IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBOTTI & COMPANY, LLC,

Plaintiff Individually and on Behalf of All Other Similarly Situated and Derivatively on Behalf of Gulfport Energy Corporation,

v.

MIKE LIDDELL, ROBERT E. BROOKS, DAVID L. HOUSTON, MICKEY LIDDELL and DAN NOLES and CD HOLDING, L.L.C.,

Defendants,

v.

GULFPORT ENERGY CORPORATION,

Nominal Defendant.

C.A. No. 3128-VCN

MEMORANDUM OPINION

Date Submitted: April 22, 2009
Date Decided: January 14, 2010

R. Bruce McNew, Esquire of Taylor & McNew LLP, Wilmington, Delaware, Attorney for Plaintiff.

Michael Hanrahan, Esquire and Laina M. Herbert, Esquire of Prickett, Jones & Elliott, P.A., Wilmington, Delaware, Attorneys for Defendants

NOBLE, Vice Chancellor

I. INTRODUCTION

This class and derivative action involves a challenged stockholder rights offering. A shareholder plaintiff alleges that the company's directors set the offering at a deliberately and inadequately low price that would trigger anti-dilution provisions in the agreements governing their stock options and the controlling shareholder's warrants. The shareholder argues that the triggering of these anti-dilution provisions worked the directors a benefit not shared by the remaining shareholders, and it therefore alleges self-dealing by the defendant fiduciaries. The complaint, however, fails to state a claim because the anti-dilution provisions simply maintained unchallenged, pre-existing contractual rights of the defendant directors, which left them in substantially the same position they were in before the rights offering. For this reason and because the shareholder has not otherwise sufficiently alleged that the directors engaged in disloyal conduct, by, for instance, bowing to the will of a controlling shareholder who received a unique benefit because of the rights offering, this action will be dismissed.

II. BACKGROUND

Plaintiff Robotti and Company, LLC ("Robotti") has been a stockholder in Nominal Defendant Gulfport Energy Corporation ("Gulfport"), a Delaware

corporation, since July 1, 2003.[1] Gulfport is an independent oil and gas exploration and production company.[2] Robotti owned 90,000 Gulfport shares at the time of the rights offering (the "Offering") at issue.[3]

Defendants, Mike Liddell, Dan Noles, David Houston, Mickey Liddell, and Robert Brooks, were the Gulfport directors who approved the Offering.[4] CD Holding, L.L.C. ("CD Holding"), Gulfport's alleged controlling shareholder at that time, is also a named defendant.[5]

The terms of the Offering were set forth and announced in a prospectus (the "Prospectus"), which Gulfport filed with the Securities and Exchange Commission on July 22, 2004.[6] At that time, Gulfport had 10,146,566 shares of common stock outstanding and 396 shareholders of record.[7] Collectively, Gulfport's officers and directors owned 1,269,416 shares of common stock (counting options then currently exercisable or exercisable within sixty days of the filing), which amounted to 12.5% of the company's equity. Of this figure, Gulfport Chairman

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[1] Second Am. Verified Class Action and Deriv. Compl. (the "Complaint") ¶ 1. The Complaint, along with its attachments and incorporated documents, is the source of the background facts.
[2] *Id.* at ¶ 2.
[3] *Id.* at ¶ 36. As part of its investigation of the Offering, Robotti used 8 *Del. C.* § 220 to inspect the Company's books and records. *See Robotti & Co., LLC v. Gulfport Energy Corp.*, 2007 WL 2019796 (Del. Ch. July 3, 2007).
[4] Compl. ¶¶ 3-8. References to the "Defendants" or to the "Board," unless otherwise noted, will be to those directors serving at the time of the Offering.
[5] *Id.* at ¶ 9. CD Holding has not been served.
[6] The Prospectus appears in the record as Exhibit A to the Transmittal Certificate of Laina M. Herbert (Feb. 20, 2009).
[7] Prospectus at 13.

Mike Liddell alone owned 1,169,416 shares, amounting to 11% of the company's equity.[8] Gulfport listed Charles Davidson as its largest shareholder. Davidson, who is not a party to this action, beneficially owned 8,177,595 Gulfport shares (including those attributable to warrants that would have been converted into 2,022,740 shares), which represented 67.2% of the all the shares outstanding. Much of Davidson's equity was held by CD Holding, of which Davidson was the sole member, or by Wexford Management, L.L.C., of which Davidson was the Chairman and controlling member.[9]

A. *The Offering*

Under the Offering, one transferable subscription right would be granted to Gulfport's common shareholders for every 1.0146 shares of common stock they owned.[10] Each right could then be exercised for $1.20 in return for one share of common stock.[11] Gulfport's common stock closed at $3.10 per share on the OTC (over-the-counter) Bulletin Board on April 21, 2004, the last day before the Board

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[8] Compl. ¶ 37; Prospectus at 48-49.

[9] *Id.* The Complaint varies between designating Davidson and CD Holding as the controlling shareholder.

[10] Compl. ¶¶ 33-34. The rights were granted to the stockholders of record as of the close of business on July 16, 2004. The Offering expired on August 17, 2004. Prospectus at 1-2.

[11] *Id.*

decided upon the rights plan, but closed at $2.19 on July 21, 2004, the day before the Board filed the Prospectus.[12]

Thus, Gulfport intended to raise $12 million from its then-current stockholders in exchange for 10 million shares of common stock.[13] To guarantee this result, Gulfport entered into a back-stop agreement with CD Holding whereby CD Holding would purchase any of the 10 million shares of common stock not subscribed for by the rights holders. Gulfport agreed to pay CD Holding a commitment fee equal to two percent of the Offering's gross proceeds, or $240,000, in return for its back-stop guarantee.[14]

Gulfport claimed that it intended to use the proceeds from the Offering "primarily to fund a portion of [its] proposed seismic and drilling programs."[15] Another identified purpose for the proceeds was the repayment of a line of credit with the Bank of Oklahoma; the balance under that facility was $2.2 million as of

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[12] Prospectus at 2-4. Robotti claims that Gulfport's net asset or "PV-10" value, after adjustment for its oil and gas reserves, was at least $14.00 a share at or around the time of the Offering. Compl. ¶ 35.

[13] Prospectus at 11-12. Although the Offering's gross proceeds would be $12 million, net proceeds would amount to $11,890,000 after accounting for costs and expenses. *Id.*

[14] Compl. ¶ 59; Prospectus at 16. Under the terms of the Offering, the common shareholders could exercise their subscription rights, sell the rights to others, or allow the rights to expire upon the transaction's closing, at which time CD Holding would purchase any outstanding subscription rights pursuant to the back-stop agreement. Prospectus at 15-16.

[15] Compl. ¶ 38. Specifically, Gulfport disclosed that it had budgeted $4.5 million for a 3-D seismic survey at its East Hackberry Field, approximately $9.6 million for drilling twelve wells at its West Cote Blanche Bay Field, and roughly $1 million for "workovers" of ten wells in the West Cote Field. Prospectus at 11.

March 31, 2004.[16] It disclosed that it had only $580,000 in cash available for investment when it filed the Prospectus, and was therefore in need of capital.[17] Gulfport also informed its shareholders that it had entered into a $3 million revolving credit facility with CD Holding on April 30, 2004 in connection with the Offering; under this facility, CD Holding could apply any unpaid principal amount and accrued, but unpaid, interest to the subscription price for rights issued to it.[18]

B. *The Options and the Warrants*

Gulfport had warrants exercisable into 2.4 million shares and options exercisable into 627,000 shares at the time of the Offering.[19] Management and the Board owned the options and CD Holding beneficially owned most of the warrants,[20] which could be exercised for $2.00 and $4.00 per share, respectively.[21] The Offering triggered anti-dilution provisions contained in the agreements governing the options and the warrants—these provisions became operative upon a

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[16] Compl. ¶ 38; Prospectus at 11.

[17] Compl. ¶ 38; Defs.' Opening Br. at 7. Gulfport additionally disclosed that it had hired Petrie Parkman in 2003 "to assist in the possible sale of its West Cote Blanche Bay Field." No sale of the field was pending as of the date the Prospectus was filed, and the Board determined that it would be in Gulfport's best interests to undertake the Offering if the sale of the oil field was not ultimately consummated. Prospectus at 31.

[18] Compl. ¶ 52(e); Prospectus at 30, 50. As a large shareholder, CD Holding held substantial subscription rights. It ultimately applied $500,000 owed to it under this credit facility toward its exercise of these rights. Compl. ¶ 38 (citing Gulfport's Form 10-Q from the quarter ending September 30, 2004).

[19] *Id.* at ¶ 39. Specifically, Gulfport had outstanding warrants for the purchase of 2,431,517 shares, and options for the purchase of 627,337 shares. Prospectus at 22.

[20] Compl. ¶ 39. Defendants Brooks, Houston, Mickey Liddell, and Noles each owned 20,000 options while Defendant Mike Liddell owned 467,270 options. *Id.* at ¶ 15.

[21] *Id.* at ¶ 39.

common stock issuance at a price less than the respective option and warrant strike prices.

According to the Prospectus, the number of shares of common stock resulting from exercise of the options "[would] be increased and the exercise price per share [would] be decreased" based upon the Offering's subscription price, the total number of shares offered, and the common stock's current market price; the aggregate exercise price would, however, remain the same. After the Offering, the option holders could acquire 1,245,612 shares of common stock for $1.01 per share.[22] As implemented, the option holders, collectively, could obtain the same percentage of Gulfport's common stock after the Offering as they could have before, and all for substantially the same price.

The anti-dilution provisions applicable to the warrants operated differently from their option counterparts. The Prospectus revealed that the exercise price of the warrants would "be reduced to the subscription price, and the number of shares to be purchased under the warrants [would] be increased by dividing the subscription price into the aggregate exercise amount of the warrant prior to the reduction in the exercise price." Thus, after the Offering, the warrant holders were entitled to acquire 8,105,057 shares of Gulfport common stock for $1.20 a share.[23]

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[22] Prospectus at 22.
[23] *Id.* at 22-23. The aggregate exercise price for the warrants was $9,726,068 ($4.00 per share times 2,431,517 shares).

In other words, a warrant that allowed for the acquisition of one share of common stock for $4.00 was adjusted after the Offering to allow for the acquisition of more than three shares of Gulfport common stock for $1.20 per share.[24]

III. CONTENTIONS

Robotti contends that the Offering's low price triggered the anti-dilution provisions, which "greatly increased" the number of shares to be issued to meet Gulfport's obligations to the holders of the warrants and options. Indeed, Robotti asserts that, "in the case of the warrants it increased more than [three] fold and the number of shares issued against the options almost doubled."[25] As a result, Robotti claims that Gulfport issued "approximately 16.2 million shares to raise only approximately $12 million," thereby reducing the average Offering price per share from the $1.20 projected in the Prospectus to a mere $0.70.[26] Robotti argues that both the shareholder class it purports to represent and Gulfport were injured by this result: the public shareholders experienced dilution in the value of their stock to the benefit of "the controlling stockholder and management," while Gulfport failed to raise the full amount of capital it could have raised had the defendants set a higher Offering price.[27] If the rights had been priced "at a more usual discount,"

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[24] If the Offering price had been, say, $1.80 per subscription right, the exercise price for the warrants would have been adjusted to $1.80, the same price. Moreover, the total number of shares to be acquired through the warrants would have increased to only 5,403,371.
[25] Compl. ¶ 55.
[26] *Id.* at ¶ 40.
[27] *Id.* at ¶¶ 61-67.

Robotti suggests that the "anti-dilutive effects of the options would not have existed and the anti-dilutive effect of the warrants would have been greatly minimized."[28]

In Robotti's view, by pricing the Offering at $1.20 a share and causing the result described above, the Defendants engaged in an "unnecessary self-dealing transaction" with no "indicia of fairness" for the purpose of obtaining a personal financial benefit.[29] In support of this argument, it relies upon a host of circumstantial facts: in particular, it questions whether the Board duly considered the consequences of the low subscription price, and it challenges the truth of certain disclosures made in the Prospectus.

Robotti contends that the Prospectus presented "vague" explanations for why the Offering was priced at $1.20 a share, and it asserts that the Board failed specifically to explain why it priced the subscription rights below the respective strike prices for the warrants and options.[30] Additionally, Robotti criticizes the Defendants' decision to deploy a rights plan as opposed to some alternative financing method that would not have triggered the anti-dilution provisions.[31] It

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[28] *Id.* at ¶ 56.
[29] Pl.'s Answering Br. at 21.
[30] Compl. ¶ 41. When setting the price, the Board considered "*such factors as* the current market price of [Gulfport's] common stock, the availability of financing alternatives and the level, volatility of commodity prices and the ability to secure an agreement from CD Holding to back-stop this rights offering." Prospectus at 8 (emphasis added).
[31] Compl. ¶ 41.

also points out that the Defendants failed to appoint or obtain an independent representative or advisor to evaluate the transaction's fairness or to issue a fairness opinion. Robotti reports that after reviewing the minutes and documents produced in response to the Court's § 220 order, it found that the Board had neglected to deliberate on the issues it claimed to have considered in its Prospectus disclosures.[32]

Indeed, although emphasizing that it is not bringing disclosure claims, Robotti maintains that the Offering's justifications as set forth in the Prospectus were inconsistent with the Board's own deliberations, as gleaned from minutes produced by, and records put before, the Board at several pre-Offering meetings.[33] Robotti contends that the Prospectus falsely disclosed deliberations by the Board to determine the need for, and the price of, the Offering, which "reveal[ed] an effort by defendants to conceal their improper actions and purpose."[34] It argues that "management and the Company's controlling shareholder" devised the Offering for the purpose of triggering the anti-dilution provisions, and did so not only

[32] *See id.* at ¶ 52. Robotti and the Defendants, in particular, debate the success of the drilling operation that the Offering was purportedly needed to fund. Robotti argues that the program was complete by the time the Offering closed, and therefore the funds were not needed, or alternatively, funds could have been had by leveraging the successful operation. *Id.* at ¶ 57.

[33] *Id.* at ¶¶ 44, 52.

[34] *Id.* at ¶ 52(c) (arguing that, although the Prospectus disclosed that when determining the subscription price the Board considered the common stock's current market price, alternatives to financing, commodity price volatility and ability to secure the back-stop agreement, "the actual records of the company demonstrate absolutely no validity to [that] assertion").

without genuine Board authorization, but instead with "rubberstamp" approval in the form of the allegedly false Prospectus disclosures regarding Board diligence.[35]

Robotti asserts a claim against the Defendants for breach of the duty of loyalty.[36] It concludes that the Defendants' alleged lack of evaluation of the effect of the anti-dilution provisions, the low price of the Offering, the false disclosures in the Prospectus, and the existence of, but failure to pursue, reasonable alternatives to financing, taken together, indicate that the Defendants knowingly and intentionally used the Offering as a means of working themselves a benefit through operation of the anti-dilution provisions, which harmed both Gulfport and its public stockholders.[37] Robotti also argues in the alternative, albeit less forcefully, that the Defendants triggered the anti-dilution provisions without considering the consequences.[38] Robotti does not, however, make clear whether this alternate allegation rises to the level of conscious disregard of one's fiduciary duties, and thus perhaps represents another claim of disloyalty, or simply

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[35] *Id.* at ¶ 49, 52(c).
[36] Pl.'s Answering Br. at 18 ("The Complaint alleges self-dealing by fiduciaries. The entire Board of Directors at the time of the transaction and the Company's controlling shareholder, all of whom owed fiduciary duties to the other stockholders are alleged to have received financial benefits not available to those other stockholders.").
[37] Compl. ¶ 52.
[38] Compl. ¶ 62.

constitutes a duty of care claim based upon gross negligence and uninformed decision-making.[39]

The Defendants moved to dismiss, arguing, *inter alia*, that the Offering's trigger of the anti-dilution provisions neither personally benefited the Defendants nor injured the public stockholders or Gulfport itself. In particular, the Defendants maintain that the operation of the anti-dilution provisions upon the options did not dilute the value and positions of the common shareholders but merely maintained the pre-Offering equity position of the option holders.[40] The Defendants argue that application of 8 *Del. C.* § 153 effectively bars Robotti's claims, and that the Court should not disrupt the valid business judgment of the board of directors.

Additionally, the Defendants address allegations that the Board failed to exercise due diligence regarding the Offering; they maintain that the minutes and records upon which Robotti relies tell an altogether different story from the one presented in the Complaint: instead of rubber stamping the transaction, the Defendants maintain that the Board duly considered the need for additional capital, financing alternatives, the subscription price, and the back-stop agreement.[41]

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[39] In its answering brief, Robotti explicitly claims that the "Complaint alleges a conscious disregard of the interests of the corporation and the rights of the stockholders." Pl.'s Answering Br. at 20.

[40] Defs.' Opening Br. at 21 ("[B]ecause the Rights Offering doubled the number of outstanding shares, the adjustments cause no dilution. The anti-dilution adjustment simply gave the directors the right after the Rights Offering to purchase the same equity interest for the same amount of money as before the Rights Offering.").

[41] Defs.' Opening Br. at 5-13.

Moreover, the Defendants argue that Robotti misinterpreted information concerning the success of the drilling program, which while successful, was not yet complete as of the Offering and therefore in need of additional funds.

Lastly, the Defendants contend that Robotti's claims are derivative and that, at the time Robotti amended its complaint to add the derivative count, a majority of the Board was not interested in the transaction.[42] Further, Defendants claim that the facts as alleged do not create a reasonable doubt that these disinterested directors were under the control of an interested party and thus not independent. They also assert that the Board exercised valid business judgment in approving the Offering. For these reasons, the Defendants conclude that Robotti failed to plead demand excusal as required by Court of Chancery Rule 23.1.

Robotti of course opposes the Defendants' substantive arguments, but also requests that the motion to dismiss be converted into a motion for summary judgment.[43] Robotti complains that the Defendants have relied upon extraneous documents to contest the factual basis of its complaint, thereby raising issues of material fact best reserved for summary judgment.

IV. ANALYSIS

Although Robotti alleges dishonest and incomplete disclosures and uninformed Board decisions, this case, by force of the focus of Robotti's

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[42] *Id.* at 35.

[43] Pl.'s Answering Br. at 12. *See* Ct. Ch. R. 12(b).

contentions, ultimately boils down to an alleged breach of the duty of loyalty and whether or not the Defendants obtained a personal benefit through the Offering.[44] The Court, however, cannot draw a reasonable inference from the facts as alleged that the Offering's trigger of the anti-dilution provisions and their effect upon the options worked a material personal gain to the Defendants at the expense of Gulfport or the public stockholders. Robotti also did not plead sufficient facts to support a claim that the Defendants acted in bad faith by consciously disregarding their fiduciary duties. Because the Court cannot reasonably infer from the facts alleged that the Defendants received a personal gain by way of the collateral consequences of the Offering or consciously disregarded their duties, their decision to consummate the Offering is protected by the business judgment rule. Of equal importance, Robotti has not duly alleged that CD Holding, the controlling shareholder, dominated the Board as it approved the Offering. Lastly, Robotti's derivative claims are barred because it has failed to plead that Gulfport's board of directors was either interested or under the control or domination of an interested party as of the time it asserted the derivative claims.[45]

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[44] Pl.'s Answering Br. at 6-7 ("In short, the Complaint in clear and explicit terms alleges that the Defendants manipulated corporate machinery for personal economic advantage in [a] self-dealing transaction.").

[45] A recurring problem is that Robotti directs a substantial portion of its efforts toward showing that the members of the Board were conflicted—because of their ownership of options—as they approved the Offering. Its other contentions were less developed—some even arguably not fairly presented—such as its argument that the Board failed to exercise due care. Thus, the Court

A. *The Court Declines to Convert Defendants' Motion to Dismiss into One for Summary Judgment*

Robotti requests that the Defendants' Motion to Dismiss be converted into one for summary judgment. It argues that the Defendants have relied upon documents neither integral to, nor incorporated within, the Complaint. These documents include minutes, the Prospectus, the documents put before the Board during meetings that took place around the time of the Offering, and contemporaneous public disclosures.[46]

If, in considering a motion under Court of Chancery Rule 12(b)(6), matters outside the pleading are "presented to and not excluded by the Court," then the motion must be treated as one for summary judgment under Court of Chancery Rule 56, thereby giving all parties reasonable opportunity to present all material relevant to a summary judgment motion.[47] Thus, matters beyond the complaint may generally not be considered in a ruling on a motion to dismiss.[48] There are exceptions to this principle: 1) when such documents are integral to, and incorporated within, the plaintiff's complaint; or 2) when the documents are not being relied upon for the truth of their contents.[49]

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is left with the task of attempting to put flesh on some bare bones arguments that were not presented in any detail.

[46] Pl.'s Answering Br. at 7, 12.

[47] Ct. Ch. R. 12(b).

[48] *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 320 (Del. 2004).

[49] *Vanderbilt Income & Growth Assocs. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996).

The Prospectus, as used here, comes within the first exception. Robotti expressly incorporates the Prospectus into its complaint,[50] and the Prospectus is integral to its claims. The Prospectus is the factual source for most of Robotti's allegations, including those regarding the Offering's allegedly low price and stated justifications, as well as the respective benefits and injuries the Offering worked for the Defendants and inflicted upon Gulfport and the public shareholders.[51]

The Court, to some extent, may also consider, under both exceptions, the content of the pre-Offering meeting minutes and documents put before the Board during these meetings. Robotti incorporated these documents into its complaint, and such documents are integral to its charge that the Board failed to duly consider the rights offering.[52] Moreover, neither the Court nor the parties rely upon these documents to prove the truth of their contents, but rather to address whether the Board considered the Offering's effect upon the anti-dilution provisions before moving forward with the transaction.

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[50] *See* Compl. ¶ 33 ("The terms of the Prospectus are incorporated herein by reference . . . .").

[51] *See id.* at ¶¶ 33-34, 38-40. ("By prospectus . . . [Gulfport] first announced a rights offering . . . [that] described a transaction whereby a single transferable subscription right at a price of $1.20 . . . [for] the purpose [of] fund[ing] 'a portion of [its] currently proposed seismic and drilling programs' . . . [D]ue to the low offering price for the subscription rights, anti-dilution provisions protecting the holders of the warrants and options were triggered by the Offering.").

Although Robotti claims that the terms of the Prospectus have not been incorporated "for the truth of the matters asserted herein" and instead only to identify certain company disclosures and admissions, it clearly uses this document as the factual basis for its claims regarding the price of the Offering and effect of the anti-dilution provisions.

[52] *See id.* at ¶ 44 ("The records of [the] Board of Director[s], however, reveal there were no such considerations. The minutes of the meetings and the documents . . . contain absolutely no information . . . regarding current [stock price], the availability of financing alternatives, the level or volatility of commodity prices or the ability to secure a back-stop agreement.").

More importantly, however, the Court ultimately does not rely upon the meeting minutes, or for that matter, any other document outside of the pleadings except for the Prospectus. Because the Court cannot reasonably infer from the facts as alleged that the triggering of the anti-dilution provisions provided the Defendants a material benefit not shared by the remaining shareholders, or that the Defendants consciously disregarded Gulfport's interests, the Court need not review in any great detail what, if any, consideration the Board gave to the subscription price, financing alternatives, or the business justifications underlying the Offering. There is, therefore, no need to rely upon the minutes or other public disclosures.

B. *The Nature of the Claims*

Robotti argues that it has brought both direct and derivative claims. As to the direct claim, Robotti contends that the Offering devalued the public's "shares [to the benefit] of the controlling shareholder and management."[53] Regarding the derivative claim, Robotti argues that the public stockholders experienced value dilution as a result of the Offering, and that Gulfport sustained an injury because the Defendants failed "to raise the full amount of capital which could have been raised through the issuance of the shares issued in the transaction."[54]

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[53] *Id.* at ¶ 63.
[54] *Id.* at ¶¶ 65-67; *see also* Pl.'s Answering Br. at 25 ("[T]he corporation has suffered injury in that it has issued something valuable, common stock, in exchange for far less than that stock was worth.").

When distinguishing between direct and derivative claims, this Court must ask the following questions: (1) who suffered the alleged harm—the corporation or the shareholders individually; and (2) who would receive the benefit of the recovery or other remedy?[55] When a plaintiff asserts a claim against fiduciaries alleging overpayment and subsequent common stock dilution, that claim is typically "regarded as exclusively derivative, irrespective of whether the currency or form of overpayment is cash or the corporation's stock."[56] Dilution in value of corporate stock "is merely the unavoidable result of the reduction in value of the entire corporate entity," and the "equal injury" to the shares that results from an overpayment should not be equated with "harm to specific shareholders individually."[57]

A direct claim results, however, when an overpayment of stock for insufficient consideration (1) goes to, and is caused by, a controlling shareholder and (2) when such overpayment "causes an increase in the percentage of the shares owned by the controlling shareholder, and a corresponding decrease in the share percentage" owned by the minority.[58] In *Gentile*, the corporation's controlling shareholder and chief executive officer caused the company to issue the controlling shareholder stock in return for debt forgiveness. The alleged value of the shares

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[55] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004).
[56] *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006).
[57] *Id.*
[58] *Id.* at 99-100.

exchanged, however, exceeded the value of the outstanding debt. The transaction not only greatly enhanced the controlling shareholder's equity position at the expense of the minority shareholders, but also injured the corporate entity.[59]

The Supreme Court in *Gentile* held that both the corporation and the shareholders were harmed by the overpayment: the corporation was harmed because it exchanged corporate property for something of a lesser value, and the public shareholders were harmed insofar as economic value and voting power had been "expropriated" by and "redistributed" to the controlling shareholder out of the minority interest.[60] Because of the dual nature of the harm, the Supreme Court considered the claims both direct and derivative.

As in *Gentile*, Robotti brings both direct and derivative claims. Its claims of overpayment to the Defendants are derivative—the directors allegedly were able to purchase stock at a price less than both its trading value and the price paid by the minority shareholders. If true, this overpayment would have diluted the public float and correspondingly injured the corporation. In addition, because Robotti's claims specifically involve a stock overpayment to the controlling shareholder, this case fits within the *Gentile* dual-claim paradigm. Had the anti-dilution provisions allowed CD Holding to purchase more stock than the other shareholders (i.e., other subscription rights holders) and at a price below its worth, CD Holding would have

[59] *Id.* at 94-96.
[60] *Id.* at 100.

increased its share percentage at the expense of the minority stockholders, thereby giving rise to a direct claim.[61]

C. *Plaintiff's Complaint Fails to State a Cause of Action*

Robotti did not adequately plead both self-dealing by the Defendants and resulting injury to Gulfport and the public shareholders, nor has it sufficiently alleged that the Defendants consciously disregarded Gulfport's interests. For these reasons, the Complaint must be dismissed for failure to state a claim. Although the Board's approval of the $1.20 subscription price did in fact trigger the anti-dilution provisions, the provisions' adjustment of the options did not confer a special benefit upon the Defendants, but instead protected them from the material dilution they would have otherwise suffered through the Offering. It cannot therefore reasonably be inferred from the facts as alleged that the triggering of the anti-dilution provisions, as applied to the options, unfairly diluted the public shareholders or that, by setting the price at $1.20, these provisions harmed Gulfport to the Defendants' personal benefit.

1. Standard of Review and the Applicable Law

On a motion to dismiss, the Court accepts the truth of all well-pled facts of the Complaint and will draw all reasonable inferences in a light most favorable to

[61] The alleged benefit to CD Holding is discussed in greater detail at note 80 *infra*.

the plaintiff.[62] The Court may not, however, assume the accuracy of a plaintiff's factual conclusions unless supported by specific factual allegations.[63] Thus, the Court need not accept as true all allegations without question, nor must it draw unreasonable inferences from these allegations.[64] This Court will only dismiss a complaint under Court of Chancery Rule 12(b)(6) "where it appears with 'reasonable certainty' that the plaintiff could not prevail on any set of facts that can be inferred from the pleadings."[65]

2. Robotti's Mathematical Conclusions

Robotti maintains that, because of its unfairly low pricing, the Offering triggered anti-dilution provisions that caused Gulfport to issue 16.2 million shares of common stock for $12 million, or $0.70 a share.[66] The pleadings adequately allege that the anti-dilution provisions, once triggered, raised the number of shares of common stock into which the options and warrants could be converted from

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[62] *Hillman v. Hillman*, 910 A.2d 262, 269 (Del. Ch. 2006).
[63] *Id.*
[64] *Gloucester Holding Corp. v. U.S. Tape & Sticky Prods.*, 832 A.2d 116, 123 (Del. Ch. 2003) (quoting *Grobow v. Perot*, 539 A.2d 180, 187 & n.6 (Del. 1988)).
[65] *In re Paxson Commc'n Corp. S'holders Litig.*, 2001 WL 812028, at *3 (Del. Ch. July 12, 2001) (quoting *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996)).
[66] Compl. ¶ 40. Robotti and the Defendants quarrel over whether and when the options or warrants were in fact exercised. *See* Defs.' Opening Br. at 24. Although the question of whether Robotti's claims are ripe may not be ignored altogether, this debate is of only marginal significance. The Prospectus disclosed the effect of the anti-dilution provisions upon the warrants and options, and thus any injury or loss of value to the common shareholders or Gulfport itself would have been understood by the investing public as of the time of the Offering, even if the effects were formally not recognized until exercise. It may be worth noting that there is evidence of exercise, especially of the warrants, in the record. Trans. Cert. of Laina M. Herbert (Apr. 28, 2008), Ex. 16, at RC0008.

3,058,854 to 9,350,669 shares, for a total increase of 6,291,815 shares.[67] Robotti's argument seems to assume that these roughly 6.3 million shares would be issued for free, in addition to the 10 million shares issued by exercise of the Offering's subscription rights.

Robotti's argument, however, fails to account for the exercise price of the options and warrants. Those 6.3 million additional shares may only be issued upon the Defendants' payment of the adjusted warrant and option prices: $1.20 per share for the warrants, and $1.01 per share for the options. Thus, Gulfport would not be issuing 6.3 million additional shares for nothing, but would instead issue such shares upon exercise of the options and warrants, and payment of their respective exercise prices.

If the option and warrant holders purchased just the additional shares available under the instruments, they would pay roughly $6.8 million for the additional shares available under the warrants, and about $624,500 for the additional shares available under the options.[68] And of course, if the defendants exercised all of their options and warrants, including the additional shares provided by the anti-dilution provisions, they would pay approximately the original

[67] The number of shares into which the options could be exercised increased by 618,275, while the number of shares into which the warrants could be exercised increased by 5,673,540.

[68] Multiplying $1.01 by 618,275 additional shares under the options equals approximately $624,500; and multiplying $1.20 by 5,673,540 additional shares under the warrants equals roughly $6.8 million. Combined, the aggregate purchase price for additional shares available under both instruments would be roughly $7.4 million.

aggregate exercise prices: $9,726,068 for stock issued under the warrants, and $1,258,068 for stock issued under the options.

Viewing the transaction as a whole: if all those entitled to participate in the Offering exercised their subscription rights, Gulfport would in fact receive $12 million in return for an issuance of 10 million shares.[69] This issuance would trigger the anti-dilution provisions, increasing the number of shares into which the warrants and options are convertible. If the adjusted warrants and options were then exercised in full, Gulfport would issue an additional 9,350,669 shares for $10,984,136. Under no circumstance would Gulfport issue 16.3 million shares for only $12 million—the option and warrants holders cannot obtain the additional 6.3 million shares provided by operation of the anti-dilution provisions without first paying their exercise price.

If all the subscription rights were exercised, and then all of the adjusted warrants and options were exercised, Gulfport would ultimately be issuing 19,350,669 shares for $22,984,136, which amounts to an average price of $1.19 per share.[70] While Robotti's argument rightfully points out that more than

[69] Even if less than all of the subscription rights were exercised, Gulfport would still receive $12 million in return for 10 million shares by operation of the back-stop agreement.

[70] To arrive at its conclusion that the Offering caused Gulfport to issue stock for $0.70 per share, Robotti added the 6.3 million additional shares made available under the options and warrants by operation of the anti-dilution provisions to the 10 million shares issued pursuant to the Offering. It then divided the $12 million to be raised in the Offering by this 16.2 (16.3) million "new" share figure. Doing so yielded a price per share of around $0.74 . Robotti, however, failed to add the aggregate $7.4 million exercise price of the new shares made available under the options

six million new shares became available under the options and warrants as a result of the Offering, such shares would not be issued for free, but would be paid for as these instruments are exercised.

3. Robotti Otherwise Fails to Establish Personal Gain for the Defendants

The heart of Robotti's complaint may be summarized as follows: Robotti maintains that the Defendants deliberately set the Offering at $1.20 per share "for the purpose of obtaining personal benefits not available to other shareholder[s]." That price triggered the anti-dilution provisions, and thereby allowed the Defendants to acquire stock on better terms than those under which the holders of the subscription rights participated in the Offering.[71] Robotti essentially "alleges self-dealing by fiduciaries," as to both the Board at the time of the transaction and Gulfport's controlling shareholder, "all of whom owed fiduciary duties to the corporation."[72]

A stockholder seeking to overcome a Rule 12(b)(6) challenge to its claim that a transaction was approved by a board with a majority of its directors interested in a transaction must allege, as to at least half of the board, facts that create a reasonable ground to infer that those directors had a material interest in the transaction and that such interest was inconsistent with that of the corporation. A

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and warrants to the $12 million Offering price. Dividing this $19.4 million figure by 16.3 million shares yields a $1.19 share price.

[71] Pl.'s Answering Br. at 5.

[72] *Id.* at 18.

director will be considered interested if he or she engaged in self-dealing, or otherwise stood on both sides of the transaction.[73] Interest may also be shown when a director authorized a transaction with the expectation of receiving a personal financial benefit not available to the other shareholders generally.[74]

The Prospectus shows that the options held by the directors were originally exercisable into 627,337 shares of Gulfport common stock at a price of $2.00 per share, which amounts to an aggregate $1,254,674 exercise price. After, and as a result of the Offering, the options could be converted into 1,245,612 shares of common stock for $1.01 a share. Thus the number of shares into which the options could be converted increased 98.55% as a result of the anti-dilution provisions. Through the Offering, however, Gulfport intended to issue an additional 10 million shares of common stock. As there were 10,146,566 shares outstanding immediately before the Offering, this 10 million share increase represented an identical 98.55% increase in new equity.

Thus, the anti-dilution provisions, once triggered, increased the number of shares that could be purchased under the options by the same percentage as the subscription rights, when exercised, would increase the total number of shares outstanding. The anti-dilution provisions essentially allowed the option holders to

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[73] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1169 (Del. 1995).
[74] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (*overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)).

stand in the same position as the shareholders in terms of the percentage increase in the number of shares they could each acquire through the Offering. Robotti therefore cannot argue that the anti-dilution provisions caused the Defendants to acquire a greater equity interest under the Offering than the common shareholders: both the option-holders and the common shareholders who exercised their rights increased their respective equity positions in lock-step by the same 98.55%.

Here is the effect of the anti-dilution provisions upon the options from a different perspective: before the Offering, had the options been fully exercised, the resulting shares would have represented 5.822% of all the common stock outstanding. After the Offering, had the options been fully exercised into the now adjusted figure, the resulting shares would still have represented 5.822% of all the common stock outstanding, including of course the new stock issued in the Offering. Thus, the anti-dilution provisions, in regard to the options, preserved the option holders' pre-Offering equity position by allowing them to pay the same aggregate price after the Offering as they would have paid before the Offering, and all for the same Gulfport equity stake.[75] Instead of diluting the other shareholders,

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[75] Although Gulfport reported that the anti-dilution provisions would adjust the post-Offering option exercise price based on, in part, the "subscription price per share of the rights issued in this rights offering," it appears that the determinative factor in the option adjustment was the number of shares to be issued through the Offering. Prospectus at 22. As explained above, the anti-dilution provisions increased the number of shares to be purchased under the options by the same percentage as the total shares increased pursuant to the Offering. After the Offering, the option holders had the right to purchase 98.55% more shares under their options, or 1,245,612 shares. The exercise price of the options was then adjusted downward by dividing the

the anti-dilution provisions prevented the Defendants from being diluted by those shareholders participating in the Offering.[76]

It is true that the directors (as option holders), after the Offering, could purchase common stock under their options for only $1.01 a share while the shareholders could purchase stock in the Offering for $1.20 a share. Although it may seem as though the directors therefore received a benefit that did not accrue to the shareholders, this is a result of their pre-Offering (and otherwise unchallenged) contractual rights under the option agreements. The directors had the right to purchase 5.822% of Gulfport's equity for $1,254,674. By triggering the anti-dilution provisions, the Defendants did not confer upon themselves a benefit but instead maintained an interest that they had held since the options were granted.[77] Robotti does not challenge the actual grant of the options and therefore cannot now challenge the directors' right to 5.822% of the Gulfport equity for $1,254,674.

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total number of shares into which the options could be exercised into the pre-Offering aggregate option exercise price ($1,254,674) to arrive at $1.0072 a share, or, when rounded to the nearest cent, $1.01 per share.

[76] In fact, Gulfport warned the shareholders that, by not participating in the Offering, they would face substantial dilution. Prospectus at 9 ("To the extent a stockholder does not exercise its rights in full, such stockholder's voting power and percentage equity interest in the Company, including its percentage interests in any future earnings, will suffer substantial dilution.").

[77] With the influx of proceeds from the Offering, the value of that same percentage may have increased; that, however, is a contention that Robotti has not advanced.

Robotti is unable, from its well-pled factual allegations, to support the inference that the Defendants received a personal benefit from the Offering.[78] The Defendants had pre-existing contractual rights to a percentage of Gulfport's equity at a predetermined price. The anti-dilution provisions preserved these rights and allowed the directors to purchase the same pre-Offering amount of equity for the same aggregate pre-Offering price after the Offering's near doubling of the outstanding common stock at a price below market value.[79] Although the option's price per share was in fact lowered to $1.01, this result was necessary to preserve the value of the directors' options, and in any event, represented a contractually established price for a percentage of equity agreed upon before the Offering. Of further importance, the anti-dilution provisions allowed the Defendants to increase their stock holdings by the same percentage as the Offering permitted the shareholders to increase their shares.[80]

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[78] Even if the Court assumes that some special benefit resulted from the anti-dilution provisions protecting the options, nothing before the Court suggests that such benefits were in any way material to a majority of the Board. *See infra* note 98 & accompanying text.

[79] Because, as even Robotti acknowledges, a successful rights offering will be priced below market value of the underlying shares to assure, to the extent possible, full subscription, Compl. ¶ 56; some loss in value of the shares outstanding before the offering is likely, simply as the result of averaging.

[80] The effect of the anti-dilution provisions upon the warrants merits discussion here. As stated previously, before the Offering, the warrants were exercisable into 2,431,517 shares of common stock at a price of $4.00 per share for an aggregate $9,726,068. After the Offering, those same warrants could be exercised into 8,105,057 shares of common stock at $1.20 per share, and again for the same aggregate $9,726,068. As explained in the Prospectus, the per share price for the shares underlying the warrants was simply ratcheted down to $1.20, and this price was then divided into the original aggregate purchase price to arrive at the total number of shares then available under the warrants after the Offering.

Unlike the options, the anti-dilution provisions did not merely prevent the warrant holders from suffering dilution, but rather allowed them to increase their stake in Gulfport. While the options were adjusted to allow for a 98.55% increase in their underlying shares—an amount commensurate with the percentage increase in the shares issued to the subscription rights holders in the Offering—the warrants were adjusted to allow for a 233.33% increase in their underlying shares. And while the options were adjusted based upon the number of shares issued in the Offering, the warrants were simply readjusted based upon the Offering's per share price—the lower the price of the subscription rights, the cheaper the price per share available under the warrants and the more equity the warrant holders could purchase for the same total investment under these instruments.

As an additional matter of contrast, the option holders were entitled to the same amount of equity after the Offering as they were before, and all for the same aggregate purchase price; the warrant holders, on the other hand, could acquire either the same amount of equity after the Offering as they could before but for less consideration, or could acquire a greater total amount of equity but for no more than the original aggregate consideration. Thus, while the option holders could acquire 5.822% of Gulfport's equity both before and after the Offering, and do so at either time for $1.26 million, the warrant holders were entitled to 19.33% of Gulfport's equity before the Offering, and 28.7% after, but for the same $9.73 million in consideration.

This last point regarding transactional arithmetic leads to a final conclusion: although the anti-dilution provisions allowed the option holders to withstand the possible dilution they faced from the participating rights holders, it did not entirely protect them from the dilution they would face from the warrant holders if the warrants were fully exercised after the Offering. On a fully diluted basis that accounts for exercise of the warrants, the option holders were entitled to 4.75% of Gulfport's equity before the Offering, but only 4.22% after. The warrant holders, also on a fully diluted basis that accounts for exercise of the options, were entitled to 18.41% of Gulfport's equity before the Offering and 27.48% after.

Whether CD Holding, which owned most of the warrants, engaged in self-dealing is not directly at issue because it was never served in this action. More importantly, Robotti has not alleged that the Defendants were beholden to the controlling shareholder at the time of the challenged transaction and therefore lacked independence with respect to the Offering. *See In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 363 (Del. Ch. 2008) (holding that a plaintiff may establish disloyalty by showing that a majority of the board suffers either from "a disabling interest or *lack of independence*") (emphasis added). Perhaps it could have been argued that the Defendants were dominated by Davidson or CD Holding, as the controlling shareholder, and, as a consequence, the Offering was carried out. Although Robotti claims that the Defendants and the controlling shareholder worked together, Compl. ¶ 15, it provides no analysis of the directors' independence at the time of the Offering in either the Complaint or its Answering Brief. In fact, Robotti does not even analyze the difference in the application of the anti-dilution provisions to the options and the warrants. Robotti, instead, argues only that the directors themselves had a personal interest in the transaction because of the alleged effect of the anti-dilution provisions upon their options. *See* Compl. ¶¶ 15-16. ("Thus, at the time the transaction was first disclosed and approved each of the directors was interested in the transaction."); *see also* Pl.'s Answering Br. at 31 (arguing that demand was excused as to the Defendants at the time of the Offering because "[t]he Complaint very specifically alleges that they personally benefited from the challenged transaction"). Thus, the Court need only determine whether the

4. Insofar as Robotti Seeks to Allege Bad Faith, That Inference Also Cannot be Drawn from the Facts as Alleged

Although Robotti alleges self-dealing many times throughout the Complaint and its answering brief in response to the Defendants' Motion to Dismiss, it also implies that the Defendants acted in bad faith by consciously disregarding Gulfport's interests.[81] Its Complaint asserts that the Directors failed to consider the effects of the Offering and its allegedly low price, while its answering brief states that "the Complaint alleges . . . conscious disregard of the interests of the corporation and the rights of the shareholders."[82] Assuming that such a theory has been set forth, it is not supported by the facts as alleged.

The methodology for analyzing allegations of bad faith within the context of a duty of loyalty claim has been set forth in *Lyondell Chemical Co. v. Ryan*.[83] Mere gross negligence, which includes the failure to inform one's self of available material facts, cannot constitute bad faith.[84] Bad faith, and thus a breach of the duty of loyalty, can arise only when a fiduciary consciously disregards his or her responsibilities.[85] The Court in *Lyondell* imposed a high standard on any plaintiff

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Complaint adequately alleges that the Defendants engaged in self-dealing on their own behalf, and not whether they breached the duty of loyalty by being beholden to, and acting for, the controlling shareholder.

[81] Robotti does not formally assert a duty of care claim, nor could it, because Gulfport's charter contains a § 102(b)(7) exculpatory provision.

[82] Pl.'s Answering Br. at 20. The Complaint does not specifically make this allegation.

[83] 970 A.2d 235 (Del. 2009).

[84] *Id.* at 240.

[85] *Id.*

advancing such a claim, and recognized a "vast difference between [an] inadequate or flawed effort to carry out fiduciary duties and a conscious disregard of those duties."[86] It concluded that fiduciaries in this context breach their duty of loyalty only if they "knowingly and completely fail to undertake their responsibilities."[87]

Robotti has never claimed that the Defendants "knowingly and completely" failed to undertake their responsibilities, nor may any such inference be drawn from the Complaint. Instead, Robotti argues that the Defendants failed to consider certain aspects of the Offering, including the effect that the low price would have on the anti-dilution provisions, alternative methods of financing, and even the need for the transaction.[88] Even if the Defendants did not consider these issues as thoroughly as they should or could have, the alleged facts show that the Defendants did not completely abdicate their fiduciary responsibilities: they met several times to discuss the Offering; it is undisputed that Gulfport was short on capital and thus needed to raise funds; and indeed, the Board considered the sale of an oil field as an alternative method of financing.

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[86] *Id.* at 243.
[87] *Id.* at 243-44.
[88] Robotti also alleged that the Prospectus contained inaccurate information, but it made clear that it was not bringing a disclosure claim. Robotti's apparent purpose for this contention is to attempt to show that the Defendants were trying to conceal their self-dealing. The consequences of the Offering for the shareholders generally were disclosed reasonably well. Whether the reasons for (or necessity of) the Offering were disclosed reasonably well might be fairly debated, but it is not a debate framed by the parties for the Court.

Thus, although the Defendants may have never fully explained why they chose to price the Offering below the option and warrant strike prices, the Court cannot reasonably infer that the Defendants completely disregarded their responsibilities to the corporation and its shareholders and therefore acted in bad faith.

5. The Business Judgment Rule Applies

Since Robotti has failed to plead that the Defendants either received a personal benefit or consciously disregarded their duties, the Defendants' decision to initiate the Offering and price it at $1.20 a share is not for the Court to second guess.

The business judgment rule, as a general matter, protects directors from liability for their decisions so long as there exist "a business decision, disinterestedness and independence, due care, good faith and no abuse of discretion and a challenged decision does not constitute fraud, illegality, ultra vires conduct or waste."[89] There is a presumption that directors have acted in accordance with each of these elements, and this presumption cannot be overcome unless the complaint pleads specific facts demonstrating otherwise.[90] Put another way, under the business judgment rule, the Court will not invalidate a board's decision or

[89] 1 Stephen A. Radin et al., *The Business Judgment Rule: Fiduciary Duties for Corporate Directors* 110 (6th ed. 2009).
[90] *Id.*

question its reasonableness, so long as its decision can be attributed to a rational business purpose.[91]

Robotti has been unable to allege that the Defendants were interested in the challenged transaction. Additionally, it has failed to allege bad faith or a conscious disregard of fiduciary duty. Although Robotti may have plead sufficient facts to permit a conclusion that the board failed to act with due care and on an informed basis regarding the transaction, such a conclusion would be unavailing in light of the § 102(b)(7) provision in Gulfport's charter, which precludes a claim for damages on that ground. For these reasons, the Defendants' decision to initiate an offering priced at $1.20 will not be disturbed by the Court.

D. *Demand Excusal*

Because Robotti's claims are largely derivative, it should have made demand on the board before amending its pleadings to sponsor such a claim, or alternatively, pleaded demand excusal with particularity under Court of Chancery Rule 23.1. Under Rule 23.1, when filing a derivative claim, the plaintiff must allege with particularity the efforts made to obtain the action the plaintiff desires from the directors or the reasons for the plaintiff's failure to obtain the action or for not making the effort.[92] Rule 23.1(a) exists to give the directors an opportunity to

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[91] *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 n.17 (Del. 1994).
[92] Ct. Ch. R. 23.1(a).

rectify the alleged wrong without the expense of a lawsuit, or if such lawsuit must be brought, to allow the corporation to control the litigation.[93]

The demand requirement also rests upon the presumption that the directors will adhere faithfully to their fiduciary duties.[94] The plaintiff, however, may rebut this presumption, and thus excuse his obligation under Rule 23.1, by creating a reasonable doubt that a majority of the board could have acted independently and without a disabling interest in responding to the demand.[95] A director will be considered incapable of acting objectively to a presuit demand "if he or she is interested in the outcome of the litigation or is otherwise not independent."[96]

Interest can be shown when a director will receive a personal benefit from a transaction not shared equally by the remaining shareholders, and also when a

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[93] *See Ryan v. Gifford*, 918 A.2d 341, 352 (Del. Ch. 2007) (stating that the demand requirement works to curb frivolous lawsuits, which may distract management with litigation and diminish the board's authority to govern corporate affairs).

[94] *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

[95] *Id.* at 1049. There is some debate over when this inquiry should have taken place: at the time when this action was filed or at the time Robotti filed the (Second Amended) Complaint to specify that its claims were derivative. The critical time is when Robotti first presented its derivative claim as such, which was December 22, 2008, when the (Second Amended) Complaint was filed. Until then, there was no claim asserting the rights of the corporation for the directors to assess.

[96] *Id.* Robotti argues that the Board's approval of the Offering was not the result of a valid business decision, and that demand should therefore be excused under the second prong of the test articulated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). Under *Rales v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993), however, the relevant inquiry is only whether the board can exercise its independent and disinterested judgment in responding to a demand, where, as here, the board made a business decision but a majority of the directors responsible for that decision have since been replaced. *See also Ryan*, 918 A.2d at 353 n.29 ("where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced . . . it would be inappropriate to challenge the business judgment of [the] current board under Rule 23.1." (citing *Rales*, 634 A.2d at 932-35)).

personal benefit or detriment may go to the director as a result of the decision to pursue litigation.[97] In the demand excusal context, this Court has required that the plaintiff do more than allege that the director is interested because he or she received a benefit or detriment not shared or incurred by the stockholders generally; instead, the plaintiff must allege that this interest is material to that director.[98] Thus, the plaintiff must show that the "alleged benefit was significant enough '*in the context of the director's economic circumstances,* as to have made it improbable that the director could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest.'"[99]

Determining whether a director is otherwise not independent involves a contextual inquiry. In making this evaluation, the Court must ask whether the directors are so "beholden" to an interested director or interested controlling shareholder, that their "discretion would be sterilized."[100] Various motivations, "including friendship," may influence this inquiry; "[b]ut, to render a director

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[97] *Beam*, 845 A.2d at 1049; *Rales*, 634 A.2d at 936.
[98] *See Transkaryotic*, 954 A.2d at 364 ("Importantly, the mere fact that a director received some benefit that was not shared generally by all shareholders is insufficient; the benefit must be material."); *see also Cinerama*, 663 A.2d at 1169 (distinguishing self-dealing—"when a director deals directly with a corporation, or has a stake in or is an officer or director of a firm that deals with a corporation"—from "incidental director interest," which, to be disqualifying, "must be substantial").
[99] *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002) (quoting *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 617 (Del. Ch. 1999) (emphasis in original)).
[100] *Rales*, 634 A.2d at 936.

unable to consider demand, a relationship must be of a bias-producing nature."[101] The Supreme Court has held that mere personal or business friendships will not raise a reasonable inference that a director cannot consider demand without specific factual allegations to support this conclusion.[102] The Court demanded that the complaint identify a relationship between the disinterested director and the interested director or controlling shareholder "that is so close" that one could infer that "the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."[103]

Robotti has not alleged that it made demand upon Gulfport's board at the time the derivative claim was added, and thus the inquiry turns to whether it adequately pleaded demand excusal. When Robotti's complaint was amended to include its derivative claim, the Gulfport board consisted of Mike Liddell, David L. Houston, James Palm, Scott Streller, and Donald Dillingham (the "Demand Board"). Even assuming for purposes of this section only that the Offering worked the Defendants a personal benefit not shared by the remaining stockholders,

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[101] *Beam*, 845 A.2d at 1050.

[102] *Id.*; *see also Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *9 (Del. Ch. Dec. 18, 2002) ("Our cases have determined that personal friendships, without more; outside business relationships, without more; and approving of or acquiescing in the challenged transactions, without more, are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment.").

[103] *Beam*, 845 A.2d at 1051-52 (holding that "this doubt might arise either because of financial ties, familial affinity, a particularly close or intimate personal or business affinity or because of evidence that in the past the relationship caused the director to act non-independently vis à vis an interested director."); *see also Rales*, 634 A.2d at 937 (finding reasonable doubt that disinterested directors lacked independence due to their employment with entities affiliated with interested directors).

Robotti has failed to plead demand excusal with particularity as to a majority of these directors.

1. Mike Liddell

Mike Liddell has served as a Gulfport director since 1997, and has been its Chairman since 1998. In addition, he served as Gulfport's Chief Executive Officer from 1998 to 2000, and was also its President in 2000. The Complaint alleges that Liddell was interested in the Offering because "he received a personal benefit not available to all stockholders" in that he held options exercisable into 457,720 shares of common stock at the time of the Offering.[104] It also insinuates, but does not state directly, that Liddell cannot exercise independent judgment to evaluate the derivative claim because of his "numerous other relationships" with Charles Davidson. Specifically, the Complaint alleges that Liddell and Charles Davidson "have a long standing history of engaging in business together and acting together as stockholders," and names their joint investment in DLB Oil and Gas in the 1990's as an example.[105]

The Complaint also alleges that Liddell, along with Wexford—a Davidson affiliate—owned the membership interest in Windsor Energy Holdings, L.L.C. and that Gulfport provided managerial and administrative services to this entity from 2003 through the first three months of 2006. In addition, Robotti claims that Mike

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[104] *Id.* at ¶ 15.
[105] *Id.* at ¶ 22.

Liddell has served since either May or December 2005 as the President and Chief Executive Officer of Windsor Energy Group, L.L.C., which is owned 50% by Wexford. Finally, at the time Robotti filed its Second Amended Complaint, Mike Liddell also served as Chairman of the Board and Director of Diamondback Energy Services, Inc., which is 100% owned by Wexford.[106]

Without deciding whether there is reason to doubt Liddell's disinterestedness and independence from CD Holding, the Court will assume, for purposes of the pending motion, that the Complaint successfully alleges that his loyalty was compromised at the time the derivative claims were added.

2. <u>James Palm</u>

Palm has served as Gulfport's Chief Executive Officer since December 2005. The Complaint alleges that he received $585,178 in compensation in 2006 and $590,398 in 2007. In addition, Robotti claims that, "as openly admitted by the Company as late as April 21, 2008," Gulfport's Compensation Committee has not determined the chief executive officer's compensation. For this reason, it concludes that Mike Liddell and the controlling shareholder exercised direct control over Palm's compensation because CD Holding, with Mike Liddell, allegedly "exercised *de facto* control over the Company."[107] Indeed, due to Palm's

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[106] *Id.*
[107] *Id.* at ¶ 19. As of April 2008 CD Holding owned 35.7% of Gulfport. *Id.* at ¶ 28. It is therefore debatable as to whether CD Holding (or perhaps more accurately, Davidson) still

considerable salary and status as an inside director, the Court is skeptical of his ability to objectively evaluate a claim against Liddell. Thus, Robotti has created sufficient reason to doubt Palm's independence.

3. David Houston

David L. Houston has served as a Gulfport director since 1998. He held options exercisable into 20,000 shares of common stock at the time of the Offering, and for this reason Robotti argues that Houston received a personal benefit in the transaction not shared by the other shareholders and is now interested in the litigation.[108] Robotti also claims that "[e]ven were Mr. Houston not interested in the transaction in question he would not be independent."[109] In support of this allegation, it states that Houston has served on the board of Bronco Drilling Company for at least two years (2007 and 2008) and that Bronco is affiliated with Wexford. Wexford allegedly owned 13% of Bronco's stock, which made it Bronco's second largest shareholder. Wexford was also a major Bronco customer and supplier, specifically transacting $5.6 million in business with Bronco during 2007, a year in which it earned total profits of $37 million. The Complaint lists Houston's compensation from Bronco at $81,484 in 2006, and $70,267 in 2007,

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controlled Gulfport at the time. The Court will assume this to be the case for the purposes of this memorandum opinion because it concludes that Robotti's pleadings have not overcome the presumption that a majority of the board was independent and disinterested in any event.

[108] *Id.* at ¶¶ 15-16.

[109] *Id.* at ¶ 27.

and concludes that this compensation, combined with the roughly $20,000 in annual director fees that Houston earns from Gulfport, "precludes him from acting independently" of Liddell and the controlling shareholder.[110]

Unlike Mike Liddell, whose options were convertible into a substantial number of shares both before and after the Offering, Houston's options were convertible into only 20,000 shares before the Offering, and slightly less than 40,000 shares after the Offering. Even if the Court assumes for purposes of this section only that operation of the anti-dilution provisions upon the agreements governing the options worked the option-holders a benefit not shared by the stockholders generally, Robotti has still failed to allege how such a benefit could be material to Houston given the number of shares into which his options could be converted.[111] In fact, Robotti presents no argument as to why this amount is material and thus why it would cast doubt as to Houston's ability to act objectively for the Company's interest and not on his own behalf.

Regarding Houston's independence, the Complaint does no more than suggest that the director fees from Gulfport and Bronco made Houston beholden to Liddell and CD Holding.[112] Annual compensation totaling roughly $100,000,

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[110] *Id.*

[111] The "new" shares that Houston had the right to purchase after the Offering represented only .12% of all the shares issued and made available under the options and warrants, as a result of the Offering.

[112] It also argues that Houston's service on the inactive Compensation Committee indicates that he acquiesced in the wishes of Liddell and CD Holding. This allegation, however, only suggests

certainly not a pittance, cannot be viewed as an unreasonable sum for two directorships, and director compensation, standing alone, cannot be the basis for asserting a lack of independence.[113] In addition, there is no allegation of fact showing that CD Holding or its affiliates controlled Bronco and thus controlled Houston's directorial compensation from that entity; instead, the Complaint merely alleges that Wexford owned a large percentage of Bronco stock and was an important customer.

4. Scott Streller and Donald Dillingham

Robotti claims that both Streller and Dillingham could not act independently from Liddell and CD Holding. It asserts that, in addition to serving on the Gulfport board, Scott Streller was also a nominee for the board of Diamondback Energy Services—another CD Holding affiliate—at the time Robotti amended its complaint. Diamondback intended to compensate its directors $12,000 a year and give them 6,667 shares of stock in 2008.[114] Robotti states that Streller received $40,231 from Gulfport in director compensation in 2007, and that he received $15,638 in 2006 for serving as director during part of the year. It concedes that

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that Houston was not meeting his responsibilities as a member of that committee by virtue of his inactivity. It sheds little, if any, light on whether he was independent of CD Holding or Liddell.

[113] *See In re The Limited, Inc. S'holders Litig.*, 2002 WL 537692, at *4 (Del. Ch. Mar. 27, 2002) ("Allegations as to one's position as a director and the receipt of director's fees, without more . . . are not enough for purposes of pleading demand futility.") (citation omitted).

[114] Compl. ¶ 22.

Streller's principal income came from the sale of insurance, and it alleges no connection between his insurance activities and Gulfport or its affiliates.[115]

Robotti alleges that Dillingham had "substantial other ties to Mike Liddell and Wexford,"[116] but does not explain, with particularity or otherwise, what these ties may have been. It claims that two of his other business activities were defunct, and thus argues that his director compensation from Gulfport was material to him as one of his primary sources of income. It concedes, however, that he could have received $100,000 a year from his employment as a Senior Portfolio Advisor to Avondale Investments, for which Robotti makes no allegations concerning possible affiliation with Gulfport or CD Holding.[117]

As with Houston, Robotti has failed to raise a reasonable doubt regarding Streller and Dillingham's independence.[118] As described above, director compensation alone cannot create a reasonable basis to doubt a director's impartiality. Robotti cites only Streller and Dillinghams' current compensation as Gulfport directors and the potential compensation they could have received for sitting on the Diamondback Board, of which they were nominees at the time the

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[115] *Id.* at ¶ 28. Streller currently operates an agency for Farmer's Insurance and Farmer's Financial Solutions. *Id.*
[116] *Id.* at ¶ 29.
[117] *Id.* The Complaint suggests that Dillingham has also been nominated to the Diamondback board, but does not say so expressly or elaborate in any detail. *Id.*
[118] Robotti also argues that Streller's membership on the defunct compensation committee indicates his lack of independence. This is substantially the same argument which Robotti made with respect to Houston's service on the same committee. *See supra* note 112.

second complaint was amended. The two directors also seemed to have received ample compensation from independent outside sources, which diminished the materiality of their director fees. The facts as alleged are therefore insufficient to support demand excusal.

Although Robotti raised a reasonable doubt regarding Mike Liddell and James Palm's independence, it has not done the same for David Houston, Scott Streller, and Donald Dillingham. Because a majority of the Demand Board was independent and disinterested, Robotti has not sufficiently pleaded demand futility. To the extent that its claims are derivative, those claims must be dismissed on this basis as well.

V. CONCLUSION

Robotti has failed to state a claim upon which relief can be granted. For one, the Plaintiff's claim is derivative in part and Robotti failed to adequately plead demand excusal. More importantly, based upon the facts as alleged, the Court cannot conclude that the Defendants received a personal benefit in the challenged transaction that was not either shared by the public shareholders or owed to the Defendants before they proceeded with the Offering. Thus, the Plaintiff's claim for self-dealing by interested fiduciaries fails as a matter of law. Additionally, the facts do not support an inference that the Defendants consciously disregarded their

fiduciary duties or entirely abdicated their responsibilities. The Complaint is therefore dismissed.

An implementing order will be entered.