dissuade the only remaining potential investor from investing in the Company, and he shared confidential Company information with the potential investor. Michael anticipated that he would be more likely to achieve his goals if the potential investor withheld any additional investment in the Company, thereby leaving the Company's management desperate for funding, or if the potential investor used the confidential information to get a "better deal" for its investment. The "better deal," Michael presaged, would undercut the authority of the balance of the Company's board of directors which he was challenging. Whether a director may engage in such conduct without breaching his fiduciary duty of loyalty is the key question before the Court.

The Court sets forth its post-trial findings of fact and conclusions of law in this memorandum opinion.

[1] Michael is the manager of Defendant Balch Hill Capital, LLC ("BHC") which is the General Partner of Defendant Balch Hill Partners L.P. ("BHP"). Of the numerous claims and counterclaims asserted in this proceeding, the Court expedited for trial only the allegations regarding Michael's fiduciary conduct. *Shocking Techs., Inc. v. Michael*, 2012 WL 165561, at *2 (Del. Ch. Jan. 10, 2012).

I. BACKGROUND

A. *The Parties*

The Company is a privately held Delaware corporation with its principal place of business in San Jose, California. Recently founded, it is developing polymeric materials that provide electrostatic discharge protection for electronic devices. Commercial success has not yet been achieved. Its revenue in 2010 was less than $100,000, and it was less than $300,000 in 2011.

Michael, through BHP, first invested roughly $100,000 in the Company during its first Series A round of financing in March 2007. With that investment came the right for BHP to continue to invest on a pro rata basis in the Company's subsequent financings in order to avoid dilution in the later rounds. Michael next invested in the Company's Series B round of financing in August 2009. Michael, along with BHP and others he brought to the Company, generated approximately $4 million out of the $10 million raised at that time. As a result of that investment, Michael, in the summer of 2009, obtained a seat on the Company's board of directors (the "Board").[2] In April 2010, the Company raised approximately $13 million in its Series B-1 round of financing. Michael and BHP invested approximately $2.8 million, while Michael's associates and related individuals invested approximately $2.5 million. In January 2011, Shocking obtained an

[2] Michael's board seat was as "the Series B designee for the Board, chosen by BHP." Joint Pre-Trial Stipulation and Order ("Pre-Trial Stip.") ¶ III.A.12.

equity investment of $6 million, of which approximately $1.8 million was provided by Michael and BHP. Between February and July 2011, the Company's Series C round of financing raised approximately $21 million in two stages. Michael and BHP invested approximately $4.2 million and Michael's associates and related individuals invested approximately $1.59 million.[3]

The Company could have six directors.[4] The Board, before April 2012, consisted of Third-Party Defendants Lex Kosowsky ("Kosowsky"), Gary Kennedy ("Kennedy"), and James Hogan ("Hogan") (collectively, the "Director Defendants"), and Michael. Kosowsky is the founder, Chief Executive Officer, and President of the Company. Kennedy and Hogan, in addition to being directors, are stockholders of the Company.[5] By the summer of 2011, the Company was in a precarious cash position. Littelfuse, Inc. ("Littelfuse") invested $3 million in the Series C round, and, thus, it had warrants that could be exercised until December 5, 2011, which would generate an additional $3 million for the Company.[6]

[3] In June 2011, BHP made a bridge loan to the Company of $500,000 that was necessary to carry the Company until the Series C round could close. Series C round investors, including Michael, BHP, and his associates, received warrants that allowed them to purchase additional shares in December 2011, but Michael, BHP, and his associates decided not to exercise those warrants.

[4] Amended and Restated Voting Agreement (JX 104) § 2(a).

[5] Two other investors have the right to designate directors. ARCH Venture Partners ("ARCH") had appointed Ajit Medhekar ("Medhekar"), but he resigned in December 2011, and no replacement has been selected. ATA Ventures ("ATA") also has the right to appoint a member of the Board. Michael Hodges ("Hodges") served as ATA's designee from October 2010 until 2011, when he resigned. ATA has not appointed a successor. Pre-Trial Stip. ¶¶ III.B.18-19.

[6] The Company licensed crucial intellectual property from Littelfuse, a maker of surge suppression products.

B. *A General Timeline*

By the summer of 2011, Michael had started to express his concerns about the Company's corporate governance.[7] Although the Series B/C investors had provided approximately sixty percent of the Company's contributed capital, they only were entitled to designate one of the Company's six directors. Kosowsky's compensation requests, presented in August 2011, also troubled Michael. Kosowsky was seeking 1.25 million options, double his award in the previous year, notwithstanding the Company's lack of sales revenue. Michael shared his concerns in an email to the directors. Although compensation to employees also pending at the time did not draw opposition from him, he sought to tie Kosowsky's compensation to a performance trigger and to address Board compensation separately from employee compensation.[8] This approach was not well-received by other directors. Hogan and Kennedy aligned with Kosowsky's compensation proposal. Their unified hostility toward Michael persuaded him that they constituted a "control group," acting to advance their own interests and, in

[7] In contrast, Shocking views Michael's corporate governance concerns as a pretext for his efforts to obtain greater control of the Company. Leverage obtained by trumpeting corporate governance concerns, coupled with Shocking's ongoing and predictable needs for cash, could have enabled Michael to pressure Kosowsky and his allies into capitulating to his demands if they wanted to save the Company.

[8] Eventually, Kosowsky would receive 1,000,000 options, 600,000 of which were conditioned on meeting performance goals.

particular, those of Kosowsky,[9] as contrasted with the best interests of the Company.

On August 23, 2011, Shocking held an executive meeting at AT&T Park in San Francisco during which compensation matters were discussed.

The rising tensions resulted in a five-hour meeting between Michael and Kosowsky on August 27, 2011. Michael emphasized his two primary concerns—Kosowsky was seeking too much compensation and Kosowsky had "too much control of the Board."[10]

The Company contends that Michael was motivated by self-enrichment—he wanted to increase his power at the Company and possibly increase his ownership percentage on the cheap. Michael, in stark contrast, claims that he was only concerned about improving the Company's corporate governance process and protecting the Company from abuses by the Defendant Directors, who with two Board seats vacant, controlled the Board.[11] The truth lies between these extremes.

[9] When Board discussions regarding Kosowsky's compensation started, he was excused from the meeting room. Soon thereafter, however, he was included on the Board's emails addressing his compensation.

[10] Tr. 761-62. Michael viewed control as a major concern for Kosowsky. Apparently, Kosowsky had been ousted as chief executive officer of a company which he had founded, and, thus, Kosowsky, worried about a "replay." Tr. 722-23.

[11] Although Michael denies it, he stated that he intended to put his own self-interest above friendship with other directors and the good of the Company. Five witnesses confirm his statement. The Court relies, in particular, upon the testimony of Michael J. Danaher, Esq. ("Danaher"), the Company's outside counsel, and Medhekar, who was, at one time, a Company director and who, when he gave his testimony to this effect, had no connection to the Company or the Board. Tr. 196 (Kosowsky); Tr. 489 (Hogan); Tr. 560 (Kennedy); Tr. 650 (Danaher); Medhekar Dep. 188-89 (Mar. 19, 2012).

Our actions are frequently the product of multiple, and sometimes conflicting, incentives. Michael chafed at the approach of the Defendant Directors, especially as to Kosowsky's compensation. He also resented their sometimes hostile and dismissive treatment.

There can be no doubt that Michael wanted to alter the Company's balance of power—to a Board alignment that increased his personal power.[12] Perhaps that would have resulted in a "better" board. Michael, perhaps conveniently, did not differentiate between a "better" board and a board over which he could exert a greater degree of control. As of the fall of 2011, if he could find a way to control an additional seat, and if ARCH and ATA would each designate a director inclined to support him, he would have been able to "control" Kosowsky (and his associates). Perhaps, Michael only aspired to an additional seat for the B/C Investors. Regardless of how one might assess such an outcome, it would have significantly increased Michael's relative power.[13]

Similarly, Michael also questioned the relationship among his fellow directors—Kosowsky, Kennedy, and Hogan. Although he had served on the Board

[12] The Company maintains that Michael was looking for an advantage beyond merely another Board seat. It argues that he sought a "down round" that would allow him to invest on better terms. Michael had the right to invest if better terms were offered. A down round would have enabled Michael to increase his ownership share by exercising rights at a reduced price.

[13] Hodges, who had been ATA's designee on the Board, understood why Michael advocated for a second director to be designated by the Series B and Series C investors: "He wants a second board seat so he has more of a control of the [C]ompany than he has with one board seat." Hodges Dep. (Mar. 29, 2012) 141.

from 2009, he came, in the spring or summer of 2011, to question the independence of Kennedy and Hogan. The trigger for this change seems to have been a revised compensation proposal for Kosowsky. Without doing much homework, however, he expressed strong oppositions to the new compensation plan which the Board had just started to assess. When the other directors reacted negatively, Michael concluded that Kennedy and Hogan must be dominated by Kosowsky.[14] Maybe Michael reached this conclusion in good faith. The tone adopted by the other directors was adverse. Michael's negative assessment of Hogan and Kennedy appears—and this does not matter much for the Court's analysis—rash; agreeing with the Chief Executive Officer and not dealing with him in a confrontational manner do not necessarily evidence a director's lack of independence. Moreover, and, of course, this might just be coincidence, Michael's attitude toward Kosowsky and his views of the other two directors changed right after his efforts to secure an additional board seat for the B/C investors had been rebuffed.

[14] That they may agree with Kosowsky, of course, does not demonstrate a lack of independence. Michael's reasoning behind his conclusion, once one moves beyond Hogan and Kennedy's agreement with Kosowsky, is sparse. Hogan had no personal relationship with Kosowsky before he invested in the Company. Michael has not provided any basis for a conclusion that Kosowsky exercises the kind of financial pressure that would allow him to dominate their decision-making processes.

Michael offered two solutions. First, he wanted Hodges, who had resigned from the Board in May 2011, back on the Board.[15] Second, he wanted another director position for the B/C investors.[16]

Whether Hogan and Kennedy should remain on the Board was also addressed.[17] Later, Michael attempted to discuss the circumstances with Kennedy, but Kennedy and Kosowsky, in the interim, had a conversation and Kennedy drew negative inferences about Michael from that conversation. He did not pick up the phone when Michael called him and soon thereafter sent Michael a profanity-laced email.[18] Since then, except at board meetings, Kennedy has not spoken with Michael.[19]

After receiving Kennedy's email, Michael sent one of his own later the same day.[20] Michael argued that a more independent board would benefit the Company, and he claimed that he was not seeking a greater degree of control for himself.[21]

---

[15] Michael believed that Hodges's departure was the product of the other three directors' berating and threatening him.

[16] Michael and his group owned approximately forty percent of the B/C shares. No other B/C investor held more than fourteen percent. Although not formally assured, Michael and his associates were likely to be able to control the selection of any director deemed to represent the B/C shareholders.

[17] Michael expressed concern that Kosowsky was attempting to set the compensation that Hogan and Kennedy would receive for service on the Board at the same time he was seeking their support for his significantly increased compensation.

[18] JX 114.

[19] Michael attributes Kennedy's hostility to Kosowsky's statements to Kennedy which Michael believes were false and intentionally inflammatory.

[20] JX 122. It carried the title "Why I am doing what I am doing—the value of an Independent Board."

[21] Michael has served on the Board since 2009. The Company raises the interesting question as

The directors' meeting the next day, August 29, 2011, did not go well.[22] Michael considered the conduct of the other directors as the product of a thought process of "attack [Michael] because he's threatening us."[23]

The hostility mutually exhibited at the August 29 meeting convinced the Defendant Directors to consult with Danaher, the Company's counsel, in an effort to ascertain their options with respect to a dissident director. Another Board meeting was scheduled for September 2 at which Danaher cautioned Michael about his conduct and urged him not to talk separately with the Company's strategic investors. Michael's communications with his fellow Board members leading up to Danaher's necessary, but unusual, guidance demonstrate that Michael understood the effects he could have on potential investors. For example, he promised that he would "not be talking to any strategic investor in the short term"

---

to why Michael did not seem troubled by any corporate governance issues at the Company until roughly August 2011, shortly after he participated in the Series C financing. Michael seems to tie his realization that there were corporate governance issues to an email from Hogan which disagreed with his position on Kosowsky's compensation. JX 341. Hogan's email is relatively unexceptional; it sets forth his view that the proposed compensation under consideration made sense. Hogan and Michael may have had legitimate disagreements about executive compensation, but the extent of the disagreement, particularly in light of how the compensation was eventually resolved, seems excessive. It was the beginning of a Board process to deal with what is frequently a difficult issue. For Michael to draw such a significant conclusion based on the beginnings of the process seems unusual.

[22] The intense and hostile responses of the Defendant Directors exacerbated a sensitive situation. It may be that they did not intend it, but their personal attacks further alienated Michael and, in a way, may have provided him with a basis to help rationalize the actions that he would undertake. Whether a more controlled reaction might have avoided this imbroglio is an unanswerable question.

[23] Tr. 786-87 (Michael).

because he "realize[d] how disruptive this could be and would not do so lightly."[24] Not long after that not-so-subtle threat, Michael made clear that such actions on his part were likely to happen if his objectives were not met.[25] When he sent a list of demands on October 10, 2011, he reiterated the power that he believed he had: "The primary concern of other Board members appears to be that I not disrupt the next fundraising of the Company, which I believe is targeted to occur on or before December 5, 2011."[26] His follow-up statement that he did not "believe that the Company [could] be funded until the Company's current corporate governance issues have been addressed," effectively linked his personal goal of a revised board structure to his ability to interfere with Shocking's short-term funding efforts.[27]

Again, the tone of the meeting was not good. Kosowsky, for example, threatened to contact the individual investors in Michael's hedge fund. Perhaps recognizing that their efforts to control Michael would not be successful, the Director Defendants convened shortly thereafter to consider how to address the difficulties associated with Michael.

One of Michael's clearest expressions of his strategy may be found in an email sent to Basil Alwan, another one of the investors whom he brought to

[24] JX 311.
[25] Tr. 632-38 (Danaher).
[26] JX 335.
[27] *Id.*

Shocking.[28] The approach set forth in this email, sometimes referred to as the "big Stick" strategy, describes how Michael believed he could coerce Kosowsky into meeting his demands through application of financial pressure that would jeopardize the existence of Shocking:

> So now that I have mapped out my "big Stick" approach (sending a letter, then requesting a special board meeting, that would be observed by both Littlefuse (sic) and Skylake) [another strategic investor] and confident I have this as a back up, I need to be very thoughtful about what I actually do.
>
> My real goal is to encourage/force Lex to deal effectively with his existing and future shareholders by increasing the "opposition" in the board.
>
> I have already made some significant steps – the other VC [venture capitalist] and I by joining forces have tabled both Lex's and the Board's compensation and I think we will be effective in requiring that any major grants to Lex be contingent on real revenues. We will also severely limit Lex's practice of "taking care of his boys" on the board. . . .
>
> But this is just one step, the next step is to move the board more fully to one whose primary focus is shareholder value, and which has what I think of as a "healthy adversarial" role with the CEO – that challenges him on his failings and makes him accountable for his failings and resolves those failures rather than just buying into his BS, which is what we basically have today.
>
> The cleanest way to achieve this would be with an additional board member – Lex will fight this tooth and nail, but my gut (which needs to be very fully thought out) is that after initially throwing a fit, he will compromise to keep the company funded.[29]

[28] JX 131
[29] *Id.*

Michael's messages to his fellow investors were not solely about increasing his power with an additional board member. There were references to shareholder value and effective dealing by management with Shocking's shareholders. Nonetheless, at this point, Michael recognized that he was seeking to leave Kosowsky with only two choices: either running a substantial risk that the Company would fail because of a cash shortfall or conceding the additional director (and perhaps some other attributes of authority) that Michael wanted.

About a month later, Michael requested a special meeting of the Company's Board; that request was denied.[30] Michael then sent a letter to his fellow Board members.[31] Michael acknowledged the Company's ongoing need for cash infusions but he asserted that the Company could not seek additional funding "until the Company's current corporate governance issues have been addressed and, if not addressed, such unresolved issues communicated to existing stockholders and potential stockholders."[32] A special meeting of the Board was eventually held on October 20, 2011. Michael's concerns were addressed to an extent. Although there is some indication that a "plan" had been developed, nothing much happened and Michael concluded that he was being "stonewalled."

[30] When Michael requested a special board meeting, he recognized that inviting "Board observers," who were strategic investors, would provide him with an audience for implementation of his strategy.
[31] JX 137.
[32] *Id.*

Michael, because the Defendant Directors were not likely to accede to his demands, along with BHP, called a special meeting of stockholders, that was held on November 28, 2011. His announced purpose was to tell other shareholders what he thought of the Company's corporate governance. He related to his fellow shareholders his concerns about the domination of the Board by Kosowsky; that the voting agreement (which had been approved by the shareholders) denied a majority of the shareholders' meaningful influence over the Board; that the B/C Investors were underrepresented; that the lack of independence hurt performance; that there was a shortage of accountability; and that management unnecessarily alienated key potential strategic partners.[33] Not surprisingly, Shocking disputes, with varying degrees of intensity, much of what Michael said.[34] It does not appear that he drew much of a reaction. He may have been incorrect, but this is the type of debate that courts are ill-equipped to referee. They may reflect an attitude or an agenda, but, by themselves, they will rarely demonstrate a breach of the fiduciary duty of loyalty.

In the meantime, Kosowsky was addressing the Company's need for cash. He talked with Paul Dickinson ("Dickinson") of Littelfuse about the possibility

[33] Shocking considers these assertions important enough to set them forth in an attachment to its post-trial brief. Pl.'s Post-Trial Br., Attach. A.

[34] *Id.* Despite complaints about Michael's lack of accuracy, Shocking has not demonstrated that comments like these somehow amounted to a breach of the fiduciary duty of loyalty. Its arguments along these lines may be designed to undercut the substance of Michael's purported corporate governance initiative.

that Littelfuse would not only invest $3 million through exercise of its warrants in early December, but also might invest even more. One of Kosowsky purposes in meeting with Dickinson was to give him advance warning about Michael's corporate governance issues.

Michael understood that Shocking's survival likely depended upon Littelfuse's investment. He sought to align Littelfuse's interests with his because he anticipated that the likely cash crunch would force Kosowsky and the rest of the Board to implement his objectives. In a series of communications with Dickinson, Michael lobbied Dickinson to hold off on additional investing in Shocking until Littelfuse could get better terms. For example, he insisted that Dickinson could "negotiate different terms" before making any additional investment.[35] He told Dickinson that Littelfuse had the "leverage for better terms."[36] Indeed, Michael hoped that Dickinson would employ Littelfuse's leverage even before it exercised the warrants.[37] Among the better terms that Michael urged Dickinson to seek was a position on the Board.[38] In sum, Michael attempted to keep Littelfuse from exercising the warrants in accordance with their terms and to persuade Littelfuse to negotiate an even better deal—whether in terms of price or in terms of an

[35] Tr. 34 (Dickinson).
[36] Tr. 58 (Dickinson); Tr. 191, 245 (Kosowsky)
[37] Tr. 950-51 (Michael).
[38] Tr. 30 (Dickinson).

additional board seat—before it exercised the warrants or made additional investments in Shocking.

A few days after Kosowsky's conversation with Dickinson, Michael called Dickinson. Michael's objective was to see if Dickinson would attend the stockholders' meeting. Curiously, when Dickinson inquired about the issues that would be brought up at the meeting, Michael refused to provide him with any material information on that call. Instead, he insisted that Dickinson call him back. Apparently, Michael believed that the world would view whatever he said more favorably if he said those words during a call initiated by Dickinson, instead of a call that he had initiated.[39] They talked of Michael's corporate governance issues and Michael complained about Kosowsky's aggressive approach. They also addressed compensation practices.

Because the Director Defendants would not go along with Michael's request that stockholders be allowed remote access to the meeting, Michael sent the stockholders his planned presentation in advance of the meeting.[40] The meeting on November 28, 2011, allowed Michael, Kosowsky, and Medhekar to make presentations. Dickinson attended the meeting. He listened to Michael's

[39] Shocking cites Michael's surreptitious conduct as evidence that Michael recognized the improper nature of his efforts. Michael's conduct—and it is far from clear as to why he thought there was a meaningful difference between his placing a call to Dickinson or Dickinson's placing a call to him—is either just plain peculiar or, as is more likely the case, tends to confirm Shocking's suspicions.

[40] JX 168.

presentation and "did not conclude that . . . Michael had valid concerns about compensation" or that he presented "specific evidence of independence problems."[41] Dickinson, however, was concerned about strife within the Board. Dickinson decided to recommend to Littelfuse that it should exercise warrants for $3 million, but that it should refrain from further capital contributions at that time.

Before the meeting, Michael had told Dickinson that he thought that Kosowsky was "fit" to serve as chief executive officer. After the meeting, Michael told Dickinson that his views had changed. During this almost two-hour conversation, Michael and Dickinson discussed, for a few minutes, Littelfuse's warrants. Michael reprised his corporate governance presentation and reminded Littelfuse that it had "leverage" with respect to the possibility of a more diversified board. Michael's guidance to Dickinson was difficult for Dickinson to follow. Michael wanted, or so he said, Littelfuse to invest in the Company, but he also suggested that Littelfuse might be able to ask for board representation as part of the price for its investment. He reiterated his concerns with what he perceived to be the "control group."

Michael not only sought to dissuade Dickinson from exercising the warrants; he disclosed to Dickinson Shocking's confidential business information to the effect that Littelfuse was, at that time, the only potential investor then at all likely

[41] Tr. 25-41 (Dickinson).

to participate in the necessary fundraising. Two other well-known potential investors were thought by those persons generally involved with the Company to be still considering investment; by informing Dickinson that there were no other options foreseeably available to Shocking, Michael's confidential information gave Littelfuse a significantly enhanced strategic bargaining position. Littelfuse knew that it had no competition and that Shocking had nowhere else to turn.

Even though the shareholder meeting did not dissuade Littelfuse from exercising the warrants, Michael persisted in contacting Dickinson.[42] Michael urged Dickinson to "use [his] leverage."[43] Michael may not have explicitly implored Dickinson not to exercise the warrants, but the substance of his message and its timing leave little doubt that Michael was endeavoring to induce Littelfuse to abstain from funding the Company and, thus, to exacerbate the Company's cash-flow problems which might give him an opportunity to achieve his objectives. Significantly, Dickinson understood that Michael was attempting to "convey a message without using specific words . . . ."[44]

Michael had been able to persuade several of his business associates to invest in Shocking. One of his associated investors is Bernard Marren ("Marren"). Marren and Michael frequently discussed Shocking, and it is clear that Marren

[42] Shortly before Littelfuse exercised the warrants, Michael, according to his phone records, made six calls to Dickinson, including three within a four minute span.
[43] Tr. 30 (Dickinson).
[44] Tr. 37 (Dickinson).

contacted Dickinson in an effort to advance Michael's agenda. Marren's urgings were less guarded than Michael's. As Dickinson put it, "Marren [was] strongly encouraging me not to recommend exercise of the warrants."[45] Marren also encouraged Dickinson to use Littelfuse's leverage to get a better price and, perhaps, even to obtain a board seat.[46]

The link between Michael and Marren is well-established when one considers the frequency with which they talked during key times in the fall of 2011.[47] This is most obvious when one considers the numerous calls between Marren and Michael and their efforts to reach Dickinson in the days leading up to Littelfuse's exercise, on December 5, 2011, of its warrants. As Michael testified, after he finished talking with Dickinson, he called Marren and "told him that I thought Littelfuse would probably exercise their warrants and . . . I was . . . disappointed that he [Dickinson] wasn't going to exert his influence."[48] Cumulatively, this demonstrates that Michael was hoping to dissuade Littelfuse from providing Shocking with desperately-needed cash through the exercise of the warrants. Not only was Marren seeking to persuade Littelfuse not to invest on the terms specified in the warrants, he also was hoping that Littelfuse, by seeking a board seat, would advance Michael's corporate governance goals of at least

[45] Tr. 63-64 (Dickinson).
[46] Tr. 28-29, 39 (Dickinson).
[47] The telephone records that amply demonstrate the frequency of their discussions may be found in JX 189.
[48] Michael Dep. (Mar. 22, 2012) 196.

diluting the influence that Kosowsky, together with Hogan and Kennedy, had over Shocking's affairs.

Although arguably not entirely clear, the better inference is that Michael was trying to persuade Littelfuse to use its economic power—through the potential for additional investment—to shake up the Company's control structure. Michael's comments about how the Company was managed were clearly negative. Despite those negative comments, Littelfuse proceeded that day with its anticipated $3 million investment in the Company.

Perhaps one of Michael's group of investors unintentionally summarized Michael's game plan after Littelfuse exercised the warrants and it had become clear that Michael's immediate objectives were not going to be achieved. On December 7, 2011, Bernard Xavier emailed Michael: "Did Lex raise the additional cash [from Littelfuse] or is he now more compliant?"[49] "More compliant" most likely refers to Kosowsky's agreeing to, at least, an extra board seat for Michael and his compatriots.

Michael's intentions and objectives through his negative comments about the Company and his communications with Dickinson prompted the Board a few weeks later to file this action.

[49] JX 190.

In April 2012, Littelfuse invested $10 million in Shocking. Littelfuse also obtained the right to designate a director. At this time, an eighth board seat, apparently serving a broader constituency of stockholders, was also authorized.

II. CONTENTIONS

Shocking asserts that Michael's delivery to Littelfuse, a party with a negotiating position adverse to it, of confidential information and bargaining advice constituted a breach of his fiduciary duty of loyalty. That breach, according to Shocking, caused it substantial damages—it reduced potential investment by Littelfuse in December 2011 and led to a Littelfuse investment in April 2012 on materially more unfavorable terms than would have resulted without Michael's actions—and entitles it to recovery of its attorneys' fees and expenses.

Michael, in contrast, argues that Shocking, despite the intensity of its allegations, has not proved that he breached his duty of loyalty or that his conduct caused any harm to Shocking. He contends that his actions were undertaken in good faith in an effort to better the corporate governance structure of Shocking and to reduce the domination by Kosowsky accomplished with the aid of his allies on the Board, Hogan and Kennedy. Shocking's litigation strategy, according to Michael, was implemented to punish him for speaking out on behalf of Shocking's underrepresented shareholders and to deter vigorous debate in the corporate setting.

III. ANALYSIS

A. *The Duty of Loyalty*

The directors of a Delaware corporation are presumed to act with care and loyalty.[50] Thus, Shocking bears the burden of proving that Michael breached his duty of loyalty.

The fiduciary duty of loyalty imposes on a director "an affirmative obligation to protect and advance the interests of the corporation" and requires a director "absolutely [to] refrain from any conduct that would harm the corporation."[51] Encompassed within the duty of loyalty is a good faith aspect as well. "To act in good faith, a director must act at all times with an honesty of purpose and in the best interest and welfare of the corporation."[52] A director acting in subjective good faith may, nevertheless, breach his duty of loyalty.[53] The "essence of the duty of loyalty" stands for the fundamental proposition that a

---

[50] *Ivanhoe P'rs v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987).
[51] *In re Walt Disney Co. Deriv. Litig.*, 2004 WL 2050138, at *5 n.49 (Del. Ch. Sept. 10, 2004) (quoting *BelCom, Inc. v. Robb*, 1998 WL 229527, at *3 (Del. Ch. Apr. 28, 1998) (quotation marks omitted). This is not a new concept. *See Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939).
[52] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).
[53] *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); *see also Johnston v. Pederson*, 28 A.3d 1079, 1092 (Del. Ch. 2011) (directors believed their conduct was in the best interest of the corporation and, thus, they acted in good faith, but they nevertheless failed to satisfy their duty of loyalty).

director, even if he is a shareholder, may not engage in conduct that is "adverse to the interests of [his] corporation."[54]

B. *Michael's Actions and Loyalty*

The issue is, of course, whether Michael satisfied his fiduciary duty of loyalty. Resolution depends upon the context. The Company, as a start up with insignificant marketing revenue, was in a precarious cash position. If Littelfuse did not exercise the warrants in early December, there apparently was no plan for obtaining an alternate source of funding. Michael knew how vulnerable the Company was and he undertook steps to gain advantage from its weakness. Michael's actions clearly demonstrated a desire to interfere with the Company's funding. The funding process—sale of stock to Littelfuse with the accompanying warrants—had been unanimously approved, without any apparent dissension.

Yet Michael sought to frustrate that objective. The best interests of the Company—finding enough cash to survive—were immediate and unmistakable. Michael, knowing the consequences if he was successful, acted against the Company's best interests. For that, he was disloyal.

That, however, does not end the inquiry. Michael had concerns about corporate governance. Could these concerns justify or excuse his conduct? Is it a matter of objective or subjective good faith on Michael's part?

[54] *Venoco, Inc. v. Eson*, 2002 WL 1288703, at *7 (Del. Ch. June 6, 2002).

Shareholders and directors, sometimes to the chagrin of a majority of the board of directors, may seek to change corporate governance ambiance and board composition. That is not merely permitted conduct; such efforts may be entitled to affirmative protection as part of the shareholder franchise. Michael's objectives as to his corporate governance agenda were not proscribed. They may have been prudent, or they may have been irresponsible. Nonetheless, it was his right to make such policy choices.

The steps that a shareholder-director may take to achieve objectives are not without limits. A director may not harm the corporation by, for example, interfering with crucial financing efforts in an effort to further such objectives. Moreover, he may not use confidential information, especially information gleaned because of his board membership, to aid a third party which has a position necessarily adverse to that of the corporation.

That is what Michael did. In an effort to pressure Kosowsky and his cohorts into implementing Michael's policy objectives, Michael not only encouraged Dickinson to withhold Littelfuse's crucially-needed financial assistance, but he also disclosed to Dickinson essential confidential information that materially altered Dickinson's understanding of Shocking's financial predicament. He informed Dickinson that there was no one—other than Littelfuse—that was capable of and considering providing the financing. This sensitive and confidential

information—learned by Michael because he served as a director—should not have been disclosed to an entity in Littelfuse's position. Disclosure of that information inevitably carried a significant risk of causing adverse consequences for Shocking. Littelfuse, thus, would have recognized the leverage that it had in the fall of 2011. It may have known—and probably did know—that Shocking was in bad financial circumstances, but, without Michael's information, it would not have known at that time how dire those straits were and, more importantly, that there was no other rescuer on the horizon.

Michael may have hoped that his disclosure of confidential information to Dickinson would have ultimately resulted in better corporate governance practices for Shocking. That hope, however, cannot outweigh or somehow otherwise counterbalance the foreseeable harm that he would likely cause Shocking. Notwithstanding his good intentions, his taking steps that would foreseeably cause significant harm to Shocking amounts to nothing less than a breach of the fiduciary duty of loyalty.

Michael has referred to this as short-term pain for long-term gain. Perhaps it is a matter of degree. Advancing a policy where short-term adverse effects are outweighed by future benefits may be the product of a prudent and dutiful fiduciary. In theory, there may be something of a continuum on which actions, such as Michael's, should be measured. Where the line is between the acceptable

and the unacceptable is not readily pinpointed. The circumstances of this case, however, leave little, if any, room for doubt. First, the short-term financial consequences of Michael's antics could have caused the demise of Shocking. Such reasonably foreseeable outcomes cannot be reconciled with the exercise of fiduciary duty.[55] Second, the disclosure of confidential information to a potential investor (an adverse party at that particular moment), especially when the director knows (and hopes) that the disclosure would benefit the potential investor to the substantial detriment of the Company, is conduct which, in and of itself, is a breach of the duty of loyalty. In short, a loyal director does not put the company in dire financial circumstances in order to obtain what he perceives as a benefit for himself and his associated investors. That there may be some theoretical improvement in "corporate governance" to the director's liking does not alter this conclusion.

Michael may, for some period of time, have been motivated by idealistic notions of corporate governance. It was no doubt convenient that his corporate governance objectives aligned nicely with his self-interest.[56] When he and his fellow B/C investors bought into Shocking, they did so knowing that they

[55] A fundamental underpinning of our law is that one is deemed to intend the logical consequences of his actions. *See In re Lassen*, 672 A.2d 988, 996 n.9 (Del. 1996) ("It is well settled that a person is presumed to have intended the natural consequences of his or her acts . . . .") (citations omitted).

[56] *See City Capital Assocs. Ltd. P'ship v. Interco. Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988) ("human nature may incline *even one acting in subjective good faith* to rationalize as right that which is merely personally beneficial").

collectively only had one out of six board slots. Apparently, Michael came to regret that decision and worked to avoid the deal that he made. He contrasted the one out of six board seats designated by the B/C investors with B/C investors' substantial shares of all funds invested in Shocking.[57] That disparity annoyed him, but it was the board representation which he negotiated. In the abstract, his argument that board representation should be more proportional to investment is plausible. To describe it as a matter of good corporate governance—something that he may have believed or rationalized in contravention of the investment commitments that he made—strikes an observer from a distance as somewhere between disingenuous and self-righteous self-interest.

Michael's actions were motivated by a number of factors, ranging from a realization that one or more additional board seats for the B/C investors would be better for him to an abstract concept that a more democratic board is inherently good.[58] We are frequently motivated to engage in certain conduct by a variety of factors. Trying to discern which factors were more important in Michael's case is not easy and, frankly, requires some speculation. For present purposes, it suffices to recognize that Michael's objectives were far from the exclusive product of idealism. It might not matter if his actions were completely altruistic. Even if he

[57] Michael believed that the B/C investors had contributed 70% of the capital paid in to the Company by the fall of 2011. JX 171.

[58] He had come to dislike Kosowsky intensely and questioned whether he was the right person to lead Shocking, and he had come to view at least one other board member with disdain.

had the best of subjective intentions, it would be difficult to reconcile Michael's conduct and its likely consequences of causing serious harm to Shocking with the fiduciary duty of loyalty he owed to Shocking.

Regardless of how one might prioritize Michael's corporate governance concepts, those objectives would not justify pushing the Company to the brink of—or beyond—a debilitating cash shortfall. It is not an act of loyalty for a director to seek to impose his subjective views of what might be better for the Company by exercising whatever power he may have to threaten the Company's survival. In short, even if Michael had reasonable goals, he chose improper means, including disclosure of confidential information, in an attempt to achieve them.

Michael's conduct had a foreseeable (and intended) consequence: depriving the Company of a cash infusion necessary for its short-term survival. It turns out that a predictable result of his actions did not occur. In these circumstances, a director may not put the existence of a corporation at risk in order to bolster his personal views of corporate governance. The lesson to be learned from these facts must be carefully confined, however. First, fair debate may be an important aspect of board performance. A board majority may not muzzle a minority board member simply because it does not like what she may be saying. Second, criticism of the conduct of a board majority does not necessarily equate with criticism of the corporation and its mission. The majority may be managing the business and

affairs of the corporation, but a dissident board member has significant freedom to challenge the majority's decisions and to share her concerns with other shareholders. On the other hand, internal disagreement will not generally allow a dissident to release confidential corporate information. Fiduciary obligations are shaped by context. A balancing of the various conflicting factors will be necessary, and sometimes the judgments will be difficult. Here, the most logical objective of Michael's actions—strangling the Company with a potentially catastrophic cash shortfall—cannot be reconciled with his "unremitting" duty of loyalty. Thus, Michael did breach his fiduciary duty of loyalty to Shocking.

C. *Damages*

Determining the damages that result from a breach of the duty of loyalty is frequently a difficult effort, requiring a willingness to accept the uncertainty that inevitably results from a process based unavoidably on assumption.[59] Fiduciaries who fail fundamentally should not benefit from the lack of precision in measuring the harm for which they are responsible. It is for this reason that "Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly."[60]

Michael focused his attention on dissuading Littelfuse from exercising the warrants ($3 million) in early December 2011. That effort failed. Nevertheless,

[59] *See, e.g.*, *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 440-41 (Del. 2000).
[60] *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del. 1996).

Shocking asserts that Michael's actions damaged it in two other ways—both involving Littelfuse. First, Littelfuse was considering investing in Shocking beyond the warrants in December. Second, Littelfuse did invest in the spring of 2012, but under terms that, according to Shocking, were much worse for Shocking because of Michael's actions. Although the Court recognizes its inherent discretion and flexibility in awarding damages for a breach of fiduciary duty, it is not persuaded that Michael's breaches materially affected Littelfuse's investments.

First, in the October-December 2011 period, Littelfuse was evaluating the purchase of additional Shocking stock—perhaps in the "range of $10-15 million" at the Series C price.[61] A cash infusion of that magnitude also would have postponed the need for additional fundraising. Dickinson (and Littelfuse) decided not to pursue that approach following the special stockholders' meeting at the end of November during which Michael openly and hostilely challenged Shocking's management. Dickinson thought that Michael was a "distraction" that would interfere with Shocking's efforts to "pursu[e] the goal of getting to customer revenue."[62] Shocking complains about Michael's arguably irresponsible actions at the stockholders' meeting, but those actions do not form the basis for this Court's finding of disloyalty. Instead, the conduct by Michael at the November meeting that bothered Dickinson was primarily part of the stockholder debate. Dissension

[61] Tr. 13-14 (Dickinson).
[62] Tr. 24-27 (Dickinson).

will likely discourage additional investment. Investors value stability. That is one unfortunate consequence of Michael's debate, but that is not how Michael breached his duty as a director.[63]

Second, in April 2012, Littelfuse again invested in Shocking, and, this time it used its leverage to obtain better terms—both in terms of price and a board seat. If the leverage had depended upon Michael's negotiating advice or disclosure of confidential information, Shocking would be entitled to damages. The more reasonable inference, however, is that, with Dickinson's involvement, Littelfuse—even without Michael—came to understand Shocking's difficult financial circumstances and, perhaps even more importantly, the absence of any other potential contributor of material amounts of needed capital. After Littelfuse exercised the warrants in early December, Michael—most likely recognizing that he had no more "leverage"—had no other contact with Dickinson regarding either confidential information or negotiating strategy. Thus, in the four months leading up to the April 2012 investment, Littelfuse received no other improper input from Michael. The information that it had obtained from Michael in the fall of 2011

[63] Dickinson seems to have viewed Michael as a director who held unusual perspectives. It is not that he accepted or endorsed Michael's articulated concerns; it is more the dissension—and perhaps its intensity—that troubled him.

This raises the question of why, in light of all of Michael's actions, did Littelfuse even exercise the warrants? In addition to not having been moved substantively all that much by Michael's actions, it may be as straightforward as (i) Dickinson had made a commitment to exercise the warrants if Littelfuse's due diligence during the late summer or early fall of 2011 was completed as expected and (ii) Dickinson, on completion of the due diligence, honored his earlier commitment.

might have been helpful in Littelfuse's negotiations with Shocking in December 2011, but that information was stale by spring 2012. By then, Littelfuse was likely not relying on anything Michael had said in the fall of 2011. Shocking's fiscal problems were severe and were obvious to someone, such as Dickinson, who was a Board observer. The lack of discussion about other potential significant investors no doubt induced Dickinson to infer that there probably was no other source of capital for Shocking in the near term. In other words, Littelfuse, on its own, by April of 2012 knew all it needed to know to negotiate a better deal.[64] In sum, even though "uncertainties in awarding damages [for breach of fiduciary duty] are generally resolved against the wrongdoer,"[65] Shocking has not proved that it should be awarded damages.[66]

---

[64] Dickinson agreed that Littelfuse obtained better terms in 2012 "because of Mr. Michael's disruptions." Tr. 50 (Dickinson). Whether these disruptions were Michael's breaches of fiduciary duty or his hostile dissension is far from clear. Moreover, Dickinson's statements do not significantly aid any quantitative analysis.

[65] *Thorpe v. CERBCO, Inc.*, 1993 WL 443406, at 963 (Del. Ch. Oct. 29, 1993).

[66] Michael's conduct has certain similarities with the tort of interference with business opportunity. The effort to calculate damages for committing that tort may be viewed as less than precise because it almost by definition—the anticipated business opportunity did not materialize as it would have without interference—requires a degree of speculation and assumption. Although damages constitute an element of the tort, a breach of the fiduciary duty of loyalty may be shown without proof of proximate damages. Here, the Court has the flexibility and the discretion that come with devising an equitable remedy and has no cause for seeking to impose a strict standard.

One of the reasons why establishing damages is difficult in this instance is that Michael failed abjectly in achieving his primary objective—preventing (or dissuading) Littelfuse from exercising the warrants for $3 million. Perhaps Shocking was inconvenienced at the time, but the warrants were exercised as, and when, expected. Shocking seeks damages for the collateral consequences that Michael's conduct may have had either on the possibility of Littelfuse's investing even more money in December 2002 or on the negotiation of relatively favorable terms for Littelfuse in April 2011. The need for extensive speculation and the recognition business

D. *Attorneys' Fees*

Shocking seeks to recover from Michael the attorneys' fees and expenses it has incurred in pursuing this matter. Under the American Rule, followed in Delaware, a litigant generally is responsible for its own legal fees and expenses.[67] Bad faith—either the underlying conduct or behavior during the proceedings—may justify shifting fees.[68] Michael's litigation conduct should not be viewed as having reached the level required for changing the standard practice. There can be no complaint about Michael's conduct (and the professional attitude exhibited by his counsel) during this proceeding.

The question presented, here, is whether Michael's failure as a fiduciary justifies (or requires) the Court to exercise its discretion to relieve Shocking of the burden of its legal fees. Our law does assess fiduciaries somewhat more sternly.

> [W]here there has been a breach of the duty of loyalty . . . potentially harsher rules come into play and the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly . . . The strict imposition of penalties under Delaware law [is] designed to discourage disloyalty.[69]

The facts of *Saliba* and the facts of this case are similar in one critical aspect: there was a breach of fiduciary duty but damages from the breach could not be

---

information would come with time to Littelfuse are, on this record, insurmountable obstacles to resolving all of this with a reasonable and reliable measure of damages or even concluding that Shocking suffered any material damages.

[67] *Montgomery Cellular Hldg. Co., Inc. v. Dobler*, 880 A.2d 206, 227 (Del. 2005).

[68] *See, e.g., id.*

[69] *William Penn P'ship v. Saliba*, 13 A.3d 749, 758 (Del. 2011) (quoting *Cantor Fitzgerald L.P. v. Cantor*, 2001 WL 536911, at *3 (Del. Ch. May 11, 2001)) (quotation marks omitted).

established. The failure of the fiduciaries in *Saliba* could not seriously be doubted. Here, Michael came to believe that there were good reasons for his conduct. Although self-interest may have encouraged him, his conduct cannot fairly be characterized as primarily manifesting subjective bad faith. Instead, at least as the Court views his actions, Michael pursued certain objectives about which reasonable people might disagree but with strategies that are simply not acceptable.

Perhaps Littelfuse would have invested more in Shocking in December if Michael had not been a distraction. Concerns over dissension within the Board dampened Dickinson's interest in a larger investment. Care must be taken, however, to differentiate between Michael's actions that Dickinson found annoying and confusing and Michael's actions that the Court has found to have been in breach of his duty of loyalty. That Michael pursued his own corporate governance agenda, that Michael's efforts engendered frustration and anger among the other Board members, and that Dickinson may have viewed Michael's behavior as counterproductive may show that Michael was a less-than-ideal director, but they do not demonstrate that he breached his duty of loyalty. The breach of the duty of loyalty—and that is what any award of attorneys' fees against Michael must be tied to—depended upon his sharing confidential information—that there were no other sources of funding—with Dickinson and his efforts to enlist Littelfuse in his efforts to change the Board composition by withholding

further funding. That confidential information and Michael's lobbying did not—as far the Court can tell—lead Littelfuse to withhold additional funds for Shocking in December. Even if it had some effect, it was minimal when compared with other factors affecting Dickinson's assessment of whether to invest more heavily at the time.

As the Supreme Court observed in *Saliba*, the decision to award attorneys' fees is a component of this Court's "broad discretionary power to fashion appropriate equitable relief."[70] Disloyalty alone does not require fee shifting.[71] Whether disloyal conduct warrants imposition of the other side's legal fees depends upon an assessment of the context. In this instance, because of the range of considerations that Michael thought were influencing him and because the disloyal conduct caused relatively little, if any, harm, a departure from the American Rule is not justified.[72] Accordingly, Shocking's application for an award of attorneys' fees and expenses is denied.

---

[70] *Saliba*, 13 A.3d at 758.

[71] A persistent subtext to the Shocking-Michael confrontation is: how far can a majority of directors go in silencing a dissident director? The risk of attorneys' fees may incentivize faithful conduct, but it also may be used to intimidate the inconvenient and annoying director into silence. The line separating fair and aggressive debate from disloyal conduct may be less than precise. This is yet another reason why care must be exercised in deviating from the recognized default rule about parties bearing their own legal fees.

[72] It may be that, without the filing of this action and Shocking's incurring the significant legal fees resulting from that action, Michael's actionable conduct would have continued or would have increased. On the record, that amounts to little more than speculation. Such inferences are simply too uncertain to support the unusual relief of shifting the normal burden of litigation expenses.

III. CONCLUSION

For the foregoing reasons, the Court finds that Michael breached the duty of loyalty he owes to Shocking, but it denies Shocking's claims for damages and for an award of attorneys' fees and expenses. Costs, otherwise, are assessed against Michael.

Counsel are requested to confer and to submit an implementing order.