IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

NORTH AMERICAN CATHOLIC EDUCATIONAL PROGRAMMING FOUNDATION, INC.,	:	
Plaintiff,	:	
v.	:	**C.A. No. 1456-N**
ROB GHEEWALLA, GERRY CARDINALE, AND JACK DALY,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: March 16, 2006
Date Decided: September 1, 2006

Edward M. McNally, Esquire of Morris, James, Hitchens & Williams LLP, Wilmington, Delaware, Attorney for Plaintiff.

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NOBLE, Vice Chancellor

Plaintiff North American Catholic Educational Programming Foundation, Inc. ("NACEPF" or the "Plaintiff") holds licenses to certain radio wave spectrum regulated by the Federal Communications Commission ("FCC"). In March 2001, NACEPF, together with other similar spectrum license-holders, entered into the Master Use and Royalty Agreement (the "Master Agreement")[1] with Clearwire Holdings, Inc. ("Clearwire"), a Delaware corporation, under which Clearwire could obtain rights to those licenses as then-existing leases of those licenses expired and the then-current lessees failed to exercise rights of first refusal. The Master Agreement did not work out well for NACEPF. NACEPF attributes its disappointment to Defendants Rob Gheewalla, Gerry Cardinale, and Jack Daly (collectively, the "Defendants"), who served as directors of Clearwire at the behest of Goldman Sachs & Co. ("Goldman Sachs"). The Defendants, even though they comprised less than a majority of the board, were able to control Clearwire because its only source of funding was Goldman Sachs, and, according to NACEPF, they used that power to favor Goldman Sachs' agenda in derogation of their fiduciary duties owed as directors of Clearwire. In addition to bringing fiduciary duty claims against the Defendants, NACEPF also asserts that they fraudulently induced

[1] The Master Agreement may be found at Aff. of John Primeau, Ex. M and Aff. of Richard P. Rollo, Ex. B.

it to enter into the Master Agreement with Clearwire and that they tortiously interfered with NACEPF's business opportunities.[2]

NACEPF is not a shareholder of Clearwire. Instead, NACEPF has come to this forum as a putative creditor of Clearwire and brings direct, not derivative, fiduciary duty claims against the Defendants, who served as directors of Clearwire while it was either insolvent or in the "zone of insolvency."

Personal jurisdiction over the Defendants is premised solely upon 10 *Del.C.* § 3114, which subjects directors of Delaware corporations to this Court's personal jurisdiction over claims "for violation of a duty in [their] capacity of [directors of the corporation]." No other basis for personal jurisdiction over the Defendants has been asserted. Thus, NACEPF's efforts to bring its other claims in this venue will fall on jurisdictional grounds unless those other claims are adequately alleged to be "sufficiently related" to a viable fiduciary duty claim against the Defendants.

For the reasons set forth in this Memorandum Opinion, the Court concludes: (1) that creditors of a Delaware corporation in the "zone of insolvency" may not assert direct claims for breach of fiduciary duty against its directors; (2) that the Complaint fails to state a claim for the narrow, if extant, cause of action for direct claims involving breach of fiduciary duty brought by creditors against directors of

[2] This action was initially filed in the Superior Court; it was dismissed without prejudice for lack of subject matter jurisdiction, *see* Compl. Ex. A, and transfer to this Court was permitted under 10 *Del.C.* § 1902.

insolvent Delaware corporations; and (3) that, with dismissal of its fiduciary duty claims, NACEPF has not offered the Court any basis for exercising personal jurisdiction over the Defendants with respect to NACEPF's other claims. Thus, the Defendants' Motion to Dismiss will be granted.

I. BACKGROUND[3]

NACEPF, an independent lay organization incorporated under the laws of Rhode Island, provides educational programming. The Defendants served, "at all relevant times," as employees of Goldman Sachs and as members of Clearwire's board.[4]

The Complaint alleges that the Defendants were "able to and did control" the Clearwire Board of Directors even though they did not constitute a majority of the board.[5] This was possible because Goldman Sachs was the principal, if not exclusive, source of future financing for Clearwire. Goldman Sachs is alleged to have invested $47 million in Clearwire, which the Complaint explains "represent[ed] 84% of the total sums invested in Clearwire in March 2001, when

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[3] The background to this dispute is based primarily on the well-pleaded allegations of the Complaint.

[4] The Complaint provides only that the Defendants served as directors of Clearwire "at all relevant times . . . ." *See* Compl. ¶¶ 2-4. Although the Court is generally restricted to the allegations contained in the Complaint in considering the Motion to Dismiss, it should be noted that significant debate has arisen over whether the Defendants were members of the Clearwire board when the Master Agreement was entered into, or whether the Defendants only assumed their positions on the board thereafter.

[5] *Id*. at ¶ 7. The Complaint does assert, however, that Goldman Sachs "controlled the majority of the votes of Clearwire's stock entitled to vote after November 2001 and had rights to acquire a majority of the shares after March 2001." *Id.* at ¶ 7(d).

Clearwire was otherwise virtually out of funds."[6] Moreover, it is alleged that, after March 2001, "Clearwire was unable to borrow or obtain any other significant financing . . . , except from Goldman Sachs."[7] As a consequence of this state of affairs, Clearwire's board was almost entirely dominated by the Defendants because the much-needed financing from Goldman Sachs would cease if its directives were not followed.[8]

* * *

The Complaint alleges that, "[b]y at least 2000," Goldman Sachs determined that it wanted "to invest in the market for wireless radio spectrum to connect to the internet."[9] Certain obstacles to the development of this market had arisen which Goldman Sachs "saw as an opportunity" on which it could "capitalize."[10] In order to implement its business plan, Goldman Sachs chose as the "vehicle for its

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[6] *Id*. at ¶ 7(a). The Complaint also alleges:

> After March 2001, Clearwire had financial obligations related to its agreement with NACEPF and others that potentially exceeded $134 million, did not have the ability to raise sufficient cash from operations to pay its debts as they became due and was dependent on Goldman Sachs to make additional investments to fund Clearwire's operations for the foreseeable future.

Id. at ¶ 7(b).

[7] *Id*. at ¶ 7(c). It is also alleged that Goldman Sachs "was virtually Clearwire's sole source of investment banking advice, contacts with potential acquisition candidates and legal advisors." *Id.* at ¶ 7(e).

[8] *Id.* at ¶ 7 (f). Indeed, the Complaint alleges: "As recently as June 2003 Clearwire admitted to potential third-party investors that its 'Board of Directors . . . is led by Goldman Sachs.'" *Id.*

According to the Complaint, Clearwire's senior management understood that continued employment was contingent on "the decisions of Goldman Sachs, as conveyed by the [Defendants]." *Id.* at ¶ 8; *see also id*. at ¶ 9.

[9] *Id*. at ¶ 16.

[10] *Id*. at ¶ 16.

internet business investment" Clearwire, "then a small, unprofitable wireless company . . . ."[11]

Clearwire had been established to "take advantage of the business opportunity in providing internet access without the use of wires or cables."[12] The company "intended to provide internet access by using electronic signals broadcast much like radio or television signals, over a range of wavelengths (known as 'spectrum')."[13]

In the 1990's, when Clearwire was created, "wireless" internet faced numerous technological and regulatory difficulties.[14] Most significant, for purposes of this litigation, was the relatively large amount of electronic data transmitted, which required the availability of ample spectrum in order to accommodate the technology's needs.

Use of radio wave spectrum is subject to regulation and licensing by the FCC. In regulating use of spectrum, the FCC "discourages interference between users" and, in reviewing license applications, will not permit new licensees to

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[11] *Id*. The Complaint alleges that Clearwire was chosen because it had certain useful technology that limited the interference of radio signals.

[12] *Id.* at ¶ 10.

[13] *Id*.

[14] *Id*. at ¶ 11. Among these was the fact that the requisite technology for access to the internet in the absence of a "physical connector to an internet service provider" was still under development. *Id*.

interfere with the signals of preexisting licensees.[15] As a consequence of these policies, opportunities for access by new licensees are limited.[16]

By 2000, however, it had become clear that some of the difficulties facing wireless internet could be ameliorated by the use of additional radio wave spectrum as it became available "from the FCC."[17] This resulted in a focus on the "large band of 'microwave' spectrum," known as "Instructional Television Fixed Service" ("ITFS") spectrum.[18] In 1999, Sprint and WorldCom "realized that . . . ITFS spectrum had value" and commenced an "aggressive campaign . . . to acquire rights to use existing licenses to operate in [the] spectrum."[19] The Complaint alleges that this strategy, which "resulted in obtaining a good portion of the commercial radio wave licenses that were available," cost Sprint and WorldCom more than $2 billion.[20]

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[15] *Id*. at ¶12.

[16] The Complaint informs, however, that the FCC "permits the use of some bands of spectrum to anyone, such as manufacturers of wireless TV systems whose customers wish to use it. This is the 'unlicensed' spectrum where signal interference is common." *Id*.

[17] *Id*. at ¶ 13.

[18] Evidently, the ITFS channels were assigned to allow educational institutions to deliver video instruction to multiple sites. Wireless video signals "similar to the 'VHF' and 'UHF' television bands" were traditionally broadcast in the ITFS spectrum, which was so labeled because it was "used by various education entities." *Id*. ITFS spectrum had also been used by certain commercial entities to provide "'wireless' cable television;" however, these entities "became insolvent when satellite television became the preferred and dominant competitor to cable television." *Id.*

[19] *Id*. at ¶ 14.

[20] *Id*. These licenses were purchased "from license holders who often could not afford to continue operating the unsuccessful wireless business." *Id.*

NACEPF alleges that, "[b]ecause these channels were close together, acquiring rights to use adjacent channels (a process known as 'rationalizing' the spectrum) was desirable;"[21] however, this had not occurred by 2000, when Goldman Sachs initiated its own investment strategy.[22] Goldman Sachs "knew that Sprint and WorldCom only held leases that would expire at some point and did not own the rights to use that ITFS spectrum permanently."[23]

In order to take economic advantage of the problems within the industry, Goldman Sachs looked for a "vehicle for its internet business investment . . . ."[24] Clearwire was chosen because "it had a technology that might be used in the 'unlicensed' band of spectrum to limit signal interference, and as this educational band became more 'rationalized,' Clearwire could transition those customers from its unlicensed 'free-for-all' band into the 'protected' license band."[25]

As NACEPF tells it, Goldman Sachs's strategy was to obtain "control over" a number of ITFS licenses "whose current leases, for example with Sprint or WorldCom," would eventually terminate.[26] Because Sprint and WorldCom, the current lessees, had already spent over $2 billion to acquire their initial rights to the spectrum licenses, they were attempting to renew their leases "for as little as

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[21] *Id*. at ¶ 15.
[22] *Id*. at ¶¶ 15, 16.
[23] *Id*. at ¶ 16.
[24] *Id*.
[25] *Id*.
[26] *Id*. at ¶ 17.

possible and under restrictive lease terms that limited the educators' [*e.g.*, NACEPF's] access to the spectrum."[27] According to the Complaint:

> If Goldman Sachs could: (a) create a high enough price with more liberal access terms in their lease "offering" to these educators, (b) that neither Sprint nor WorldCom would want to match, (c) then in the traditional right of first refusal contained in these leases, (d) when Sprint and WorldCom would not match Clearwire's "offer", Goldman Sachs could position Clearwire to acquire the spectrum, (e) at a small fraction of the investment that WorldCom and Sprint had invested.[28]

As the Complaint explains, "[i]n the United States, there are a few networks of education licensees in the microwave ITFS band."[29] Three of the largest of these networks (one of which was NACEPF) joined to form ITFS Spectrum Development Alliance, Inc. (the "Alliance") in 2000.[30]

In 2000, Goldman Sachs began negotiations with the Alliance and its members to obtain rights to the ITFS spectrum. Negotiations continued until March 2001, when Clearwire and the Alliance, including NACEPF and its other members, executed the Master Agreement.[31] The Complaint alleges that the negotiations were "directed" by the Defendants and that Clearwire "was the

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[27] *Id*.

[28] *Id*.

[29] *Id*. at ¶ 18.

[30] *Id*. The Complaint sets forth that the "funding [sic] members" of the Alliance were NACEPF, Hispanic Information and Telecommunications Network, Inc. ("HITN"), Instructional Telecommunications Foundation, Inc. ("ITF") and various affiliates of ITF. *Id.* at ¶ 19. These entities together held licenses for a "significant portfolio of the ITFS spectrum in the United States." *Id.*

[31] The Master Agreement is both integral to NACEPF's claim and repeatedly referenced in the Complaint; therefore, the Court may consider its provisions, notwithstanding the fact that they may not have been cited in the Complaint. *See, e.g.*, *Khanna v. McMinn*, 2006 WL 1388744, at *30 (Del. Ch. May 9, 2006).

vehicle Goldman Sachs used to contract with the Alliance and its members."[32] The "business plan reflected in the terms of the Master Agreement" envisioned that Clearwire would exercise its power to obtain rights in the Alliance's ITFS licenses as the existing leases for Alliance spectrum expired and current lessees failed to exercise their rights of first refusal.[33]

Important to NACEPF's claims is its allegation that the Defendants made several material statements regarding Goldman Sachs's intent with respect to Clearwire on which NACEPF relied in entering into the Master Agreement.[34] NACEPF has alleged that "throughout" the negotiations from 2000 to March 2001, the Defendants "emphasized that Goldman Sachs was committed through

[32] Compl. at ¶ 20.

[33] *Id*. at ¶ 21. "At the time the Master Agreement was signed, most of the Alliance member licenses were already licensed to third parties, such as Sprint." *Id.* The Court notes that the terms "licensee" and "lessee" appear to be used interchangeably in certain portions of the Complaint when referring to lessees/sub-licensees of spectrum licensed to Alliance members by the FCC.

The Complaint also recites several provisions of the Preamble to the Master Agreement, one of which states that the agreement with "Clearwire will best facilitate the development of wireless access to (the Alliance's planned nationwide broadband educational network) and will maximize the financial and other resources available to the Alliance Members to provide an innovative and comprehensive package of services" and that "Clearwire desires to expand its business . . . to a national platform utilizing the Commercial Spectrum Capacity of the [Alliance] Channels . . . to their maximum extent provided for herein . . . ." *Id*. at ¶ 38. Additionally, the Preamble recites that Clearwire "is prepared" to make the necessary payments under the agreement. *Id*.

[34] *See id*. at ¶ 24 ("This commitment of Goldman Sachs to develop the wireless network using the licenses of the Alliance members was important to and relied upon by NACEPF when it signed the Master Agreement in March, 2001."). The Complaint explains that Goldman Sachs's business plan—as represented to Alliance members—if fulfilled, would have aided NACEPF in performing its non-profit function. *See id.* NACEPF sets forth that "[t]he proposal made by Clearwire provided the Alliance members with additional use of the wireless spectrum so that the Alliance members and NACEPF would have an increased ability to provide its services on a high speed internet platform to further expand their services." *Id.*

Clearwire to providing adequate capital and management to develop the spectrum assets of Alliance members into an operating, national system of wireless connections to the internet."[35] On June 7, 2000, Defendant Cardinale sent a memorandum to the Alliance "on Goldman Sachs' behalf" outlining Goldman Sachs's ostensible business strategy.[36] Following the closing on the Master

[35] *Id*. at ¶ 22. The Complaint states that the Defendants "represented" to NACEPF between June 2000 and May 2002 that Goldman Sachs:

> would do what was necessary to cause Clearwire to: (1) continue to expand its existing markets with its proprietary technology, (2) acquire the NACEPF's license rights in spectrum as the existing licenses for that spectrum expired and were not renewed, and (3) use the then-available technology of Clearwire or its equivalent to incorporate in its expanding unlicensed band build-outs, the Alliance spectrum as it became rationalized in an operating wireless network to access the internet while permitting the NACEPF to offer its services to its clients and to otherwise use that spectrum to maintain the NACEPF licenses.

Id. at ¶ 38.

[36] The Complaint quotes the letter in pertinent part:

> As part of our proposal, <u>we</u> wanted to reiterate again our philosophy in partnering with the alliance to meet the objectives of both sides, alleviate any material upfront concerns, and <u>provide as much assurance as possible</u> that the partnership going forward represents the best interests of the Alliance and its constituencies. As we tried to articulate in our last two meetings, we take a long-term view to wealth creation in these type of projects.
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> * * *
>
> As we mentioned in our meeting, <u>we</u> believe in being fair and <u>are absolutely prepared to not only pay competitive market prices for the assets which you can deliver but also finance the acquisition cost for your entire portfolio of spectrum</u> (i.e., all 140 million channel POPs, as well as any additional affiliated channel POPs which you can deliver).
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> * * *
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> <u>This</u> results in upfront cash payment to the Alliance of $8 million (assuming 20 million channel POPs), which together with our funding of the engineering study and related legal/upfront development costs to be determined, <u>establishes our commitment to the Alliance of a long-term partnership</u> for the development of the ITFS spectrum via an ongoing, fully funded operating vehicle.
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> * * *
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> [A Goldman Sachs affiliate], with the assistance of Jimmy Mansour [Chairman of Clearwire's board and its Chief Executive Officer] and Goldman Sachs, will

Agreement on March 13, 2001, NACEPF alleges, this understanding was "publicly confirmed" by Goldman Sachs through announcements made by Clearwire and Goldman Sachs.[37]

In contrast to their private and public assurances, it is alleged, however, that the Defendants "never intended to do the build out" of the envisioned wireless network,[38] but instead had a "hidden agenda . . . to use the rights granted Clearwire in the Master Agreement to extract concessions from Sprint, WorldCom and other wireless operators . . . ."[39] Soon after entering into the Master Agreement, the Defendants "secretly" began meeting with commercial lessees of the Alliance's

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> manage the engineering project and <u>ensure timely completion</u> under FCC guidelines.
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> * * *
>
> Based on our current projections, the purchase and build-out costs associated with the delivery and operationalization of 140 million channel POPs will require approximately $350 million over the build-out period.

Id. at ¶ 23 (emphasis and alterations in Complaint). "Channel POPs" (Point of Presence) "in a Market Area . . . are the number of total service area households times the number of Channels an Alliance Member is licensed to operate in a protected service area . . . ." Master Agreement at 9.

[37] *Id*. at ¶ 25. The Complaint provides that "[f]or example, Clearwire announced the recent funding should 'take us well into 2002' in expanding into new markets and Goldman Sachs stated, 'we identified Clearwire as the ideal platform for delivering data and voice services.'" *Id.*

[38] *Id*. at ¶ 31. The Complaint alleges that the Defendants knew the representations they were making were not true and that, to the extent any of those representations were "stated as their opinions of what Clearwire would do after the Master Agreement was signed," the Defendants "did not actually hold those opinions at that time." *Id*. at ¶ 41. In addition to their alleged knowledge of Clearwire's lack of funds and that Goldman Sachs "did not intend to provide the funding required," the Complaint also states that the Defendants "knew," both before and at the time of signing of the Master Agreement, that "Clearwire's equipment subsidiary (that was to supply the technology it needed) was for sale." *Id.*

[39] *Id*. at ¶ 28.

ITFS spectrum.[40] The Complaint provides that "Goldman Sachs/Clearwire" met with WorldCom on April 12, 2001; Sprint on April 3, 2001; and Bell South on April 14, 2001.[41] At those meetings, the "Goldman Sachs/Clearwire message" conveyed was that the Master Agreement granted them "topping leases" over a substantial portion of the spectrum subject to temporary leases and that, "by virtue of the consideration to be paid to the Alliance members," Clearwire was the probable successor to those leases on their expiration.[42] In light of Clearwire's "topping leases," "Goldman Sachs/Clearwire" encouraged wireless operators to "agree to cooperate" with Clearwire in rationalizing spectrum for their "material benefit," since they could otherwise "face the loss of valuable spectrum or interference with any spectrum they held next to ITFS channels acquired by Clearwire."[43] The Complaint alleges that, "rather than fulfill their representations to the Alliance and its members to build out [the wireless-internet] network," the

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[40] *Id*. at ¶ 26. The Defendants "secretly began a series of meetings without the Alliance['s] prior knowledge with the Alliance commercial lessees." *Id.*

[41] *Id*. The Complaint alleges that those meetings occurred "[i]n addition to [meetings with] other potential acquirers . . . ." *Id.*

[42] *Id*. at ¶ 27. With respect to the consideration provided, the Complaint states: "For example, the Clearwire consideration included a substantial equity component in the form of preferred stock in Clearwire and greater access rights to Alliance members to the spectrum post-acquisition . . . ." *Id.*

[43] *Id*.; *see also id*. at ¶ 28.

Defendants and Goldman Sachs attempted to "flip" Clearwire's "rights" in Alliance spectrum.[44]

The Defendants were unable to persuade the targeted wireless operators of the seriousness of their threat, however, and their attempts to "extract concessions" ultimately failed.[45] Indeed, any hope the Defendants may have had of succeeding in their plan was largely demolished by the collapse of the market for wireless spectrum in June 2002 after revelations regarding WorldCom's accounting problems and market participants began to anticipate a glut of available spectrum.[46]

"From the initial Alliance closing in March 2001 until May 2002," the Defendants "caused Clearwire to continue to assert to the Alliance members that Clearwire had the right to acquire from them any of their spectrum licenses that became available."[47] The Complaint explains that, as a consequence, Alliance members, including NACEPF, were "preclud[ed] . . . from offering those licenses to third parties or extending the term of any expiring licenses."[48] Indeed, the

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[44] *Id*. The Complaint further explains that "the undisclosed plan of Goldman Sachs was to leverage the Alliance's spectrum licenses when the market for spectrum improved as demand for internet access increased, while maintaining the pretense of an industry participant." *Id*. at ¶ 31. It perhaps bears noting, however, that the Master Agreement does, *inter alia*, explicitly permit Clearwire to enter into certain "swap transactions with third parties," *see* Master Agreement, § 1.4(g)(ii), as well as, subject to certain conditions, to "sell, transfer, sublease and assign any Individual Use Agreement . . . ." *See id.* at § 1.5(a).

[45] *See* Compl. ¶ 29.

[46] *See id*. at ¶ 34.

[47] *Id*. at ¶ 32.

[48] *Id*. The Complaint alleges that, "[t]hroughout this period," ready, willing, and able acquirors existed, "but none of those potential acquisitions went forward because of Clearwire's claims." *Id*.

Complaint alleges that Clearwire's claims "were not made in good faith,"[49] but it "continued to claim entitlement to those licenses to pressure Sprint, WorldCom and others to agree to cooperate with Clearwire in dividing the wireless market."[50] Additionally, the Complaint states that the Defendants "directed" Clearwire to assert "its claims to the Alliance's ITFS spectrum, while knowing that Clearwire lacked the funding to acquire and use that spectrum and that Goldman Sachs would not provide that funding."[51]

Following the collapse of the market for wireless spectrum, Clearwire began negotiations with the Alliance members to extricate itself from its obligations. Clearwire paid over $2 million to HITN and ITF to settle claims they may have had against the company and "was only able to limit its payments to that amount by otherwise threatening to file for bankruptcy protection."[52] NACEPF, however, refused to settle its claims.[53] The Complaint alleges that, by October 2003, Clearwire "had been unable to obtain any further financing and effectively went out of business."[54]

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[49] Compl. ¶ 33. The Complaint asserts that the Defendants "understood" that Clearwire "would need substantially more financial support than it had obtained in March 2001," *id*. at ¶ 30, and that it "lacked funding to acquire and operate the spectrum involved in expiring licenses." *Id*. at ¶ 33.
[50] *Id*.
[51] *Id*.
[52] *Id*. at ¶ 35.
[53] *See id*. ("These settlements left NACEPF as the sole remaining member of the Alliance.").
[54] *Id*. at ¶ 36 ("Except for money advanced to it as a stopgap measure by Goldman Sachs in late 2001, Clearwire was never able to raise any significant money.").

II. CONTENTIONS

NACEPF asserts three claims against the Defendants. First, NACEPF, in Count I of the Complaint, contends that the Defendants fraudulently induced it to enter into the Master Agreement and, thereafter, to continue with the Master Agreement to "preserv[e] its spectrum licenses for acquisition by Clearwire."[55] Second, in Count II, NACEPF argues that because, at all relevant times, Clearwire was either insolvent or in the "zone of insolvency," the Defendants owed fiduciary duties to NACEPF "as a substantial creditor of Clearwire," and that the Defendants breached those duties by:

> (1) not preserving the assets of Clearwire for its benefit and that of its creditors when it became apparent that Clearwire would not be able to continue as a going concern and would need to be liquidated and (2) holding on to NACEPF's ITFS license rights when Clearwire would not use them, solely to keep Goldman Sachs's investment "in play."[56]

Finally, in Count III, NACEPF claims that the Defendants tortiously interfered with a prospective business opportunity belonging to NACEPF in that they caused Clearwire wrongfully "to assert the right to acquire NACEPF wireless spectrum," which resulted in NACEPF losing "the opportunity to convey its licenses for spectrum to other buyers."[57]

[55] *Id*. at ¶ 40.
[56] *Id*. at ¶ 45.
[57] *Id*. at ¶ 50.

The Defendants have moved to dismiss this action on two grounds: first, for lack of personal jurisdiction under Court of Chancery Rule 12(b)(2); and, second, for the Plaintiff's failure to state a claim upon which relief can be granted under Court of Chancery Rule 12(b)(6). With respect to their first basis for dismissal, the Defendants observe that NACEPF's sole ground for asserting personal jurisdiction over them is 10 *Del.C.* § 3114. The Defendants argue, however, that personal jurisdiction under § 3114 requires, at least, sufficient allegations of a breach of fiduciary duty owed by director-defendants. With respect to their second basis for dismissal, the Defendants contend that, even assuming that personal jurisdiction does lie, NACEPF has failed to set forth allegations which adequately support its claims for relief.

III. ANALYSIS

The Defendants have moved to dismiss this action under Court of Chancery Rule 12(b)(2), for lack of personal jurisdiction, and under Court of Chancery Rule 12(b)(6), for failure to state a claim. Typically, motions on these grounds can be resolved independently. In this instance, however, they are not readily cabined.

A. *Motion to Dismiss under Court of Chancery Rule 12(b)(2)*

First, the Court addresses the Defendants' motion under Court of Chancery Rule 12(b)(2).[58] The Court may exercise personal jurisdiction over nonresident directors of Delaware corporations under 10 *Del.C.* § 3114.[59]

> "[T]he Delaware courts have consistently held that Section 3114 is applicable only in connection with suits brought against a nonresident for acts performed in his . . . capacity as a director . . . of a Delaware corporation." Further narrowing the scope of Section 3114, "Delaware cases have consistently interpreted [early cases construing the section] as establishing that [it] . . . appl[ies] only in connection with suits involving the statutory and nonstatutory fiduciary duties of nonresident directors."[60]

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[58] *See Branson v. Exide Elecs. Corp.*, 625 A.2d 267 (Del. 1993).

[59] Section 3114(a), the basis for personal jurisdiction relied upon by the Plaintiff, provides:

> Every nonresident of this State who after September 1, 1977, accepts election or appointment as a director, trustee or member of the governing body of a corporation organized under the laws of this State or who after June 30, 1978, serves in such capacity, and every resident of this State who so accepts election or appointment or serves in such capacity and thereafter removes residence from this State shall, by such acceptance or by such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation (or, if there is none, the Secretary of State) as an agent upon whom service of process may be made in all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such director, trustee or member is a necessary or proper party, or in any action or proceeding against such director, trustee or member *for violation of a duty in such capacity*, whether or not the person continues to serve as such director, trustee or member at the time suit is commenced. Such acceptance or service as such director, trustee or member shall be a signification of the consent of such director, trustee or member that any process when so served shall be of the same legal force and validity as if served upon such director, trustee or member within this State and such appointment of the registered agent (or, if there is none, the Secretary of State) shall be irrevocable.

(emphasis added).

[60] *Canadian Commercial Workers Indus. Pension Plan v. Alden*, 2006 WL 456786, at *11 (Del. Ch. Feb. 22, 2006) (alterations in original) (quoting DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 3-5[a] (2005)).

The appropriate analytical response to a defendant's challenge to personal jurisdiction under § 3114 has been explained:

> "[O]nce a defendant has moved to dismiss the complaint for lack of personal jurisdiction the plaintiff bears the burden of showing that the court has personal jurisdiction over the defendant." Where, as here, "no evidentiary hearing [has been] held, the plaintiff typically meets this burden by making a prima facie showing that the exercise of personal jurisdiction is appropriate." "[I]n such a case, the record is construed in the light most favorable to the plaintiff."[61]

Based on the particular arguments advanced by NACEPF,[62] and the Court's ruling below, the Court only analyzes whether personal jurisdiction exists over the Defendants with respect to Count II of the Complaint.

Count II alleges that the Defendants breached a fiduciary duty while they served as directors of Clearwire and while Clearwire was either insolvent or in the zone of insolvency. The facts alleged in the Complaint,[63] as bolstered and confirmed by the affidavit submitted by NACEPF, constitute a *prima facia* showing of a breach of fiduciary duty by the Defendants in their capacity as

[61] *Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *11 (citations omitted); *see also Cornerstone Techs., LLC v. Conrad*, 2003 WL 1787959, at *3 (Del. Ch. Mar. 31, 2003).

[62] *See infra* note 71 and accompanying text.

[63] *See Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *11 n.93 (explaining that, notwithstanding suggestion that a plaintiff typically cannot rely simply on the allegations contained in its complaint once jurisdiction is challenged, "a plaintiff can, in fact, make the necessary prima facie showing using only the facts alleged in the complaint" (citing *Optimalcare, Inc. v. Hightower*, 1996 WL 417510 (Del. Ch. July 17, 1996)); *see also Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *11-*12 (examining allegations contained in complaint for personal jurisdiction analysis).

directors[64] of a Delaware corporation.[65] NACEPF has met its burden;[66] the Court,

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[64] *See infra* text accompanying note 80 (suggesting that NACEPF's theory of the case might have more likely met with success had it been used as the basis for a derivative claim for breach of fiduciary duty).

[65] The parties have joined issue over personal jurisdiction with the submittal of affidavits directed at the debate about whether Clearwire was insolvent or in the zone of insolvency. Affidavits are routinely used to assist the Court in assessing the success of a plaintiff in making the *prima facia* showing of the factual basis enabling exercise of personal jurisdiction. The proper approach, in this circumstance, is complicated by the confluence of (1) § 3114 which has been construed to require a fiduciary duty as a predicate and (2) the substantive law that the existence of a fiduciary duty is related in some way to insolvency.

As an initial matter, assuming *arguendo* it is required, NACEPF has met its burden of making a *prima facie* showing, through its allegations as well as its supporting affidavits, that, at least at some time during the relevant periods, Clearwire was either insolvent or in the zone of insolvency. *See, e.g.*, Aff. of John Primeau (President of NACEPF), ¶ 13, Exs. D & G; Tr. 36:7-37:6 (comparing Aff. of Jimmy M. Mansour, Ex. B at 2 with *id.*, Ex. A at 10); *see also* Part III(B), *infra*. Certainly, the evidence offered by NACEPF (much of it consisting of financial projections of future events) does not stand uncontested. *See*, *e.g.*, Aff. of Jack Daly, ¶ 7 ("[P]ayment for Spectrum under the Master Agreement was not due in full immediately upon signing or even shortly thereafter, but rather payments were spread over <u>a thirty year period</u>. Further, these obligations and payment amounts were contingent upon Spectrum licensed by the Alliance becoming available at a future date and being presented to Clearwire for leasing—vents that would happen (if at all) over the span of decades.") (citations omitted) (emphasis in original); *see also id.*, ¶¶ 8, 9 (countering assertions in NACEPF affidavit in reliance on financial projections by purporting to identify actual financial outcomes). The Court is not, however, seeking to make a conclusive determination of fact for Court of Chancery Rule 12(b)(2) purposes. Also compare note 97, *infra*, explaining that the allegations do not support a reasonable inference, for purposes of Court of Chancery Rule 12(b)(6), that Clearwire was insolvent at the time of entering into the Master Agreement.

The Court notes, however, that *prima facie* evidence demonstrating that the suit involves acts by the Defendants in their "capacity as . . . director[s]" and that the suit involves the "statutory [or] nonstatutory fiduciary duties]" of the Defendants likely satisfies NACEPF's burden for purposes of resolving the Defendants' motion to dismiss NACEPF's fiduciary duty cause of action under Court of Chancery Rule 12(b)(2). Conducting a more searching inquiry into the evidence proffered by NACEPF would arguably violate the understanding, expressed in our case law, that analysis of a motion to dismiss under Court of Chancery Rule 12(b)(2) is distinct from the analysis applicable to a motion to dismiss under Court of Chancery Rule 12(b)(6). *Cf. Hana Ranch, Inc. v. Lent*, 424 A.2d 28, 32 (Del. Ch. 1980) ("In a 12(b)(2) motion, such as the one before the Court, it is necessary, in order to decide it, to examine the cause of action alleged in order to ascertain whether or not it is directed against the defendant in his capacity as a corporate director. Thus, the legal sufficiency of the complaint is not . . . brought into question as in a [Rule] 12(b)(6) motion but merely that of the [personal] jurisdiction of the Court over a non-resident on the basis of a complaint which fails to state a cause of action against such a non-resident in his capacity of director."); DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, therefore, concludes that that a statutory basis for the exercise of personal jurisdiction exists for purposes of litigating Count II of the Complaint. In addition, the Court's exercise of jurisdiction over the Defendants is consistent with principles of due process[67] because the Defendants' acceptance of their positions as directors of Clearwire made it foreseeable that they would be haled into court in Delaware to respond to challenges based on their fiduciary obligations as directors

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CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 3-5[a], 3-63 (2006); *but cf. Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 787 n.1 (Del. Ch. 1992).

It should be noted that an alternate view of personal jurisdiction, in this context, might require that the Court determine whether a fiduciary duty of the type for which NACEPF argues exists for purposes of resolving the motion to dismiss for lack of personal jurisdiction. *See id.*; *see also Oryx Capital Corp. v. Phoenix Laser Sys., Inc.*, 1990 WL 58180, at *3 (Del. Super. 1990) (decision of Superior Court holding that, in order to obtain jurisdiction under Section 3114, plaintiff must be owed a fiduciary duty). The Court is reluctant to adopt such a restrictive interpretation, however, given prior case law, described above, requiring that a distinction between motions to dismiss under Court of Chancery Rules 12(b)(2) and 12(b)(6) be maintained. Indeed, to hold otherwise, might produce the potentially awkward result of a finding of personal jurisdiction if litigation had been pursued on a derivative basis, but not as a direct action.

An argument, not without significant merit, can be made, however, that the determination of whether the argued-for cause of action exists is a proper subject for resolution under Court of Chancery Rule 12(b)(2). The Court declines, in this instance, to adopt such an approach on the ground that it views these questions, regarding the fiduciary obligations of directors of a Delaware corporation, as warranting a final resolution on the merits, especially given the purposes underlying adoption of Section 3114.

[66] *See, e.g.*, Aff. of John Primeau, ¶¶ 13-14 ("On May 1, 2002, all the members of the Alliance met with Messrs. Cardinale, Gheewalla in New York City to discuss Clearwire's finances. At that meeting, Mr. Gheewalla told us that Clearwire could not pay its debts without concessions as to the amounts to be paid for spectrum. I understood this to be a threat that unless we Alliance members made substantial concessions that Clearwire would be allowed to go bankrupt and through such a long process the remaining Clearwire cash (about $20 million) would be kept until exhausted and bankruptcy followed."); *see also* Aff. of Jack Daly, ¶ 1 (stating that Defendant Daly has served as a director of Clearwire "from March 2001 to the present"). It should perhaps be noted, however, that the Affidavit of Jack Daly also informs that the Defendants did not become directors of Clearwire until after the Clearwire board approved the Master Agreement. *See id.* at ¶ 7, *see also id.*, Ex. A (containing written consents of then-current Clearwire directors "to be effective as of March 6, 2001"); Aff. of Jimmy M. Mansour, Ex. E at 5.

[67] The Defendants did not raise this issue; instead, they focused on Section 3114 as a statutory basis for obtaining personal jurisdiction over them.

of a Delaware corporation and because the exercise of jurisdiction otherwise comports with traditional notions of fairness and justice.[68]

NACEPF argues that this Court also has personal jurisdiction over the Defendants with regard to the other claims asserted in the Complaint because they are "sufficiently related" to NACEPF's fiduciary duty claim. Indeed, "once jurisdiction is obtained pursuant to Section 3114, nonresident directors are properly before the court with respect to any claims that are sufficiently related to the cause of action asserted against such directors in their capacity as directors."[69] As alluded to above, however, NACEPF has expressly premised its arguments for personal jurisdiction over the Defendants for Counts I and III (*i.e.*, the non-fiduciary duty claims) on the Court's first determining that Count II (*i.e.*, the fiduciary duty claim) survives the Defendants' motion to dismiss.[70] In setting forth why the Court has personal jurisdiction over the Defendants with respect to Counts I and III, NACEPF contends:

> [Section 3114] contemplates jurisdiction over directors of a Delaware Corporation "where the cause of action is grounded on such individuals' breach of the fiduciary duties owed to the corporation and

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[68] *See, e.g.*, *Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *12; *see also Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1996 WL 608492, at *5 (Del. Ch. Oct. 16, 1996); WOLFE & PITTENGER, *supra* note 65, § 3-3; *cf. Cornerstone Techs. LLC*, 2003 WL 1787959, at *13.

[69] *Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *11 (quoting WOLFE & PITTENGER, *supra* note 60, § 3-5[a]).

[70] The standard applicable to dismissal under Court of Chancery Rule 12(b)(6) is the subject of the introduction to Part III(B), below.

> its owners." When a breach of fiduciary duty is *well pled*, this Court may join "sufficiently related" causes of action.[71]

Although perhaps likely correct,[72] the Court notes that this statement could arguably also be viewed as overly-restrictive.[73] NACEPF has not argued

[71] Ans. Br. at 46 (quoting *Armstrong v. Pomerance*, 423 A.2d 174, 176 n.5 (Del. 1980)) (emphasis added). At oral argument, NACEPF did not address further the consequences of dismissing the fiduciary duty claim under Court of Chancery Rule 12(b)(6) on NACEPF's "related," non-fiduciary duty claims; instead, NACEPF, in substance, reiterated its contention that jurisdiction over Counts I and III depends, in the general case, "upon whether those claims are sufficiently related to the fiduciary claim." *See* Tr. 49:20-50:3; *see also id.* at 50:3-8.

[72] NACEPF has not offered case law standing squarely for the proposition that only a well-pleaded fiduciary duty claim will be sufficient to sustain personal jurisdiction with respect to other "sufficiently related" causes of action.

[73] The notion that a plaintiff might be permitted to continue to pursue litigation in which personal jurisdiction is premised upon the consent-to-service statute for claims that are merely "sufficiently related" to a fiduciary duty claim which has been dismissed under Court of Chancery Rule 12(b)(6) would seem, at least upon initial examination, to violate the understanding implicit in our jurisprudence's narrow interpretation of Section 3114. *Cf. Norman v. Paco Pharm. Servs., Inc.*, 1989 WL 110648 (Del. Ch. Sept. 22, 1989) (appearing to dismiss claims against particular directors for lack of personal jurisdiction under Section 3114 after dismissing the fiduciary duty claim against all defendants for lack of standing); *Van de Walle v. L.F. Rothschild Holdings, Inc.*, 1994 WL 469150, at *3 (Del. Ch. Aug. 2, 1994) (dismissing suit against defendant directors because they "ha[d] been sued based solely upon their status as directors of a Delaware corporation" when no cause of action for breach of fiduciary duty was alleged); *compare Hana Ranch, Inc.*, 424 A.2d at 31 **("**[A] valid cause of action against a non-resident defendant for acts within the scope of a directorship [is] a sine qua non to the successful assertion of a claim against such a non-resident in his capacity as a stockholder."). On the other hand, that the averments fail to state a claim upon which relief can be granted does not determine whether the Court has personal jurisdiction with respect to any claim, as an initial matter. *Cf. Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1995 WL 694397, at *13 (Del. Ch. Nov. 21, 1995) ("The ability of a shareholder to invoke Section 3114 cannot turn upon whether the facts allege[d] constitute a valid claim. If they do not, the director may have the case dismissed on its merits under Rule 12(b)(6), not under 12(b)(2) or (4)."); *see also id.* (quoting *Bell v. Hood*, 327 U.S. 678, 682 (1946)). It is important, however, to recognize that the immediately preceding proposition perhaps more properly relates to the fiduciary duty claim, in the context of Section 3114, and is at least arguably distinct from the multiple complications raised by non-fiduciary duty claims for which plaintiffs seek to obtain statutory personal jurisdiction over non-resident directors solely because those claims are "sufficiently related" to the putative breach of fiduciary duty. *See, e.g., Manchester v. Narragansett Capital, Inc.*, 1989 WL 125190, at *7 (Del. Ch. Oct. 19, 1989) ("The issue is whether plaintiff's contract claims are sufficiently related to the claims alleging breach of fiduciary duty by the nonresident director defendants so as to require

them to appear and defend the contract claims in Delaware."); *see also id.* (finding contract claims "sufficiently related" to plaintiff's "breach of fiduciary duty and corporate waste claims" such that defendants "should expect to answer in a Delaware court for the contract actions related to plaintiff's breach of fiduciary duty claims"); *cf. Armstrong*, 423 A.2d at 176 n.5 (explaining that [Section] 3114 authorizes service "where the cause of action is grounded on such individuals' breach of the fiduciary duties owed to the corporation and its owners"); *id.* ("Thus, [Section] 3114 authorizes jurisdiction only in actions which are inextricably bound up in Delaware law and where Delaware has a strong interest in providing a forum for redress of injuries inflicted upon or by a Delaware domiciliary, i.e., the Delaware corporation."). Additionally, it should perhaps be noted that the legislative synopsis accompanying § 3114 might arguably inform, and lend support to, the restrictive view of personal jurisdiction over "related" claims assumed by NACEPF in this context. *See* 61 Del. Laws, c. 119 (July 7, 1977) (explaining, in pertinent part: "Delaware has a substantial interest in defining, regulating and enforcing the fiduciary obligations which directors of Delaware corporations owe to such corporations and the shareholders who elected them. In promoting that interest, it is essential that Delaware afford a convenient and available forum for supervising the affairs of Delaware corporations and the conduct of directors of Delaware corporations. This legislation is designed to accomplish that objective.").

Moreover, consideration of these issues "might lead to an interesting procedural conundrum." WOLFE & PITTENGER, note 65, *supra*, § 3-5[a], at 3-63. One might argue that once personal jurisdiction is obtained, it is at least unusual to say that it could be lost. Such difficulties arguably arise, however, because personal jurisdiction under Section 3114, unlike 10 *Del.C.* § 3104, has been interpreted, for special reasons, *see* WOLFE & PITTENGER, note 65, *supra*, § 3-5[a], to require not only a demonstration of facts in existence regardless of the cause of action pursued, but also the existence of a relationship that is itself the premise of a cause of action. *Compare* 4A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE: *Civil* § 1069.7 (in discussing the doctrine of "pendent personal jurisdiction," stating: "Of course, if the only jurisdictionally sufficient claim is dropped or dismissed, particularly if that occurs early in the litigation, the pendent claim should be dismissed as well." (citing *Olin Corp. v. Fisons PLC*, 47 F. Supp. 2d 151, 155 (D. Mass. 1991))).

Notwithstanding this, it should also be noted that "Delaware courts have tended to construe the scope of a director's fiduciary duties broadly in assessing whether jurisdiction is properly premised under Section 3114." *Id.* at § 3-5[a], at 3-59 (citing *Hoover Indus., Inc. v. Chase*, 1988 WL 73758 (Del. Ch. July 13, 1988)); *see also id.* at § 3-5[a], at 3-60 (stating that "Delaware courts . . . have similarly construed broadly the classes of persons to whom fiduciary duties are owed by the directors of a Delaware corporation" in applying Section 3114 (citing, *inter alia*, *Geyer*, 621 A.2d at 787-90)). Thus, the potential difficulty here is not so much whether the Defendants are properly before the Court on NACEPF's claim for breach of fiduciary duty, but, instead, the consequences to NACEPF's putatively "sufficiently related" claims of a finding that NACEPF has failed to state a claim for breach of fiduciary duty upon which relief can be granted. Given the lack of briefing by the parties on the implications of this question and, more importantly, that NACEPF has expressly adopted the more restrictive view, as described in the text above, this question need not be resolved for purposes of the present litigation.

otherwise, however; and, therefore, at least for purposes of this litigation, the Court employs the rule for which NACEPF has argued.

Thus, should the Court find that Count II must be dismissed under Court of Chancery Rule 12(b)(6), then the Court will conclude that it is without personal jurisdiction over the Defendants for purposes of moving forward with the merits of Counts I and III. Therefore, in order to resolve the lingering questions of personal jurisdiction, the Court must first examine whether Count II properly states a claim upon which relief can be granted.

B. *Motion to Dismiss under Court of Chancery Rule 12(b)(6)*

The standards governing motions to dismiss under Court of Chancery Rule 12(b)(6) are well-settled:

> (i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are "well-pleaded" if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the "plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof."[74]

A number of considerations flow from these general criteria:

> Although the Court must "accept as true all of the well-pleaded allegations of fact and draw reasonable inferences in the plaintiff's favor," it is "not . . . required to accept as true conclusory allegations 'without specific supporting factual allegations.'" Instead, the Court must "accept only those 'reasonable inferences that logically flow

[74] *In re General Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002)).

> from the face of the complaint' and 'is not required to accept every strained interpretation of the allegations proposed by the plaintiff.'"[75]

These principles guide the Court's analysis, below, with respect to the Defendants' motion to dismiss under Court of Chancery Rule 12(b)(6).

In this action, the Court is confronted with the question of whether a corporation's creditors may assert direct claims against directors for breach of fiduciary duties when the corporation is insolvent or in the zone of insolvency. The Court need only answer this question on two narrow lines of approach. First, the Court examines whether a *direct* claim may be asserted by creditors for breach of fiduciary duty if the corporation is in the zone of insolvency. Second, assuming *arguendo* that a direct claim may be asserted against directors by creditors of an insolvent corporation in this context, the Court turns to the narrow question of whether NACEPF has satisfied its burden of alleging the requisite unusual facts necessary to maintain such a claim.

NACEPF has waived any basis it may have had for pursuit of its claim derivatively; instead, it has made it clear that it seeks to assert only a direct claim for breach of fiduciary duties.[76] It contends that direct claims by creditors have

[75] *Khanna*, 2006 WL 1388744, at *29 (quoting *Hughes*, 897 A.2d at 168).

[76] *See* Pl. N. American Catholic Educ. Programming Found., Inc.'s Ans. Br. in Resp. to the Defs.' Mot. to Dismiss Pl.'s Compl. ("Ans. Br.") at 19 ("Here, NACEPF is asserting just such a direct claim on its own behalf."); *see also id.* at 19 n.16 ("While the Defendants do not mention it, the NACEPF claim also constitutes a 'direct' claim under *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and its progeny.").

been recognized, in the context of both insolvency and the zone of insolvency by prior decisions of this Court.[77] Furthermore, NACEPF argues that the challenged conduct, here, is "similar to the hypothetical conduct used . . . to illustrate when directors have violated their duty to creditors" in the now-famous footnote fifty-five of *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*[78] Similarly, NACEPF contends that the Defendants' conduct constitutes the "sort of self-dealing that is actionable under the decisions cited in *Production Resources*."[79]

NACEPF argues that the Defendants "breached their fiduciary duties by engaging in self-dealing to further the plans of their employer, Goldman Sachs. This self-dealing occurred in the pursuit of a business that 'had no reasonable likelihood of succeeding,' but rather depleted Clearwire's assets to NACEPF's

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Although derivative claims and direct claims may arise out of the same conduct, *cf. Gentile v. Rossette*, 2006 WL 2388934, at *6 n.19 (Del. Aug. 17, 2006); *Grimes v. Donald*, 673 A.2d 1207, 1212 (Del. 1996) ("Courts have long recognized that the same set of facts can give rise both to a direct claim and a derivative claim."), a claim that is fairly characterized as derivative is just that: one that must, if at all, be brought on behalf of the corporation. The waiver of any derivative claim deprives NACEPF of the broad opportunity to recover for the Clearwire entity—perhaps the principal victim of the Defendants' alleged faithless conduct in favoring Goldman Sachs over Clearwire—and leaves it with a narrower claim which it may or may not be able to assert on its own behalf.

Also, because NACEPF disavows assertion of any derivative claim, the procedural questions linked to the requirements of Court of Chancery Rule 23.1 need not be contemplated. *See, e.g.*, *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 795-96 (Del. Ch. 2004).

[77] *See* Ans. Br. at 17-19 (quoting *Production Resources*, 863 A.2d at 790-91, 796-98 (assuming, without deciding, that a direct claim may be asserted by creditors of an insolvent corporation)); *see also* Ans. Br. at 21 n. 31 (identifying *Penn. Co. for Ins. on Lives & Granting Annuities v. S. Broad St. Theatre Co.*, 174 A. 112 (Del. Ch. 1934); *Geyer*, 621 A.2d 784).

[78] Ans. Br. at 21 (citing *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991) (discussing conduct of directors in the zone of insolvency)).

[79] Ans. Br. at 21 (identifying *Penn. Co. for Ins. on Lives & Granting Annuities*, 174 A. 112; *Geyer*, 621 A.2d 784).

detriment."[80] NACEPF contends that Goldman Sachs controlled the Clearwire board through its financing and that the Defendants negotiated the Master Agreement while under the control of Goldman Sachs. "[The Defendants] provided assurances that Goldman Sachs would infuse adequate capital and management assistance to develop the spectrum assets into a national system of wireless connections to the internet benefiting NACEPF."[81] NACEPF argues that it justifiably relied on the Defendants' "commitments on behalf of Goldman Sachs" in entering into the Master Agreement.[82] Counsel for NACEPF, at oral argument, cogently summarized the basis for his client's claim:

> The idea that was sold to us, as an owner of some of this educational spectrum, was that when the licenses that had previously been given to the Sprints and WorldComs of this world expired, then Clearwire would come in, acquire those licenses, pay us the additional consideration that the [M]aster [A]greement required, and develop a system of wireless internet services that—Clearwire already had some technology, would permit them to do this. And then we would be better off and running with a much better deal than we had with Sprint and WorldCom at that point in time.
>
> The key thing is that Clearwire, through the financial strength of Goldman Sachs, would actually develop this network. . . . We say that on days after the [M]aster [A]greement was signed in March of 2001, rather than pursue the development of this wireless network, the defendants had a secret plan, which is that instead of paying us for

[80] Ans. Br. at 19 (quoting Compl. ¶ 46). These allegations might have provided NACEPF with a solid foundation for a derivative action, but it did not pursue that strategy.
[81] Ans. Br. at 20.
[82] *Id*. It should be noted that, although not considered for purposes of resolving the Defendants' Motion to Dismiss, given the somewhat ambiguous allegations of timing contained in the Complaint, the issue of whether these statements were made before the Defendants became directors of Clearwire has been the subject of vigorous debate.

these licenses when they became off-licensed from Sprint and WorldCom, they instead went to Sprint and WorldCom . . . and said to them, "Look, we won't buy your license. We won't outbid you under our deal with the Alliance. Instead, we will stand by. You just pay us off to do that. Then, because we won't be competing with you to get the Alliance's licenses under our [M]aster [A]greement, you can do whatever you want, leaving us without the payments that we were supposed to get, but leaving Clearwire enriched by the deals they were going to make with the Sprints and the WorldComs of this world."

We didn't say that stayed the same thereafter, forever, as part of their scheme. We say that failed. Thereafter, when they became increasingly insolvent, they simply held on to the rights that they had under the [M]aster [A]greement, with knowledge that they could not fulfill those rights and knowledge that we could have renewed our licenses with Sprint and WorldCom if they had gotten out of the way, and thereby made some real money with Sprint and WorldCom.

That continued not in March of 2001, but after March of 2001, into 2002, when Clearwire was clearly insolvent, or certainly in the vicinity of insolvency. And at that point in time, rather than acknowledge to us that they were not going to be able to fulfill their contractual obligations, they, instead, insisted on asserting those rights and precluded us from going out in the market when they were not able to do so. With some details, that is the outline of the theory here behind what was going on.[83]

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[83] Tr. 33:14-35:20. NACEPF's briefing also elaborates on its theory of the case:

> Contrary to the Defendants' commitments to develop Clearwire into a national wireless internet provider, [the Defendants] began secretly meeting with leading wireless providers to extract concessions based on Clearwire's claims to be able to interfere with their spectrum licenses. The Defendants continued to assert, after they took positions on Clearwire's Board and after it was clear that Clearwire was insolvent, that Clearwire had the right to acquire the spectrum licenses from NACEPF. These claims prevented NACEPF from offering the same licenses to other parties and were not undertaken to further Clearwire's legitimate business plan, but to hold NACEPF's spectrum hostage until the other wireless providers gave in to Defendants' scheme.

The Complaint alleges that the directors did not take steps to "preserv[e] the assets of Clearwire for its benefit . . . when it became apparent that Clearwire

NACEPF argues that, "[t]aken together, these acts instrumented by the Defendants during the Clearwire insolvency, violated the good faith required by their fiduciary duties to NACEPF."[84]

The Defendants counter that NACEPF improperly seeks to assert "a direct creditor claim more akin to one for breach of contract by Clearwire than for breach of directorial duty by individual directors . . . ."[85] The Defendants contend that they owed no fiduciary duty to Clearwire's creditors and, therefore, no claim for breach of fiduciary duty may be asserted against them directly.[86] Instead, the Defendants argue that Delaware jurisprudence recognizes only that a corporation's creditors are, in the context of insolvency or the "vicinity of insolvency," permitted standing to assert fiduciary duty claims derivatively on behalf of the corporation.

> would not be able to continue as a going concern and would need to be liquidated." The Defendants' act of keeping the spectrum 'in play' for Goldman Sachs's benefit without any prospect of Clearwire actually using those licenses, deprived NACEPF of the ability to sell the spectrum. That self-dealing includes the [Defendants'] knowledge that Clearwire was in danger of liquidation and that Goldman Sachs would not carry through the grand plans it trumpeted. . . . Such acts were pernicious to NACEPF's economic rights.

Ans. Br. at 20-21. NACEPF also mentions that the "Defendants' further act of investing the spectrum licenses in a Florida business that had no reasonable likelihood of success jeopardized NACEPF's prospects of recovery on its debts owed by Clearwire." *Id.* at 21 (citing Compl. ¶¶ 46, 47). This matter is discussed in greater detail, below. *See infra* note 127 and accompanying text.

[84] Ans. Br. at 21.

[85] Defs.' Reply Br. in Supp. of Their Mot. to Dismiss Pl.'s Compl. ("Reply Br.") at 2.

[86] *Id*. at 3-5.

Specifically, the Defendants maintain that the Court's opinion in *Production Resources*—on which NACEPF has placed particular reliance—acknowledged merely the *possibility* that a direct claim could be asserted by creditors of an insolvent corporation, but that the Court by no means definitively resolved this question.[87] The Defendants argue that, notwithstanding the Court's prior reluctance to preclude the possibility of a direct claim by creditors in this context, NACEPF's direct claim for breach should not now be permitted to continue.

Below, the Court examines whether either insolvency or zone of insolvency has been adequately pleaded for these purposes; the Court then briefly describes the background for determining the critical question, in the general case, of what constitutes a direct or derivative claim. Next, the Court turns to the narrow question of whether a direct claim asserted by creditors of a corporation in the zone of insolvency is cognizable under Delaware law. Finally, the Court examines whether, assuming *arguendo* that a direct claim might be asserted in the context of insolvency, NACEPF has satisfied the demanding pleading burden required to set forth such a claim.

1. <u>Allegations of insolvency or zone of insolvency</u>

In support of its claim that Clearwire was either insolvent or in the zone of insolvency during the relevant periods, NACEPF alleges that Clearwire needed

[87] *See* Defs.' Br. in Supp. of Their Mot. to Dismiss Pl.'s Compl. ("Opening Br.") at 16, 24.

"substantially more financial support than it had obtained in March 2001."[88] As described above, Goldman Sachs had invested $47 million in Clearwire, which "represent[ed] 84% of the total sums invested in Clearwire in March 2001, when Clearwire was otherwise virtually out of funds."[89]

> *After March 2001*, Clearwire had financial obligations related to its agreement with NACEPF and others that *potentially* exceeded $134 million, did not have the ability to raise sufficient cash from operations to pay its debts as they became due and was dependent on Goldman Sachs to make additional investments to fund Clearwire's operations for the foreseeable future.[90]

The Complaint also alleges:

> For example, upon the closing of the Master Agreement, Clearwire had approximately $29.2 million in cash and of that $24.3 million would be needed for future payments for spectrum to the Alliance members. Clearwire's "burn" rate was $2.1 million per month and it had then no significant revenues. The process of acquiring spectrum upon expiration of existing licenses was both time consuming and expensive, particularly if existing licenseholders contested the validity of any Clearwire offer that those license holders were required to match under their rights of first refusal.[91]

Elsewhere in the Complaint, NACEPF alleges that, "[b]y October 2003, Clearwire had been unable to obtain any further financing and effectively went out of

[88] Compl. ¶ 30.
[89] *Id*. at ¶ 7(a). Simple arithmetic provides that the total amount invested in Clearwire in March 2001 was, therefore, approximately $56 million.
[90] *Id*. at ¶ 7(b) (emphasis added). NACEPF also asserts that "Clearwire was unable to borrow money or obtain any other significant financing after March 2001, except from Goldman Sachs." *Id*. at ¶ 7(c).
[91] *Id*. at ¶ 30.

business. Except for money advanced to it as a stopgap measure by Goldman Sachs in late 2001, Clearwire was never able to raise any significant money."[92]

Insolvency may be demonstrated by either showing (1) "a deficiency of assets below liabilities with no reasonable prospect that the business can be successfully continued in the face thereof,"[93] or (2) "an inability to meet maturing obligations as they fall due in the ordinary course of business."[94] Applying the standards applicable to review under Court of Chancery Rule 12(b)(6), the Court accepts that NACEPF has satisfactorily pleaded facts permitting a reasonable inference that Clearwire operated in the zone of insolvency[95] during at least a substantial portion of the relevant periods for purposes of this motion to dismiss.[96]

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[92] *Id*. at ¶ 36.

[93] *Production Resources*, 863 A.2d at 782 (quoting *Siple v. S & K Plumbing & Heating, Inc.*, 1982 WL 8789, at *2 (Del. Ch. Apr. 13, 1982)); *see also Geyer*, 621 A.2d at 789 (explaining that corporation is insolvent if "it has liabilities in excess of a reasonable market value of assets held"); *McDonald v. Williams*, 174 U.S. 397, 403 (1899) (defining insolvent corporation as an entity with assets valued at less than its debts).

[94] *Production Resources*, 863 A.2d at 782 (quoting *Siple*, 1982 WL 8789, at *2).

[95] In light of the Court's ultimate ruling, here, the Court does not attempt to set forth a precise definition of what constitutes the "zone of insolvency." It is sufficient, for purposes of this litigation, merely to state that NACEPF has pleaded facts permitting a reasonable inference that, during at least some portions of the relevant period, Clearwire operated at the brink of insolvency. *Cf. Credit Lyonnais*, 1991 WL 277613, at *34; *see also Production Resources*, 863 A.2d at 789 n.56 (describing the difficulties presented in identifying "zone of insolvency").

[96] Although not considered for purposes of the insolvency inquiry under Court of Chancery Rule 12(b)(6), affidavits submitted by the Defendants for purposes of the Court's potentially broader examination of personal jurisdiction under Court of Chancery Rule 12(b)(2) indicate that Clearwire may not have become insolvent or, if it did, then only for limited periods.

Similarly, insolvency has been adequately pleaded, for these purposes, for at least a portion of the relevant periods following execution of the Master Agreement.[97]

2. Whether direct claims for breach of fiduciary duties may be asserted by creditors of corporations in the zone of insolvency

Analysis of NACEPF's putative direct claim first requires an understanding of the distinction between direct and derivative claims—a distinction drawn with the assistance of the test set forth in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*[98] In *Tooley*, the Delaware Supreme Court held that the relevant inquiry in determining whether a claim is direct or derivative "must be based solely on the following questions: Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?"[99] In other words, "[a] direct claim . . . is a claim on which the stockholder can prevail without showing an injury or breach of duty to the

[97] NACEPF's allegation that "*[a]fter March 2001*, Clearwire had financial obligations related to its agreement with NACEPF and others that *potentially* exceeded $134 million," Compl. ¶ 7(b) (emphasis added), does not permit the reasonable inference that Clearwire was insolvent *at the time of contract*, especially given the context of the contract entered into and the substantial influx of capital provided to Clearwire in March 2001. *See also id.* at ¶¶ 30, 36 (indicating that Clearwire was insolvent, if ever, after the contract was executed). The conclusory allegations contained in Paragraph 7(b) do not aid in drawing this inference, either.

[98] 845 A.2d 1031 (Del. 2004). The fact of insolvency or entry into the zone of insolvency does not impinge upon the applicability of the test setting forth the derivative/direct distinction recognized by our jurisprudence. *See, e.g., Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 2006 WL 846121, at *6 (Del. Ch. Mar. 28, 2006); *Production Resources*, 863 A.2d at 792; *see also Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 2006 WL 2333201, at *22 n.75 (Del. Ch. Aug. 10, 2006) (explaining that, in the Court's "short answer" view, the "substantive effect the question of insolvency should have . . . on the application of the derivative/direct claim distinction" is "none").

[99] 845 A.2d at 1035.

corporation, and one in which no relief flows to the corporation."[100] Thus, in order to assert a direct claim for relief, a plaintiff must satisfy the requirements of *Tooley*; but, more fundamentally, a plaintiff, in order to succeed in that effort, must also demonstrate that its claim is one that is cognizable under our jurisprudence.[101] This latter point, then, frames the question raised by the present litigation.

"Typically, creditors may not allege fiduciary duty claims against corporate directors."[102] When a corporation has become insolvent, however, directors have been "said to owe fiduciary duties to the company's creditors."[103] The extent to which such statements may, in the context of *insolvency*, confer rights to assert

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[100] *Big Lots Stores, Inc.*, 2006 WL 846121, at *6. Although the Plaintiff in this action claims status as a creditor, the direct/derivative distinction would not vary because the claim was asserted by a creditor instead of a stockholder.

[101] *Cf. Tooley*, 845 A.2d at 1039 ("In this case it cannot be concluded that the complaint alleges a derivative claim. . . . But, it does not necessarily follow that the complaint states a direct, individual claim. While the complaint purports to set forth a direct claim, in reality, it states no claim at all. The trial court analyzed the complaint and correctly concluded that it does not claim that the plaintiffs have any rights that have been injured.").

[102] *Production Resources*, 863 A.2d at 787; *see also Geyer*, 621 A.2d at 787 ("[T]he general rule is that directors do not owe creditors duties beyond the relevant contractual terms.").

[103] *See Production Resources*, 863 A.2d at 790-91 (citing *Geyer*, 621 A.2d at 787 ("[W]hen the insolvency exception [arises], it creates fiduciary duties for directors for the benefit of creditors.")). As the Court observed in *Production Resources*:

> When a firm is *insolvent*, the directors are said to owe fiduciary duties to the creditors, much like the directors of solvent firms owe such duties to the stockholders. The important unanswered question is precisely what the contents of those duties are. As Justice Frankfurter famously stated: "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as fiduciary? In what respects has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

863 A.2d at 797 (quoting *Sec. & Exch. Comm'n v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943) (emphasis added)).

claims for breach of fiduciary duties, as traditionally understood, perhaps remains the subject of legitimate debate.[104]

Some have interpreted prior opinions of the Court[105] to authorize fiduciary duty claims by creditors in what is referred to as the "zone of insolvency," as well.[106] Indeed, in this instance, NACEPF contends that the Defendants, as directors of Clearwire, a corporation alleged to have been either insolvent or operating in the zone of insolvency, breached fiduciary duties allowing NACEPF, as its creditor, to seek to hold the Defendants individually liable for direct

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[104] Regarding the effect of insolvency, if any, it is perhaps unclear whether, for example, such statements, in practice, only describe persons who may enforce duties or point to whom duties are owed. *See infra* note 108; Part III(B)(3).

[105] For example, the Court's analysis in *Credit Lyonnais*, *see* 1991 WL 277613, at *34 n.55, has been interpreted by some commentators (and jurisdictions) as suggesting the existence of a cognizable claim for relief which may be asserted by creditors, *see Production Resources*, 863 A.2d at 789 ("Creative language in a famous footnote in *Credit Lyonnais* was read more expansively by some . . . to expose directors to a new set of fiduciary duty claims, this time by creditors. . . . [S]ome read *Credit Lyonnais* as authorizing creditors to challenge directors' business judgments as breaches of fiduciary duty owed to them." (citations omitted)); however, the Court's language is, perhaps, better viewed merely as a shield for directors from stockholder claims, in this context. *See id.*; *see also Credit Lyonnais*, 1991 WL 277613, at *34 (explaining, in the text of the opinion, that the directors of a corporation operating in the vicinity of insolvency owe a duty to the corporate enterprise "to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity"); *Angelo, Gordon & Co., L.P. v. Allied Riser Commc'ns Corp.*, 805 A.2d 221, 229 (Del. Ch. 2002); *cf. Production Resources*, 863 A.2d at 791 (explaining that, when a firm has become insolvent, "[t]he directors continue to have the task of attempting to maximize the economic value of the firm").

A recent decision of this Court suggested that cases following *Credit Lyonnais*, which have been the subject of considerable academic debate, are "more a judicial method of attempting to reinforce the idea that the business judgment rule protects the directors of *solvent, barely solvent, and insolvent* corporations, and that the creditors of an insolvent firm have no greater rights to challenge a disinterested, good faith business decision than the stockholders of a solvent firm." *Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75 (emphasis added).

[106] *See supra* note 95.

claims.[107] In the following passages of this Subpart, the Court discusses the two principal grounds, appearing in case law and potentially implicated here, for imposing liability. First, the Court addresses the "incentive-to-enforce rationale," described in greater detail below. This paradigm has been employed to support standing for creditors in their pursuit of derivative claims on the behalf of insolvent corporations. The principles underlying this doctrine are arguably compatible with its application in the zone of insolvency, as well; and, as a consequence, the doctrine may also, by analogy, lend support for the pursuit of derivative claims by creditors of corporations in the zone of insolvency. The incentive-to-enforce rationale, however, says little or nothing about whether direct claims should lie. Therefore, the Court next turns to so-called "trust fund theory," which is the only principled basis, appearing in case law, *potentially* supporting direct fiduciary duty claims by creditors (which is the subject of Part III(B)(3), below). Unlike the "incentive-to-enforce rationale," however, the principles of "trust fund theory," as described by our case law, do not support its extension, by analogy, to the zone of insolvency. Therefore, although "trust fund theory" *might* lend support to the notion that a limited direct claim could lie for creditors of an insolvent corporation,

[107] In this Subpart, the Court addresses *only* the narrow issue of whether direct claims may be asserted by creditors against directors of corporations operating in the zone of insolvency. To the extent that debate may remain over the existence of, scope of, or analysis applicable to derivative claims brought by creditors—whether arising in the context of insolvency or, presuming such claims may be asserted, in the zone of insolvency—the Court does not address these issues in this Memorandum Opinion.

so-called "trust fund theory" fails to provide an adequate, principled basis for the recognition of direct claims in the zone of insolvency.

The notion that creditors of an *insolvent* corporation are permitted standing to maintain derivative claims for breach of existing fiduciary duties on behalf of the corporation is relatively uncontroversial.[108] Indeed, the idea that an insolvent corporation's creditors (having been effectively placed "in the shoes normally occupied by the shareholders—that of residual risk-bearers"[109]) should be granted standing because they are the principal remaining constituency with a material incentive to pursue derivative claims on behalf of the corporation has significant intuitive and persuasive merit.[110] This exception for creditors in these limited circumstances arguably maintains the delicate balance achieved by the standing requirements for pursuit of derivative actions outside of this context—*i.e.*, balancing the "Delaware prerogative that directors manage the affairs of a

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[108] That creditors of an insolvent corporation may assert derivative claims is generally accepted as a practical matter, even if the theoretical underpinnings for such a view may be fairly debated. *See Production Resources*, 863 A.2d at 776-77; *see also id.* at 792 (in explaining why creditors may be granted standing to pursue derivative claims in this context, reasoning that "[t]he firm's insolvency simply makes the creditors the principal constituency injured by any fiduciary breaches that *diminish the firm's value* and logically gives them standing to pursue these claims to rectify that injury" (emphasis added)); *id.* at 794 n.67. *Compare infra* notes 134.

This Court has recently suggested that the principal effect of insolvency is perhaps merely that "the creditors become the enforcement agents of fiduciary duties . . . ." *Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75 ("In other words, the fiduciary duty tool is transferred to the creditors when the firm is insolvent in aid of the creditor's contract rights."); *cf. id.* at *4.

[109] *Production Resources*, 863 A.2d at 791.

[110] *See id.* at 792 ("The firm's insolvency . . . makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value and logically gives them standing to pursue these claims to rectify that injury.").

corporation with the realization that shareholder policing, via derivative actions, is a necessary check on the behavior of directors that serve in a fiduciary capacity to shareholders."[111] It arguably follows, then, that this "incentive-to-enforce rationale" would, to a degree, be comparably applicable to derivative claims asserted on behalf of corporations operating in the zone of insolvency, as well.[112] As emphasized above, however, this is not the question framed by the present litigation, and, therefore, the Court expresses no conclusions about such arguments' validity.[113]

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[111] *Agostino v. Hicks*, 845 A.2d 1110, 1117 (Del. Ch. 2004); *see also Tooley*, 845 A.2d at 1036 ("The derivative suit has been generally described as 'one of the most interesting and ingenious of accountability mechanisms for large formal organizations.'" (quoting *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 351 (Del. 1988) (quoting R. CLARK, CORPORATE LAW 639-40 (1986)))); *Guttman v. Huang*, 823 A.2d 492, 500 (Del. Ch. 2003) (noting the "deterrence effects of meritorious derivative suits on faithless conduct"); *cf. Khanna*, 2006 WL 1388744, at *11 n.50 (describing the policy considerations underlying derivative-action standing requirements).

[112] It may bear noting that, although the reasons for standing to assert derivative claims in the insolvency context would arguably apply to the zone of insolvency, as well (*i.e.*, the incentive-to-enforce rationale may remain, countering any attempt to draw a bright-line distinction), the Court merely presumes, in the text above, that standing would be available to creditors of corporations in the vicinity of insolvency to assert derivative claims on behalf of the corporation. Indeed, this issue is not without some debate. *See, e.g.*, *Production Resources*, 863 A.2d at 789 n.54, 790 n.56 (describing potential arguments against such standing); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1510 (1993). *Cf.* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992 – 2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1432 (2005) (citing *Kohls v. Kenetech Corp.*, 794 A.2d 1160 (TABLE), 2002 WL 529908 (ORDER) (Del. 2002) (affirming Court of Chancery decision "without reaching the general question of whether or to what extent directors of a corporation said to be in the so-called 'vicinity of insolvency' owe fiduciary duties to preferred stockholders")). This question, however, need not be resolved within the narrow ambit of the present litigation—*i.e.*, the existence of direct claims for breach of fiduciary duties in this context.

[113] *See* note 107, *supra*.

With respect to the narrow question presented here, the "incentive-to-enforce rationale" provides negligible, if any, analogous support for recognition of direct fiduciary duty claims brought by creditors of corporations in zone of insolvency. Put simply, in contrast to stockholder and (by analogy in this limited context) creditor derivative actions, *direct* claims by creditors would not help the corporate collective because the benefit would accrue to the creditor bringing the direct claim.[114] Any marginal benefit of such enforcement effort potentially accruing to the corporate collective would likely be outweighed by the disruption of the established corporate governance mechanism. NACEPF has neither offered any persuasive policy rationale favoring recognition of such claims which might mitigate or rebut these concerns nor has it identified any case law supporting its theory that claims are directly assertible by creditors in this context.[115]

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[114] The focus on the distinction between derivative and direct claims is not without its limitations. For example, it is dependent upon a relatively consistent boundary line between the two categories. Also, the incentive for a creditor to bring a derivative claim may not be as great as the incentive to bring a direct claim because the fruits of his efforts as a derivative plaintiff would benefit the corporate entity first and whether any of the benefit would pass down to the creditor may be problematic.

[115] The principal case implicating the zone of insolvency, *Credit Lyonnais*, which NACEPF cites as authority, *see* Ans. Br. at 21 (contending that the Defendants' conduct is "similar to the hypothetical conduct" described in footnote fifty-five of *Credit Lyonnais*), does not provide the definitive support NACEPF seeks. *See supra* note 105 and accompanying text. The decision which arguably comes closest to providing support for NACEPF's position—one on which NACEPF has not relied—is *Bren v. Capital Realty Group Senior Housing, Inc.*, 2004 WL 370214, at *7 (Del. Ch. Feb. 27, 2004) (denying motion to dismiss claim by noteholder for breach of fiduciary duty because "the existence of a duty to disclose is sufficiently plausible to survive").

NACEPF cites a number of decisions, some from other jurisdictions, in support of the proposition that "[i]t is settled Delaware law that when a firm enters insolvency or its vicinity, The source of some uncertainty in this regard may be the result of efforts to accommodate the so-called "trust fund doctrine"[116] within the zone of insolvency context.[117] Although "trust fund doctrine" to some extent arguably undergirds the Court's tentative recognition of a narrow direct claim by creditors in the context of insolvency,[118] these principles do not compel recognition of comparable direct claims in the zone of insolvency.[119]

'the firm's directors are said to owe fiduciary duties to the company's creditors.'" Ans. Br. at 26 n.59 (quoting *Production Resources*, 863 A.2d at 790-91 (addressing "[w]hen a firm has reached the point of insolvency")). This bare proposition, however, does little to resolve the questions at issue here. *See supra* note 103 and accompanying text. As this Court has recently suggested, "insolvency does not suddenly turn directors into mere collection agents" on the behalf of creditors, *see Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75; taken as accurate, this observation would apply, *a fortiori*, in the zone of insolvency.

[116] *See Production Resources*, 863 A.2d at 792 ("A strand of authority (*by no means universally praised*) therefore describes an insolvent corporation as becoming akin to a trust for the benefit of the creditors. This line of thinking has been termed the 'trust fund doctrine.' Under a trust fund approach, the directors become trustees tasked with preserving capital for the benefit of creditors who are deemed to have an equity-like interest in the firm's assets." (emphasis added) (citations omitted)).

[117] As explained above, the two principal theories implicated here are the "incentive-to-enforce rationale" and the "trust fund theory."

[118] *See, e.g.*, *Production Resources*, 863 A.2d at 798 n.77 (noting duties owed by trustees under trust law, which might, possibly bear on analysis "[t]o the extent that the directors are analogized as becoming trustees of a corporate pool of assets for creditors when the corporation is insolvent"). *Compare Price v. Wilmington Trust Co.*, 1996 WL 560177, at *2 (Del. Ch. Sep. 3, 1996) (opinion granting interlocutory appeal) ("For example, while trustees, directors, administrators, partners, guardians, etc are all called fiduciaries from time to time because all an important element of dependency, all of these special relationships are institutionally somewhat different in the types of circumstances in which each sort of legal relationship occurs. A trustee of an express trust *is different* from a corporate director for example, in the degree of trust, passivity or diligent self protection that the law should encourage, *see Kahn v. Seaboard Corp.*, 625 A.2d 269 (Del. Ch. 1993), and different with respect to the length of the period in which the dependence is designed to continue.").

[119] "Trust fund theory," to the extent that it might apply, is not implicated until insolvency, as indicated by, for example, the cases cited in *Geyer*. *See* 621 A.2d at 787 (citing *Bovay v. H. M. Byllesby & Co.*, 38 A.2d 808, 813 (Del. 1944) (holding that "when [insolvency] is established," conduct may "thereafter" be analyzed differently) (citing *McDonald*, 174 U.S. at 404 (in

The Court has traditionally been reluctant to expand existing fiduciary duties, including the range of persons by whom those duties may be enforced and, therefore, whom fiduciaries might feel compelled to consider.[120] As a consequence, the rationale advanced in support of imposition of unique or additional duties should be relatively compelling in order for such recognition to be extended. In this instance, however, the arguments opposing recognition of

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applying so-called "trust fund doctrine," holding that "[a]lthough *no trust exists while the corporation is solvent*, the fact which creates the trust is the insolvency, and, when that fact is established, *at that instant* the trust arises**"** (emphasis added)))). *But cf. infra* note 148 (noting the narrow, *potential* issue of "acts committed in contemplation of insolvency").

Credit Lyonnais does not support the application of "trust fund theory" principles to conduct of directors in the zone of insolvency. Instead, the language employed in footnote fifty-five of *Credit Lyonnais* suggests that, in the zone of insolvency, directors may act to obtain what (in the narrow sense, *i.e.*, insofar as the interests of the corporate collective are concerned) could be described as a "socially optimal" outcome. 1991 WL 277613, at *34 n.55. This does not implicate "trust fund theory," however, which seeks to compel conduct, as presented in *McDonald*, directed toward the best interests of creditors as a particular constituency of residual risk-bearers.

For perspective, also compare *Asmussen v. Quaker City Corp.*, 156 A. 180, 181 (Del. Ch. 1931) ("The word 'trust' in [the] phrase ['trust fund doctrine'] has given rise to some confusion due to the fact that some courts have carried the logic of its connotations to a degree quite beyond the length to which its aptness as descriptive of the relations between the corporation and its creditors would warrant.").

[120] *See, e.g.*, *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611, 625 (Del. Ch. 2005) ("The Delaware courts have been reluctant to extend too broadly the applicability of fiduciary duties. . . . Furthermore, while some cases in Delaware have found certain aspects of a commercial relationship to implicate fiduciary duties, these cases should not be read so broadly as to engulf in fiduciary duties ordinary commercial relationships."), *aff'd in part and rev'd in part on other grounds*, 901 A.2d 106 (Del. 2006); *Bird's Constr. v. Milton Equestrian Ctr.*, 2001 WL 1528956, at *4 (Del. Ch. Nov. 16, 2001) ("Our courts have been cautious when evaluating entreaties to expand the number and kinds of relationships that are denominated as 'fiduciary.'"); *see also Heller v. Kiernan*, 2002 WL 385545, at *3 (Del. Ch. Feb. 27, 2002). *See also infra* note 156.

Among the reasons underlying the Court's reluctance is the recognition that any additional duty may subject fiduciaries to greater risk (or liability), which may, in turn, have an undue chilling effect on conduct—a result that may be especially troubling in the context of corporate directors who must make business decisions on the behalf of a financially troubled, but solvent, corporation.

direct claims by creditors in the zone of insolvency are both substantial and persuasive. In *Production Resources*, the Court remarked that recognition of fiduciary duties in the "zone of insolvency" context may involve:

> using the law of fiduciary duty to fill gaps that do not exist. Creditors are often protected by strong covenants, liens on assets, and other negotiated contractual protections. The implied covenant of good faith and fair dealing also protects creditors. So does the law of fraudulent conveyance. With these protections, when creditors are unable to prove that a corporation or its directors breached any of the specific legal duties owed to them, one would think that the conceptual room for concluding that the creditors were somehow, nevertheless, injured by inequitable conduct would be extremely small, *if extant*.[121]

Indeed, it would appear that creditors' existing protections—among which are the protections afforded by their negotiated agreements, their security instruments, the implied covenant of good faith and fair dealing, fraudulent conveyance law, and bankruptcy law—render the imposition of an additional, unique layer of protection through direct claims for breach of fiduciary duty unnecessary.[122] Moreover, any

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[121] 863 A.2d at 790 (emphasis added). The Court also posited: "Having complied with all legal obligations owed to the firm's creditors, the board would, in that scenario, ordinarily be free to take economic risk for the benefit of the firm's equity owners, so long as the directors comply with their fiduciary duties to the firm by selecting and pursuing with fidelity and prudence a plausible strategy to maximize the firm's value." *Id.*; *see also id.* at 790 n.57. Of course, this Subpart addresses only direct claims in the vicinity of insolvency.

[122] *See, e.g.*, *Big Lots Stores, Inc.*, 2006 WL 846121, at *8 (remarking, in the context of an insolvent corporation: "As numerous commentators have observed, creditors are usually better able to protect themselves than dispersed shareholders." (citing Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, J. BUS. & TECH. L. (forthcoming) http://ssrn.com/abstract=832504 at 30)); *cf. id.* at *8 n.50 (noting contrary commentary providing that "the greater protection generally due to debt-holders over shareholders is not an inherent characteristic of either instrument, because such distinctions may not apply to closely held corporations, or public corporations held substantially by institutional shareholders who can act collectively or through intermediaries" (citing Larry E. Ribstein &

benefit to be derived by the recognition of such additional direct claims appears minimal, at best, and significantly outweighed by the costs to economic efficiency. One might argue that an otherwise solvent corporation operating in the "zone of insolvency" is one in most need of effective and proactive leadership—as well as the ability to negotiate in good faith with its creditors—goals which would likely be significantly undermined by the prospect of individual liability arising from the pursuit of direct claims by creditors.[123] NACEPF has not persuasively argued otherwise.

These considerations compel the conclusion that no direct claim for breach of fiduciary duties may be asserted by creditors of a solvent corporation operating in the zone of insolvency. Therefore, the Court concludes that Count II of the Complaint fails as a matter of law to the extent that it attempts to state a direct claim for breach of fiduciary duty while Clearwire was in the zone of insolvency.

3. <u>NACEPF's failure to allege facts necessary to plead a direct claim during insolvency</u>

As described above, NACEPF has predicated its argument in favor of personal jurisdiction over the Defendants on the Court's first concluding that

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Kelli Alces, *Directors' Duties in Failing Firms*, J. Bus. & Tech. L. (forthcoming) http://ssrn.com/abstract=880074 at 8)).

[123] Certainly this is true of corporations that were once solvent but have entered the zone of insolvency; however, the same may also be said of, for example, start-up firms that may often operate in the zone of insolvency until their business plan succeeds. The negative consequences to innovation potentially resulting from an expansion of possible individual liability through direct claims for breach of fiduciary duties, in that context, should give considerable pause to any court contemplating an expansion of direct claims.

NACEPF has sufficiently alleged a direct claim for breach of fiduciary duty by the Defendants in their capacity as directors of Clearwire.[124] Therefore, the Court must now turn to the question of whether NACEPF has adequately alleged a direct claim for breach of a fiduciary duty occurring during insolvency, to the extent that NACEPF has alleged insolvency, as well.

In its Complaint, NACEPF states that, because Clearwire was either insolvent or in the zone of insolvency "from March 2001 until it went out of business," "[a]t all times after March 2001, the . . . Defendants owed a fiduciary duty to NACEPF, as a substantial creditor of Clearwire."[125] As recited above, NACEPF alleges that a breach of fiduciary duty by the Defendants occurred either by:

> (1) not preserving the assets of Clearwire for its benefit and that of its creditors when it became apparent that Clearwire would not be able to continue as a going concern and would need to be liquidated and (2) holding on to NACEPF's ITFS license rights when Clearwire would not use them, solely to keep Goldman Sachs's investment "in play."[126]

Additionally, NACEPF alleges that the Defendants:

> engaged in self-dealing by: (1) keeping Clearwire in business to preserve the ability of Goldman Sachs to carry its investment without

[124] *See supra* note 76 and accompanying text.
[125] Compl. ¶ 44. Of course, to the extent that Clearwire was merely in the zone of insolvency, no direct claim may be asserted. *See* Part III(B)(2). Additionally, as explained above, the allegations do not support the inference that Clearwire was insolvent at the time the Master Agreement was executed. *See supra* note 97. Thus, to the extent that a direct claim properly might be asserted during insolvency—an issue discussed in detail, below—the underlying breach of fiduciary duty would have had to have occurred during a period of insolvency.
[126] Compl. ¶ 45.

> admitting Clearwire was a failure and (2) investing Clearwire assets in a wireless business in Jacksonville, Florida that had no reasonable likelihood of succeeding but whose existence was utilized as a justification for the strategy of the . . . Defendants to not honor the Alliance members' rights.[127]

In formulating its argument, NACEPF has placed heavy reliance on this Court's analysis in *Production Resources.*[128] In that case, the Court denied, in part, the defendants' motion to dismiss the plaintiff-creditor's fiduciary duty claims on

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[127] *Id.* at ¶ 46. The only additional information provided in the Complaint regarding the Jacksonville investment is set forth in Paragraph 47, which states:

> The Jacksonville business: (1) never had sufficient assets to build out the suppositional technology with its complex network of towers and sectors that were required to adequately service potential wireless customers, (2) never had the technology necessary to provide mobile wireless access to the internet, and (3) involved extraordinary expenses not justified by a customer base.

Based on NACEPF's answering brief, it appears that the allegations concerning Clearwire's investment in the "Jacksonville business" are intended as support for NACEPF's first argument for breach of fiduciary duty (*i.e.*, failure to "preserve" the assets of Clearwire). *See* Ans. Br. at 19, 21; text accompanying note 126, *supra*. To the extent that this is intended as a stand-alone claim, it is a derivative claim under the test of *Tooley.* The alleged harm is one to the corporation (a diminution of the pool of available assets), and any recovery would flow to the corporation. *Cf. Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75 (in discussing related academic arguments, suggesting that, "if the directors of an insolvent firm commit a breach of fiduciary duty reducing the value of the firm, any claim belongs to the entity and . . . creditors would benefit from the recovery derivatively, based on their claim on the firm's assets"). Indeed, it would appear to be a classically derivative claim for waste. Because NACEPF has chosen not to pursue a derivative claim in this litigation, *see supra* note 76 and accompanying text, the Court does not address it further.

However, to the extent that these allegations are offered to demonstrate, in support of its claim that the Defendants breached a duty in "holding on to" NACEPF's license rights, *see* text accompanying note 126, *supra*, that the alleged "self-dealing occurred in the pursuit of a business that had 'no reasonable likelihood of succeeding,'" *see* Ans. Br. at 19, the allegations might implicate conduct material to analysis of a direct claim in this context. *Cf. Production Resources*, 863 A.2d at 800 (denying motion to dismiss where facts pleaded involved allegations that board was, *inter alia*, "engaging in preferential treatment of the company's primary creditor and de facto controlling stockholder (and perhaps of its top officers, who are also directors) without any legitimate basis for the favoritism"). The Court need not reach this question, however, given the analysis, below.

[128] 863 A.2d 772 (Del. Ch. 2004).

the "*conservative assumption* that there *might, possibly* exist circumstances in which directors display such a marked degree of animus towards a particular creditor with a proven entitlement to payment that they expose themselves to a direct fiduciary duty claim by that creditor."[129] The Court emphasized its reluctance to offer a definitive statement of law, especially given the limited briefing of the issues by the parties,[130] remarking instead that it would "resolve the [defendants'] motion without making any broad pronouncements that would have large policy implications."[131] In addition, the Court explained merely that it was "not prepared to rule out" the possibility that the plaintiff had alleged conduct that "might support" a limited direct claim.[132] Importantly, the Court noted that the

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[129] *Id*. at 798 (emphasis added).

[130] The Court noted that it had addressed a number of issues without the benefit of input from counsel. *See id.* at 797-98 ("Another question the parties do not confront is what the direct/derivative claim distinction means when a firm is insolvent."); *see also id.* at 798-99 ("To at least my mind, there are a myriad of policy considerations that would arise by the indulgence or non-indulgence of a fiduciary duty claim of this type and I am reluctant to ponder their viability without better help from briefing by adversarial parties.").

[131] *Id*. at 798.

[132] *Id.* at 800. The Court reserved "the opportunity . . . to revisit some of these questions with better input from the parties." *Id.* at 801. The Court explained:

> In particular, it will be important to better understand the precise justification for equity's role in cases like this, an understanding that needs to be informed by the scope of the legal rights that PRG possesses as a creditor against NCT and its directors and officers. Evaluating a creditor's claim that directors have breached fiduciary duties owed to the firm involves no novel inquiry, as the court can draw deeply on the principles that apply in typical derivative cases. The extent of the fiduciary obligations directors and officers owe in their dealings with specific creditors of insolvent firms is a far less settled matter. In general, equity is reluctant to create remedies when adequate legal remedies already exist. It may well be, for example, that upon close examination, existing principles of tort or contract law are sufficient when applied with the understanding that directors bear a fiduciary relation to creditors when a firm is insolvent.

plaintiff's complaint sufficiently alleged a derivative claim, as well—rendering it unnecessary to resolve the question of the existence of direct claims in the insolvency context.[133]

In light of the Court's analysis in *Production Resources*, its decision to permit the plaintiff's direct claim to continue is perhaps best described as tentative. The Court, however, largely focused on the notion that—in most, if not all, instances—claims for breach of fiduciary duty in the insolvency context would be asserted derivatively by creditors.[134] In response to the plaintiff's contention that

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Id. (citations omitted).

[133] In *Production Resources*, the Court held that the plaintiff's allegations with respect to the surviving fiduciary duty claim (*i.e.*, its claim regarding conscious, faithless conduct) set forth sufficient particularized facts to allege a derivative claim for breach of fiduciary duty. *See id.* at 800 (explaining that the plaintiff had set forth an "unusual set of particularized facts" and that it "*might* prevail on either a derivative *or* individual claim" (emphasis added)).

It should also be noted that, with respect to the Court's earlier decision in *Geyer*, although not addressed, *see* 621 A.2d at 790-91 (analyzing claim for breach of fiduciary duty under general standards of Court of Chancery Rule 12(b)(6)), the plaintiff's claim in that case would likely be characterized as derivative under the test prescribed in *Tooley*.

[134] The Court stated:

> The reason for this bears repeating—the fact of insolvency does not change the primary object of the director's duties, which is the firm itself. . . . Put simply, when a director of an insolvent corporation, through a breach of fiduciary duty, injures the firm itself, the claim against the director is still one belonging to the corporation.

Production Resources, 863 A.2d at 792; *see also id.* (explaining that "the transformation of a creditor into a residual owner does not change the nature of the harm in a typical claim for breach of fiduciary duty by corporate directors"). As a consequence, the Court in essence reasoned that recognition of standing for creditors, at least in order to assert derivative claims in the context of insolvency, "does not completely turn on its head the equitable obligations of the directors to the firm itself." *Id.* at 791. *See generally id.* at 792-93 (describing how most potential claims foreseeable by the Court would be derivative in nature). *Cf. Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75.

all its claims for breach transformed into direct claims upon insolvency, the Court emphasized:

> The fact that the corporation has become insolvent does not turn [derivative] claims into direct creditor claims, it simply provides creditors with standing to assert those claims. At all times, claims of this kind belong to the corporation itself because even if the improper acts occur when the firm is insolvent, they operate to injure the firm in the first instance by reducing its value, injuring creditors only indirectly by diminishing the value of the firm and therefore the assets from which the creditors may satisfy their claims.[135]

NACEPF argues that "[w]hat the Court *did not rule out*, however, is that those fiduciary duties may also include the obligation to not unreasonably hurt the creditors—a direct claim."[136]

NACEPF has left ambiguous—perhaps intentionally—the issue of whether it predicates its present argument on allegations of "animus" of the type described in *Production Resources*, or whether it alleges breach of some additional or unique duty owed by the Defendants that is remediable through a direct claim.[137] To the extent that NACEPF argues that it may assert a potential direct claim for breach of

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[135] *Production Resources*, 863 A.2d at 776; *see also Trenwick Am. Litig. Trust*, 2006 WL 2333201, at *22 n.75.

[136] Ans. Br. at 18 (emphasis added).

[137] Although our understanding of the duties of corporate fiduciaries does (and should) evolve, stability and predictability are, nonetheless, important objectives. *See, e.g., Harff v. Kerkorian*, 324 A.2d 215, 220 (Del. Ch. 1974), *aff'd in part and rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975). To embrace NACEPF's approach would increase the uncertainty of directors (already challenged by the financial difficulties of the corporations they serve) as to: the scope of their duties; to whom they owe those duties; how to accommodate potentially competing interests; and how to discharge their duties without an unwarranted risk of becoming ensnarled in litigation regardless of the choices they may make.

fiduciary duty beyond the realm mapped in *Production Resources*, however, this Court's recent ruling in *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*[138] precludes such a claim. In dismissing the plaintiff's direct claim for breach of fiduciary duty, the Court, in substance, held that the scope of *potentially* cognizable direct claims assertible by creditors in the insolvency context is restricted to instances in which invidious conduct toward a particular "creditor" with a clear "entitlement to payment" has been alleged.[139] As a consequence, assuming, *arguendo*, that a direct claim may be asserted, NACEPF's allegations need only be analyzed, in this instance, to determine whether this restricted type of claim has been adequately alleged.

In *Big Lots Stores, Inc.*, the Court emphasized the unusual nature of the direct claim described in *Production Resources*—"a decision which relied heavily on its unique facts."[140] The Court explained that the "unusual allegations of the plaintiff in *Production Resources* vividly illustrate" how a direct claim might be pleaded:

[138] 2006 WL 846121 (Del. Ch. Mar. 28, 2006).
[139] *See, e.g.*, *id.* at *6 (granting that there "might nonetheless" exist a direct claim in "some circumstances" and reciting only the narrow language mentioning "animus" set forth in *Production Resources* (quoting 863 A.2d at 798)).
[140] 2006 WL 846121, at *7; *see also id.* at *7 n.47 ("As the court noted, it was the 'odd' circumstances of *Production Resources* in concert that were 'suggestive of . . . bad faith on the part of the NCT board members.'"). It perhaps bears repeating that the Court's decision in *Production Resources* describes circumstances in which "*such a marked degree* of animus" is alleged. 863 A.2d at 798 (emphasis added).

> As the court's opinion [in *Production Resources*] sets out, the plaintiff had obtained a judgment against the defendant for $2 million in 1999, and had attempted to compel payment since that time. The facts alleged in the complaint established that the defendant had been insolvent for several years and, yet, had gone to extreme lengths both to avoid paying its judgment creditor and to misuse corporate power for the purpose of improperly benefiting itself and others in control. In the face of such extraordinary machinations, the court was unwilling to dismiss the creditor's claims of specific injury as derivative because it seemed possible that the creditor in question was the only one that had been injured, and was thus the only one to which recovery was due.[141]

Among other things, the Court, in *Big Lots Stores, Inc.*, pointed out that the plaintiff-creditor in *Production Resources* was, in fact, a judgment creditor. The Court reasoned that "[t]he immediacy of the *Production Resources* defendant's debt was a necessary underpinning of the court's finding that the debtor's recalcitrance might have been motivated by targeted animus towards the plaintiff."[142] The Court distinguished the plaintiff's claim in *Big Lots Stores, Inc.* from the *Production Resources* defendant's debt on the ground that the credit agreement benefiting the plaintiff in *Big Lots Stores, Inc.* consisted of an unsecured note "due eight years after the 2002 transaction was set to close."[143] Moreover, the Court emphasized that, while, in *Production Resources*, "all the challenged transactions occurred in the context of an already insolvent company,"[144] in *Big*

[141] 2006 WL 846121, at *7.
[142] *Id.*
[143] *Id.*
[144] *Id.*

Lots Stores, Inc., the complained-of breaches of fiduciary duty were alleged to have caused the insolvency, which the Court found to be "classically derivative."[145] The Court concluded that such claims "do not become direct simply because they are raised by a creditor, who alleges that the breaches of fiduciary duty caused it specific harm by preventing it from recovering a debt outside of bankruptcy."[146] Assuming, *arguendo*, that a direct claim may potentially be asserted in these circumstances, the Court follows this approach in analyzing NACEPF's claim.

The analysis employed by the Court in *Big Lots Stores, Inc.* effectively limits direct claims, assuming *arguendo* that they are cognizable, by creditors of insolvent firms for breach of fiduciary duty to allegations of fact substantially similar to those pleaded by the plaintiff in *Production Resources*. Indeed, *Big Lots Stores, Inc.* suggests a two-step approach for determining whether a creditor has properly asserted a direct claim for breach of fiduciary duty in the insolvency context. First, the Court must determine whether the plaintiff-creditor has pleaded facts demonstrating, with a high degree of certainty, that the creditor is entitled to payment and that the entitlement is either currently or imminently due.[147] If the Court concludes that the pleadings satisfy the demanding burden set forth by this initial requirement, the Court must then consider whether the claimant's allegations

[145] *Id.*
[146] *Id.*
[147] *See also Production Resources*, 863 A.2d at 798 (positing that a direct claim might exist when directors display "marked degree of animus towards a particular creditor with a *proven entitlement* to payment" (emphasis added)).

satisfy the second step of the analysis, which asks whether a direct claim implicating invidious conduct or, in the words of *Production Resources*, "such a marked degree of animus" has been properly pleaded.

In this instance, NACEPF has failed to allege facts satisfying the first step of the above analysis. Put simply, the pleadings neither identify an entitlement to payment that is *clearly and immediately* due nor do they permit a reasonable inference to that effect. As a consequence, the Court need not consider whether the Complaint properly sets forth allegations satisfying the second element of the analysis.[148]

First, NACEPF has failed to allege the existence of an entitlement that is "clearly" due. Instead, NACEPF's theory of the case assumes *a priori* the

[148] Because of its conclusion below, the Court does not attempt to define "animus" in this context. "Animus," of course, is only a convenient (and, one hopes, helpful) label for a concept that likely will require iterative development. More specifically, the Court need not resolve the question, posed in *Production Resources*, of whether "pure self-dealing is the only fiduciarily-invidious reason that might justify a direct claim by a disadvantaged creditor." 863 A.2d at 798. The Court notes that this question is likely to be answered affirmatively—*i.e.*, that in determining whether the second-step of the analysis in this context has been satisfied, the Court should examine whether, during the period of insolvency and for self-dealing purposes, collection of the entitlement at issue has been wrongfully made more difficult or other creditors have been wrongfully preferred. *Cf. Production Resources*, 863 A.2d at 800 (noting the unique and "suspicious pattern of dealing" alleged permitting an inference of preferential treatment benefiting insiders and the "de facto controlling stockholder" over plaintiff-creditor).

It should also be noted that, although the Court uses the term "self-dealing" for convenience, this claim would conceivably also extend to wrongful preferences by directors for the benefit of persons controlling the directors. Additionally, there is the possibility that a direct claim might lie for "acts committed in contemplation of insolvency." *McDonald*, 174 U.S. at 404-05 (applying principles of so-called "trust fund doctrine"). Of course, this notion is very distinct from (and substantially more limited than) the broader "zone of insolvency." The Court only notes the possibility that this narrow exception *might* apply in very limited circumstances, given our case law's previous, intermittent citation to *McDonald*.

existence of a fiduciary duty, upon Clearwire's entry into insolvency, requiring that the Defendant Directors variously preserve certain assets or relinquish Clearwire's claimed rights in those assets. This assumption is made without first carefully delineating the nature of Clearwire's obligations which make NACEPF a creditor holding a clear and immediate claim.[149] For their part, the Defendants have vigorously denied that NACEPF should be considered a "creditor" at all for purposes of this litigation. In *Production Resources*, the plaintiff-creditor was a judgment creditor. In this instance, in support of its status as a "creditor" of Clearwire, NACEPF merely identifies a clause of the Master Agreement providing:

> WHEREAS, Clearwire is prepared, and the Alliance Members are prepared to accept, as royalties, the payments . . . for access to the Commercial Spectrum Capacity of the Channels . . . which payments and transfers are intended to generate an aggregate value, as of Initial Closing, of $0.90 for each Channel POP through a combination of cash commitment royalty, equity in Clearwire, an earn-out, use agreement execution and usage royalties.[150]

NACEPF argues that "[t]his shows that Clearwire had financial obligations towards NACEPF and Alliance members, rendering NACEPF a creditor of Clearwire with a right to demand its monetary dues for license usage."[151] NACEPF also seeks to rely on financial projections prepared for the Clearwire

[149] It may be that NACEPF considers itself a creditor simply because of the obligations that flow in both directions between NACEPF and Clearwire under the Master Agreement.
[150] Master Agreement at 2.
[151] Ans. Br. at 28.

board of directors that projected certain outlays payable to NACEPF and Alliance members.[152]

As an initial matter, the financial projections referenced by NACEPF are not contained within the allegations of the Complaint and therefore lie outside the scope of matters that may be considered by the Court. Moreover, even if the Court could consider them, the budgets of anticipated future expenditures fail here to demonstrate a clear entitlement to payment, much less one that is currently due. Significantly, the Defendants argue that NACEPF recites the "WHEREAS" clause of the Master Agreement, in its answering brief, "[p]resumably [in order to] draw[] the conclusion that [P]laintiff 'had a right to payment' under the terms of the Master Agreement."[153] The Defendants rightly point out that NACEPF has failed to demonstrate, through the facts pleaded in the Complaint or even in its brief, that "it was not paid what it was owed under the Master Agreement, or that [NACEPF] performed under the terms of the Master Agreement in some way that triggered an unfulfilled obligation of Clearwire to pay [P]laintiff."[154] As a consequence, the

[152] *Id*.
[153] Reply Br. at 12.
[154] *Id*. at 12-13. On February 12, 2004, NACEPF voluntarily dismissed a separate action, filed on November 20, 2003, against Clearwire for breach of contract. *See N. Am. Catholic Educ. Programming Found., Inc. v. Clearwire Holdings, Inc.*, C.A. No. 03C-11-172 (RRC) (Del. Super.).

Court cannot, based on the arguments advanced by NACEPF, conclude that NACEPF has met its burden of alleging a clear entitlement to payment.[155]

[155] The Court notes that, at oral argument, NACEPF's counsel only briefly stated: "At the time when we get to 2002, . . . the agreements with Sprint and WorldCom, some of them had expired or come to their end. At that point, there was an immediate cash obligation on the part of Clearwire." Tr. 41:1-5; *see also* Tr. 40:1-7 (citing Master Agreement, Preamble Clause (a)); Tr. 40:7-14. As an initial matter, it does not appear that the Complaint sets forth facts supporting this particular proposition—nor was it referenced in NACEPF's answering brief. The Complaint's principal allegations related (perhaps only tangentially, at best) to this proposition state, *inter alia*, that the market for wireless spectrum "collapsed" in June 2002 and that Clearwire "thereafter" entered into negotiations with Alliance members to "end Clearwire's obligations to the members." Compl. ¶¶ 34-35. The Complaint also provides that Clearwire ultimately settled with HITN and ITF and that, "by October 2003," Clearwire "effectively went out of business;" but the Complaint never alleges that a monetary obligation of Clearwire to NACEPF, coming due under the terms of the Master Agreement, actually arose and was left unpaid. Certainly, it is difficult to view these suppositions as satisfying the requirement that allege a clear entitlement to payment.

By scouring the terms of the Master Agreement, the Court, of its own accord, is able to pick up a basis from which an obligation to pay *potentially* could have arisen. *See, e.g.*, Master Agreement, §§ 1.2(a) (describing a process by which "Individual Use Agreements" would be subsequently entered into upon the occurrence of an "Availability Event," as those terms are defined in the Master Agreement); § 9.3. NACEPF, however, has failed to place this argument before the Court, instead making only general references to obligations for payment, as described above. Indeed, it is unclear precisely when these obligations may have arisen, if ever. For example, NACEPF has identified no information which the Court may consider for purposes of this motion to dismiss regarding whether an "Availability Event" occurred during the relevant periods, whether obligations arising pursuant to such an occurrence were left unmet by Clearwire, and, most importantly, the extent to which Clearwire may have had discretion in entering into additional agreements. Even assuming that an obligation to enter into additional "Individual Use Agreements" (or any other unidentified obligation) arose, the bare pleadings of NACEPF (and its references, in briefing and at oral argument, to the introductory provisions of the Master Agreement) leave the Court unable to infer that any of those obligations was not fulfilled. At best, NACEPF's arguments in this regard could be described as only conclusory allegations (if they are allegations, at all), which do not aid in making the necessary inferences in NACEPF's favor.

Additionally, even assuming that a clear entitlement were shown, NACEPF's claim in this respect would ultimately be derivative. The Court is required to make all *reasonable* inferences in favor of the plaintiff on a motion to dismiss under Court of Chancery Rule 12(b)(6); however, the only reasonable inference that may be drawn, based on the allegations, regarding non-payment of this obligation, assuming it existed and was adequately pleaded, was that no funds (or only inadequate funds) were available. NACEPF premises its claims on the theory that the Defendants failed to pursue adequately the ostensible business plan of Clearwire, which resulted

Indeed, it appears that the best argument in NACEPF's favor, given the allegations contained in the Complaint, would be that Clearwire breached its implied duty of good faith and fair dealing in failing to pursue aggressively build-out of the envisioned wireless internet network. Such a claim would not, on these facts, give rise to a clear entitlement to payment satisfying the first prerequisite for a cognizable direct claim in this context. NACEPF is one party to a contract, and its frustration is perhaps—indeed, likely—better characterized as a claim under contract or tort law.[156] Perhaps NACEPF has a colorable claim that Clearwire failed to abide, in good faith, by the terms of the Master Agreement;[157] however, this is the subject of legitimate debate and therefore fails to constitute a "clear" debt obligation of the firm.[158]

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in its coffers being empty. Thus, the harm was to the corporation, and the benefit of any remedy would flow to the corporation.

[156] *Cf. Production Resources*, 863 A.2d at 801 (citing *RGC Int'l Investors, LDC v. Greka Energy Corp.*, 2001 WL 312454, at *10 n.45 (Del. Ch. Mar. 7, 2001) ("Equity historically 'follows the law' and does not create remedies where the parties' behavior is already closely regulated by the law.")); *Production Resources*, 863 A.2d at 801 n.88 ("In general, . . . there seems to be utility in applying fiduciary duty law quite cautiously, to avoid unduly benefiting creditors by enabling them to recover in equity when they could not prevail on legal tort or contract claims.").

[157] *But see supra* note 154**.**

[158] Similarly, NACEPF has not argued that Count I of the Complaint, for fraudulent inducement, is a proper basis for creditor status in this context. The bulk of its arguments with respect to that claim are directed toward allegedly fraudulent conduct of the Defendants, not Clearwire. Therefore, to the extent NACEPF might have a claim (regardless of its viability), it is against the Defendants. The Court notes, however, that NACEPF has briefly mentioned conduct that might be charged to Clearwire—principally, if not entirely, in reference to statements of intention contained in the Preamble of the Master Agreement. *See* Compl. ¶ 38. This argument, although not advanced by NACEPF in support of its creditor status, would, *inter alia*, obviously fail to set forth a clearly held entitlement to payment and therefore could not serve as the basis of a direct fiduciary duty claim in this context—assuming such a claim exists.

Second, given the Court's analysis above that NACEPF has failed to demonstrate a clear entitlement to payment**,** NACEPF has also necessarily failed to demonstrate that the alleged entitlement on which it seeks to premise its claim has the immediacy necessary to maintain a direct claim in this context. As in *Big Lots Stores, Inc.*, no claim of NACEPF has been reduced to judgment, even assuming that a breach of contract has occurred. Judgment creditor status might not be necessary in the face of an entitlement that is otherwise clearly and currently due.[159] In this instance, however, the pleadings fail to allege facts from which the existence of such a debt can be reasonably inferred.

The two-step approach followed here with respect to direct claims comports with the principal policy considerations that underlie analysis in this context. Foremost among these is the notion that directors of insolvent corporations must retain the freedom to engage in vigorous, good-faith negotiations with their creditors for the benefit of the firm.[160] To hold otherwise would, in the context of

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Additionally, to the extent that Count III arguably, might theoretically serve as the basis for claiming creditor status in this context—an argument NACEPF has not advanced—such an argument fails, *inter alia*, for similar reasons in this context. Moreover, the "nexus" between the claimed breach of fiduciary duty and such an entitlement, even if it were adequately alleged, is not readily apparent.

[159] This is an issue that the Court need not resolve, however, given the other inadequacies of NACEPF's allegations described above. *But cf. Johnston v. Wolf*, 487 A.2d 1132, 1135-37 (Del. 1985) (holding that plaintiff was not a "creditor" (of pre-merger corporation) granted standing under 8 *Del.C.* § 174 to pursue claims against pre-merger directors for unlawful redemption of stock where plaintiff's claim had not been reduced to judgment prior to merger).

[160] *Cf. Production Resources*, 863 A.2d at 797 ("[D]irectors of an insolvent corporation must retain the right to negotiate in good faith with creditors and to strike fair bargains for the firm."); *id.* at 800 ("I do not rest my decision in any manner on the proposition that it is a breach of

insolvency, not only cast a cloud of uncertainty over directors' ordinary discretion to exercise freely their rational business judgment, but arguably also would diminish the potential that an insolvent corporation might emerge from insolvency on its own. Moreover, to some extent, albeit neither easily defined nor universally praised, the so-called "trust fund doctrine" may, however, inform analysis in this context.[161] Assuming the so-called "trust fund doctrine" does, to some degree, apply,[162] the initial requirement that a debt be both clearly and immediately due

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fiduciary duty for the board of an insolvent company to engage in vigorous, good-faith negotiations with a judgment creditor. That, in fact, might be the *duty* of a board, which necessarily has to balance the interests of all those with a claim to the firm's inadequate assets.").

[161] In conceding that a direct claim for "animus" might exist, *Production Resources* suggests that, to some extent, semi-analogous trust principles *might* require that creditors not, in certain circumstances (*e.g.*, for self-dealing purposes), be wrongfully disadvantaged vis-a-vis other creditors. *See* 863 A.2d at 798 n.77. *Cf. supra* note 118.

[162] *But cf. Asmussen*, 156 A. at 181. The Court, in *Production Resources*, acknowledged that venerable case law holds that directors of an insolvent corporation may generally prefer one creditor over another. *See* 863 A.2d at 792, 798 (citing *Asmussen*, 156 A. 180). This line of case law, however, imposes the limitation that directors may not exercise this discretion for self-dealing purposes. *See Penn. Co. for Ins. on Lives & Granting Annuities*, 174 A. 112. This limitation would also most likely extend to preferences for the benefit of persons or entities by which the directors are controlled.

It may bear repeating that the analysis contained in the text above only assumes the existence of a direct claim which may be asserted by creditors for "animus." The venerable line of case law discussed above, however, arguably addresses only *distributions* of corporate assets—*i.e.*, dissipating the corporation's pool of available assets, which would presumably constitute a derivative claim under the modern test enunciated in *Tooley*. *See, e.g.*, *Penn. Co. for Ins. on Lives & Granting Annuities*, 174 A. at 116 (suggesting, through its "lifeboat" example, that recognition of claims for preference implicating directorial self-dealing may be limited to instances in which injury to the corporation occurs and that this doctrine is perhaps better viewed as flowing from "applied common honesty" than "so-called 'trust fund theory'").

arguably achieves a workable balance between the complex realities of serving as a director of an insolvent firm and the concerns implicit in "trust fund doctrine."[163]

Additionally, although NACEPF argues that Clearwire was insolvent or in the vicinity of insolvency from the moment the Master Agreement was entered into, when the Complaint is "shorn of excess verbiage," it becomes clear that the alleged conduct of the Defendants challenged by NACEPF is better viewed as the cause of Clearwire's approach to the brink of insolvency and, perhaps, slide into actual insolvency. The allegations in the Complaint suggest that, as of the time of contract, Clearwire had been provided with funds that, although not sufficient for the long-term, appear to have been sufficient for the purpose of developing the "intended" business opportunity in the short-term.[164] As in *Big Lots Stores, Inc.*, "claims of this type are classically derivative."[165]

Unlike in *Production Resources*, Clearwire's alleged debt obligation, as alleged in the Complaint, to NACEPF was neither clear nor immediate.[166]

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[163] It should be noted that this Memorandum Opinion does not reach the applicability of the presumptions of the business judgment rule, because the Court concludes that NACEPF has failed, as an initial matter, to set forth allegations satisfying the elements of the underlying claim—assuming, *arguendo*, such a claim exists.

[164] *See supra* note 97 and accompanying text.

[165] 2006 WL 846121, at *7 (quoting *Production Resources*, 863 A.2d at 776). It is not as easy to fault Clearwire's directors as NACEPF suggests it should be for failing to relinquish Clearwire's claim to license rights under the Master Agreement—conduct which forms the principal basis for NACEPF's alleged breach of fiduciary duty claim—when that was the one significant asset Clearwire appears to have had.

[166] As noted above, because NACEPF's claim fails to satisfy the foundational requirements for a direct claim for breach of fiduciary duty in this context, the Court does not consider whether the pleadings properly allege facts supporting the second step of the analysis. Therefore, the Court

Therefore, even assuming that a limited direct claim might be asserted by a creditor of an insolvent corporation in this context, the Court concludes that NACEPF has failed to allege facts which set forth such a claim. NACEPF may not now recover for its own benefit what it perhaps could not have recovered through contract or tort by transforming its claims into one claim for breach of a fiduciary duty that it can directly pursue.

IV. CONCLUSION

Accordingly, Count II of the Complaint fails to state a claim upon which relief can be granted and must be dismissed. Therefore, for reasons also set forth above, the Court is without personal jurisdiction over the Defendants with regard to Counts I and III, which must be dismissed. Accordingly, the Defendants' Motion to Dismiss is granted. An implementing order will be entered.

also does not reach the issue of whether "animus," *see supra* note 148, can supply the final ingredient for a direct claim for breach of fiduciary duty in this context.