

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE  
IN AND FOR NEW CASTLE COUNTY

DHRUV KHANNA, PATRICK SAMS, and )  
SYBIL MEISEL, derivatively, and on behalf )  
of all those similarly situated, )  
Plaintiffs, )

v. )

C.A. No. 20545 NC

CHARLES MCMINN, DANIEL LYNCH, )  
FRANK MARSHALL, RICH SHAPERO, )  
ROBERT HAWK, ROBERT E. )  
KNOWLING, JR., DEBRA DUNN, )  
HELLENE RUNTAGH, LARRY IRVING, )  
CHARLES HOFFMAN, L. DALE CRANDALL, )  
RICHARD A. JALKUT, and )  
CROSSPOINT VENTURE PARTNERS, L.P., )  
Defendants, )

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and )

COVAD COMMUNICATIONS GROUP, )  
INC, a Delaware corporation, )  
Nominal Defendant. )

**PLAINTIFFS' ANSWERING BRIEF IN OPPOSITION TO DEFENDANT  
CROSSPOINT VENTURE PARTNERS, L.P.' S MOTION TO DISMISS  
AMENDED DERIVATIVE AND CLASS ACTION COMPLAINT**

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DATED: November 19, 2004

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## PRELIMINARY STATEMENT

This case challenges a series of transactions entered into by Covad Communications Group, Inc. (“Covad” or the “Company”) solely for the benefit of certain directors of Covad and their own personal outside investments. The major force behind this scheme was defendant Crosspoint Venture Partners, L.P. (“Crosspoint”), a significant shareholder of Covad. Crosspoint not only had its own two designees on Covad’s Board (defendants Rich Shapero (“Shapero”) and Robert Hawk (“Hawk”)), but also two of its business partners (defendants Charles McMinn (“McMinn”) and Frank Marshall (“Marshall”)). Those directors alone gave Crosspoint sufficient control over Covad to force through its own investing agenda. Crosspoint, however, also had the benefit of the support of the Company’s CEOs (who sat on the Board and whose compensation was controlled by Shapero) and numerous other directors who have various disabling conflicts.

Crosspoint caused Covad to enter into multiple highly unfavorable transactions with companies in which Crosspoint had a financial interest. The results were, predictably, disastrous for Covad. Plaintiff Dhruv Khanna (“Khanna”), a co-founder of Covad, protested against the self-dealing, and was summarily fired by the Crosspoint-dominated Board. After successfully pursuing his right under 8 *Del. C.* § 220 to inspect Covad’s corporate records, Khanna discovered that Crosspoint had not only caused Covad to enter into these harmful transactions but had also usurped Covad’s corporate opportunity in founding a company. Khanna amended his complaint (“Amended

Complaint”) and was joined in the suit by two other Covad shareholders, Patrick Sams and Sybil Meisel.

Crosspoint seeks to dismiss this action on a number of grounds, all equally without merit. First, Crosspoint argues that plaintiffs have failed to state a claim for Crosspoint’s usurpation of Covad’s corporate opportunity because the claim is time-barred. Opening Brief in Support of Defendant Crosspoint Venture Partners, L.P.’s Motion to Dismiss Amended Derivative and Class Action Complaint (“Crosspoint Motion to Dismiss”), at 8. What Crosspoint conveniently overlooks is that while the usurpation occurred in 1999, plaintiffs could not have discovered Crosspoint’s role in it because Crosspoint’s involvement in the transaction was never disclosed to Covad’s shareholders. Plaintiffs only learned of Crosspoint’s usurpation as a result of the § 220 production made in May 2004, and under the inherently unknowable injuries doctrine, the statute of limitations was tolled until that time. *Official Comm. of Unsecured Creditors of Integ. Health Servs., Inc. v. Elkins*, 2004 WL 1949290, at \*8 (Del. Ch.); *In re Dean Witter P’ship Litig.*, 1998 WL 442456, at \*5 (Del. Ch.).

Crosspoint next contends that the usurpation claim must be dismissed because the Amended Complaint does not allege a basis for finding that Crosspoint owed any fiduciary duty to Covad. Crosspoint Motion to Dismiss, at 8-11. The Amended Complaint, however, is replete with factual allegations establishing that Crosspoint not only had – but exercised – complete control over Covad’s business affairs.

Crosspoint argues that plaintiffs’ respondeat superior claim fails because plaintiffs have not adequately pled that Shapero or Hawk breached their fiduciary duties to Covad

in connection with the Certive or the BlueStar transactions because the claims are time-barred and the transactions satisfy the safe harbor of 8 *Del. C.* § 144. Crosspoint Motion to Dismiss, at 12-15. Crosspoint is wrong on both counts. The Certive claims cannot be time-barred because plaintiffs had no way to know Shapero and Hawk's actions on the transaction until they received the § 220 production in May 2004. The BlueStar merger claim is not time-barred because a cause of action did not accrue until the merger was completed on September 22, 2000. *Dofflemyer v. W.F. Hall Printing Co.*, 558 F. Supp. 372, 379 (D. Del. 1983). The BlueStar earnout payment giving rise to the earn out claim occurred in April 2001 – certainly well within the three year statute of limitations.

Crosspoint has not even attempted to meet its burden of demonstrating that the Certive and BlueStar transactions meet the requirements of § 144, nor could it do so. There was no approval of the Certive transaction by a majority of disinterested and independent directors. Hawk, an admittedly interested director, voted in favor of the Certive transaction, as did three other directors who lacked independence from Crosspoint. As to the BlueStar merger, Crosspoint cannot establish that the Board was informed of Hawk's personal interest in BlueStar, and as such, has not met a requirement of § 144. As with Certive, the BlueStar merger was not approved by a majority of disinterested and independent directors. The BlueStar earnout payment was approved by a single director who lacked independence from Crosspoint.

Crosspoint also contends that the respondeat superior claim is barred as a matter of law by this Court's decision in *Emerson Radio Corp. v. Int'l Jensen Inc.*, 1996 WL 483086 (Del. Ch.). Crosspoint Motion to Dismiss, at 15-17. *Emerson* stands for no such

proposition. Rather, *Emerson* holds only that where plaintiffs cannot allege any facts supporting a contention that a shareholder controls a corporation's business affairs, they cannot rely on an imputation as a matter of law of the fiduciary duties of that shareholder's designee on the board to the shareholder. Such is not the case here. Ample facts showing control have been pled.

Finally, Crosspoint argues that plaintiffs have not alleged the necessary knowing participation element of an aider and abettor claim. Crosspoint Motion to Dismiss, at 17-22. The Amended Complaint, however, is replete with factual allegations (all ignored by Crosspoint) from which the Court can infer that Crosspoint knowingly participated in the Covad directors' breaches of fiduciary duty.

#### **NATURE AND STAGE OF THE PROCEEDINGS**

Khanna brought this action on September 15, 2003. He had previously brought a § 220 proceeding against Covad, but that action was not fully adjudicated until January 2004. After receiving Covad's § 220 production in May 2004, Khanna amended the complaint. Two new plaintiffs, Patrick Sams and Sybil Meisel, joined the action with the filing of the Amended Complaint.

Plaintiffs were forced to file the Amended Complaint under seal because Covad had designated its entire § 220 production confidential pursuant to a confidentiality stipulation entered in this action. Plaintiffs challenged the confidentiality designation of the information in the Amended Complaint under Chancery Court Rule 5, and Covad responded on August 12, 2004 with a motion for the continued sealing of the Amended Complaint. On August 23, 2004, Covad moved to strike certain allegations in the

Amended Complaint as revealing Covad's attorney-client privileged information. Covad also moved on August 23, 2004 to disqualify the plaintiffs.

Covad, the director defendants and Crosspoint each filed motions to dismiss this action under Chancery Court Rules 23.1 and 12(b)(6) on August 23, 2004. Crosspoint filed its opening brief in support of its motion to dismiss on October 8, 2004. This is plaintiffs' answering brief on that motion.

### FACTUAL STATEMENT

Defendant McMinn, along with plaintiff Dhruv Khanna and another investor, founded Covad in the late 1990s. Amended Derivative and Class Action Complaint ("Am. Compl.") ¶¶ 5, 8. McMinn, the Company's first Chairman and CEO, was business partners with Crosspoint and good friends with its Managing General Partner, Shapero. Am. Compl. ¶¶ 11, 34. Shapero and Defendant Robert Hawk ("Hawk"), a special limited partner in Crosspoint, joined McMinn on Covad's Board. *Id.* ¶¶ 11, 12, 34 & 36. Defendant Frank Marshall ("Marshall"), another of McMinn's lifelong friends and a co-investor with Crosspoint, rounded out the McMinn cronies on the Covad Board. *Id.* ¶¶ 10, 35.

McMinn, Shapero and Hawk caused Covad to enter into a series of transactions designed to bolster their own personal investments. The terms and conditions of Covad's investments in these companies were always shockingly unfair to Covad – in certain of them Covad paid three times as much for its shares as Crosspoint and McMinn did for their shares only three weeks prior. An examination of each of the transactions, set forth

below, reveals the rampant self-dealing by Crosspoint and certain of Covad's directors and the acquiescence therein by the directors they dominated.

**I. THE SELF-DEALING TRANSACTIONS.**

**A. THE CERTIVE TRANSACTION.**

By May 1999, McMinn had successfully launched Covad and was anxious to pursue other investment opportunities with and on behalf of Crosspoint. *Id.* ¶ 42. He informed Covad's CEO, defendant Robert Knowling ("Knowling") by email dated May 3, 1999 that he was actively pursuing his own personal investment opportunities with Crosspoint, and was on the verge of taking a board seat and advisor position with a Crosspoint affiliate. *Id.* He wrote to Knowling, "[t]he taking of board seats [with Crosspoint affiliates] and coming up with ideas that Crosspoint and I could invest in is what [C]rosspoint wanted me to do and what I thought we had agreed to with me helping them." *Id.*

McMinn's justification for this shocking lack of loyalty to Covad was that "these would be deals that Covad would benefit from [and] that Covad may or may not want to invest in/partner with." *Id.* ¶ 44. There is no mention in the McMinn/Knowling email chain that McMinn should be looking for investment and/or acquisition transactions for Covad only – instead of for himself and Crosspoint. Knowling responded that "I trust you and Rich [Shapero - General Partner and Managing Partner of Crosspoint]" and that

“[t]he manner in which you are approaching the Crosspoint relationship is good.” *Id.*  
¶ 46.<sup>1</sup> *Id.*

The investment McMinn found for Crosspoint was the founding of a company called Certive Inc. (“Certive”), a privately-held internet company. At no time prior to September 1999 did McMinn or Crosspoint (through its designees Shapero and Hawk) offer the Certive business opportunity to Covad despite the fact that Certive, a provider of computerized data integration services, was clearly within Covad’s line of business. *Id.*  
¶ 48. Knowing, Shapero and Hawk knew that McMinn was developing Certive for himself and Crosspoint rather than for Covad – and doing it on Covad’s time to boot. *Id.*

Crosspoint and McMinn rewarded themselves handsomely in the founding of Certive. McMinn received 1,333,333 founders’ shares, and invested \$1 million for an additional 666,667 Series A Preferred shares. *Id.* ¶ 49. Crosspoint received 3 million Series A Preferred shares for an investment of \$4.5 million. *Id.* Thus, Crosspoint and McMinn received their Series A Preferred shares for \$1.50 per share. *Id.*

Crosspoint and McMinn did not offer Covad the opportunity to invest in the Certive Series A Preferred shares at the bargain-basement price of \$1.50 per share prior to or at the time they themselves were investing in Certive. *Id.* ¶¶ 51, 52. Rather, they subsequently offered Covad the right to purchase Series B-1 Preferred shares (ranking lower in the equity hierarchy than Crosspoint’s and McMinn’s shares) at three times the

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<sup>1</sup> It was not until Covad was ordered to produce documents in Khanna’s § 220 action that plaintiffs learned of McMinn’s working for Crosspoint in early 1999, the exact timing of certain of McMinn’s investment activities on behalf of himself and Crosspoint (and, therefore, also on behalf of Hawk and Shapero) and of Knowing’s assistance to and cooperation with McMinn, Shapero, Hawk and Crosspoint in that regard. Am Compl. ¶ 46.

price they had paid. *Id.* ¶ 55. They offered Covad 1,111,111 Series B-1 Preferred shares at \$4.50 per share. *Id.*

The Board met on September 22, 1999 to bless Crosspoint's and McMinn's usurpation of Covad's corporate opportunity in Certive – nearly two months after McMinn had incorporated Certive and more than one month after McMinn and Crosspoint invested in Certive's Series A Preferred Shares.<sup>2</sup> *Id.* ¶ 54. The Board expressly found that Certive was too risky a venture for Covad and that Covad would not invest in Certive. *Id.* ¶ 55. To make this action seem less offensive and suspicious, the Board adopted a corporate opportunity policy which expressly required the prior approval of the Board before a fiduciary of Covad could take a corporate opportunity for himself (“Corporate Opportunity Policy”). *Id.* The Corporate Opportunity Policy also expressly forbade any Covad director to sit on the board of or invest in a company in competition with Covad. *Id.*

Only nineteen days later, the Board abruptly reversed course and with no analysis approved an investment in Certive. *Id.* ¶ 55. Despite the Board's having stated on September 22, 1999 that Covad was not interested in “pursuing an investment in [Certive] on the terms and conditions offered to Mr. McMinn and Crosspoint” due to the “seed stage nature of [Certive] and other circumstances regarding the status and risk of [Certive],” the Board on October 11, 1999 approved Covad's investment in Certive on Certive's Series B-1 Preferred shares. *Id.* In other words, the Board had found Certive to

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<sup>2</sup> Khanna was present for only a portion of this meeting. He was asked to leave the meeting when the Board discussed and voted to approve McMinn's usurpation of the Certive opportunity and to adopt a corporate opportunity policy going forward.

be too risky to invest in at \$1.50 per share on September 22, 1999, but on October 11, 1999 the Board was willing to invest in a subordinated class of shares for \$4.50 per shares. The reason for this sudden change is obvious: in September McMinn needed the Board to reject the investment so he could mask his corporate opportunity problem. In October, McMinn needed funding for Certive. The Board added insult to injury by causing Covad to enter into a Shareholders' Rights Agreement with Crosspoint, McMinn and other shareholders which contractually bound Covad to vote its shares in favor of Crosspoint's and McMinn's designees on the Certive board. *Id.*

Despite the obvious scheme of wrongdoing perpetrated by Shapero, Hawk, Crosspoint and McMinn in founding and funding Certive, Lynch (who was a Covad director at that time and continues to serve on the Board today) and Marshall (Crosspoint's business partner) also joined and continue to serve on Certive's Advisory Board. *Id.* ¶ 56 Crosspoint (through Shapero) and McMinn caused Certive to grant stock interests in Certive and/or provide of compensation to both Lynch and Marshall. *Id.* According to Certive's website, while "many companies use Advisory Boards as window dressing[,] Certive believes they should be much more... [The Certive Advisory] Board meets quarterly and provides insight that we actively use to run the business. [Advisory] Board meetings are lively and protracted – one and a half days. And, everyone attends." *Id.*

**B. THE TWO BLUESTAR TRANSACTIONS.**

By August 1999, Crosspoint, Hawk and McMinn had invested heavily in BlueStar Communications Group, Inc. ("BlueStar"). *Id.* ¶ 59. BlueStar, a Nashville, Tennessee-

based DSL service provider, served small and mid-sized businesses in the southeastern United States. *Id.* Crosspoint owned approximately 46% of BlueStar's outstanding shares, and Hawk and McMinn individually owned a substantial number of BlueStar's shares.<sup>3</sup> *Id.* ¶¶ 59, 72. Shapero sat on BlueStar's board as Crosspoint's designee. *Id.* ¶ 60. Despite the adoption of Covad's Corporate Opportunity Policy in September 1999, there was no finding by the Board that Hawk's and Shapero/Crosspoint's direct investments in BlueStar were proper, *i.e.*, not usurping a corporate opportunity. *Id.* ¶ 60. There was no finding that BlueStar was not a competitor of Covad, a finding which was required for Shapero to sit on the BlueStar board and for Hawk to invest in BlueStar. *Id.*

By 2000, BlueStar was hemorrhaging millions of dollars every month, and had failed at its attempt to launch an IPO. *Id.* ¶¶ 61, 63. At the end of its fiscal year just preceding the merger, BlueStar had revenues of less than \$500,000 and a negative EBITDA. *Id.* ¶ 63. BlueStar's investment banker, Donaldson, Lufkin & Jenrette stated that "[t]he management of the Company . . . informed us that the Company, as of June 14, 2000, expected to exhaust its liquidity in the near term and did not have a financing source for funding its anticipated operating and capital needs over the following 12 months" *Id.*

Crosspoint (with Shapero as its Managing General Partner) and Hawk needed a savior for BlueStar. *Id.* ¶¶ 61, 62. They turned to Covad and proposed a merger between the two companies. *Id.* Shapero lobbied then-CEO Knowling through lengthy emails on

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<sup>3</sup> McMinn was the beneficial owner of approximately 656,942 shares of BlueStar common stock. Shapero's venture capital firm, Crosspoint, owned approximately 30 million shares of BlueStar stock. Am. Compl. ¶ 72.

the weekend of May 20-21, 2000 to have Covad acquire BlueStar. *Id.* ¶ 62. After Shapero's full-court press, Knowling decided on May 21, 2000 – without any due diligence – that Covad should acquire BlueStar. *Id.* The Board formally approved the BlueStar merger on June 15, 2000. *Id.* ¶¶ 58-61.

The merger with BlueStar made no financial sense from Covad's standpoint. BlueStar's services competed directly with Covad's services in large areas of the southeastern part of the United States. *Id.* ¶¶ 58-59. The BlueStar business model was based upon a model tried and rejected by Covad – direct sales through salespeople or "feet-on-the-street." *Id.* BlueStar sold its DSL services directly to retail customers, but Covad was fundamentally a wholesaler, selling its DSL services to ISP partners, such as Earthlink, who in turn sold to retail customers. *Id.*

Even setting aside BlueStar's dismal performance, Covad would not be gaining much in service territory, as BlueStar and Covad had territorial overlap in roughly 70% of BlueStar's service areas. *Id.* ¶ 68. This fact was made known to Knowling as early as May 1999 by McMinn himself. *Id.* ¶ 60. Shapero and Hawk clearly knew about the overlap, but were only concerned with saving Crosspoint's significant investment in the now failing BlueStar. To the extent that the rest of the Board did not already know this stunning fact, it was informed of it on or prior to June 15, 2000 when a Covad executive, Ron Marquardt, presented a due diligence report which stated that the acquisition would be virtually useless because of the overlap in the companies' networks. *Id.* Despite having been warned off by Covad's executives, the Board on June 15, 2000 approved the merger with BlueStar.

On September 22, 2000, Covad completed the merger with BlueStar by issuing approximately 6.1 million shares of Covad common stock to BlueStar stockholders according to an exchange ratio by which BlueStar stockholders received an average market price of \$14.23 in exchange for all outstanding preferred and common stock. *Id.* ¶ 73. In addition, the outstanding BlueStar stock options and warrants were converted into options to purchase approximately 225,000 shares of the Company's common stock at a fair value of \$6.55 per share. *Id.* The value of the options, as well as direct transaction costs, were included as elements of the total purchase cost. *Id.* As a result, the Covad Board, in order to further the bail-out needs of Shapero and Hawk, effectively put a grossly inflated price of at least \$200 million on BlueStar in connection with the merger. *Id.* Crosspoint had now converted its ailing BlueStar stock into a more palatable currency – Covad stock – and had thereby increased its hold on Covad as well.

The merger agreement also provided Crosspoint and its fellow BlueStar shareholders with a follow-up bonus of up to 5 million additional Covad shares to be paid at the end of 2001 if BlueStar achieved certain specified levels of revenues and EBITDA throughout 2001. *Id.* ¶ 74. The earning benchmarks of this provision, known as the “earnout,” were never met. *Id.* BlueStar continued to lose millions, even with Covad's coffers now shoring it up. *Id.*

The dismal performance of BlueStar is almost an aside, however, because only seventeen days into BlueStar's benchmark year the Covad Board determined that it should reach a settlement of the earnout provision. *Id.* Without even waiting to see if any liability for payment of the earnout shares would arise, the Board, now with McMinn

back at the helm as Chairman,<sup>4</sup> tasked Lynch to begin negotiating with the former BlueStar shareholders (which group included Shapero's Crosspoint, Hawk and McMinn). *Id.* ¶¶ 74-75. Lynch, who owed his Certive Advisory Board position to Crosspoint and McMinn, concluded the "negotiations" in short order.

In April 2001 Covad finalized an agreement with BlueStar representatives. *Id.* ¶ 74. After obtaining the concurrence of defendants Marshall, Irving and Runtagh, defendant Lynch agreed to the price of 3.25 million Covad shares, or 65% of the maximum payout under the earnout provision. *Id.* ¶ 75. Amazingly, at the same time this "earn-out" settlement was reached, defendant Marshall was sending emails to the Covad Board calling the BlueStar acquisition "a very costly mistake, probably the worst mistake I have ever seen a company make." *Id.* ¶ 74.

There can be no doubt that the BlueStar transactions were an unmitigated disaster for Covad and a bonanza for Crosspoint, Hawk and McMinn. On June 25, 2001, just nine months after the merger was completed and an incredible two months after the payment of the earnout shares, Covad announced it would dissolve BlueStar and lay off 400 employees. *Id.* ¶ 82. BlueStar made an irrevocable assignment for the benefit of its creditors ("ABC") of all its assets to an independent trustee (the "Assignee") in the State of Tennessee. *Id.* ¶ 83. Immediately thereafter, the Assignee began an orderly liquidation of BlueStar that was expected to take approximately one year. *Id.* Under Tennessee law, an ABC is a non-judicial alternative to a plan of liquidation under

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<sup>4</sup> McMinn returned to Covad as its Chairman on November 1, 2000. Am Compl ¶ 8.

Chapter 7 of the Bankruptcy Code. *Id.* Consequently, the liquidation of BlueStar's assets and the discharge of its liabilities have been under the sole control of the Assignee. *Id.*

## **II. THE § 220 ACTION.**

Khanna made a demand pursuant to § 220 action to inspect the books and records of Covad. *Id.* ¶ 135. That demand was made on June 10, 2003 and was flatly rejected, without the production of a single document, on June 18, 2003. *Id.* Thereafter, Khanna filed a §220 action on August 11, 2003. *Id.* The Court found in Khanna's favor on his § 220 demand, and Covad was ordered to produce virtually every category of document sought by Khanna. *Id.*

As a result of that production, Khanna learned for the first time that: (i) McMinn was actively pursuing Crosspoint's interests when he located the Certive opportunity; (ii) Crosspoint was a co-founder of Certive; and (iii) Shapero had, on behalf of Crosspoint, directly lobbied Covad's CEO and pressured him into agreeing to the ill-fated BlueStar merger.

## **ARGUMENT**

### **I. STANDARD OF REVIEW ON A MOTION TO DISMISS.**

In the context of a motion to dismiss, "the truthfulness of all well-pleaded allegations in the complaint is to be assumed." *Solomon v. Pathe Comm. Corp.*, 672 A.2d 35, 38 (Del. 1996). In addition, the plaintiff must be given "the benefit of all reasonable inferences that can be drawn from its pleading." *Id.* (quoting *In re USACafes, L.P. Litig.*, 600 A.2d 43, 47 (Del. Ch. 1991)). The Court should not dismiss a complaint

“unless [it is] reasonably certain that plaintiff is not entitled to relief under any set of facts which could be inferred.” *In re Fuqua Indus., Inc. S’holder Litig.*, 1997 WL 257460, at \*2 (Del. Ch.).

Each of Crosspoint’s asserted grounds for dismissal ignore the detailed factual allegations of the Amended Complaint. Plaintiffs have more than adequately pled a timely claim for Crosspoint’s usurpation of the Certive opportunity, and have set forth a litany of facts which establish Crosspoint’s control over Covad and its concomitant fiduciary duty not to usurp that opportunity. Plaintiffs’ respondeat superior claim is not barred by Chancery caselaw, and its underlying element of breaches of fiduciary duty by Shapero and Hawk is established on the Amended Complaint’s allegations. The aiding and abetting claim’s underlying breach of fiduciary duty by Covad’s directors and Crosspoint’s knowing participation therein is fully supported by the detailed factual allegations of the Amended Complaint, all set forth below.

## **II. PLAINTIFFS HAVE STATED A VALID AND TIMELY CLAIM FOR USURPATION OF A CORPORATE OPPORTUNITY AGAINST CROSSPOINT.**

### **A. THE USURPATION CLAIM WAS TIMELY FILED.**

Crosspoint contends that plaintiffs fail to state a claim for Crosspoint’s usurpation of Covad’s corporate opportunity because the claim “is barred by a three-year statute of limitations or its equitable analogue, the doctrine of laches.” Crosspoint Motion to Dismiss at 8. Crosspoint is simply incorrect, because as a matter of law plaintiffs could not have stated a claim for usurpation against Crosspoint until – at the earliest – May 2004.

As an initial matter, Crosspoint has completely ignored the caselaw of this Court that laches is a fact-based defense and cannot be decided on a motion to dismiss. *Goldman v. Pogo.com Inc*, 2002 WL 1358760, at \*2 n.16 (Del. Ch.) (refusing to dismiss claims for laches on undeveloped factual record); *see also Erickson v. Centennial Beauregard Cellular LLC*, 2003 WL 1878583, at \*9 (Del. Ch.) (laches defense could not be decided on incomplete factual record); *Tafeen v. Homestore, Inc.*, 2004 WL 556733, at \*8 (Del. Ch.) (“[W]hether or not [the] elements [of laches] exist is generally a fact-based inquiry, and therefore summary judgment is rarely granted on a laches defense.”); *Clark v. Packem Assoc.*, 1991 WL 36470, at \*5 (Del. Ch.) (“[T]he determination of the validity of the laches defense is one of fact, and is rarely granted on summary judgment.”) (internal citations omitted). Crosspoint simply is not entitled to dismissal on laches grounds at this stage of the proceedings.

Even if Crosspoint could legitimately raise the defense at this stage of the proceedings, it has not established that plaintiffs were on direct or inquiry notice of the facts underlying the usurpation and Crosspoint’s role in it more than three years prior to asserting the claim. It is well-known that “the running of the statute of limitations is tolled while the discovery of the existence of a cause of action is a practical impossibility.” *In re Dean Witter Partnership Litig.*, 1998 WL 442456, at \*5 (Del. Ch.). This is the doctrine of inherently unknowable injuries, and it “tolls the limitations period until a plaintiff had ‘reason to know’ that a wrong has been committed.” *Id.* (quoting *Seidel v Lee*, 954 F. Supp. 810 (D. Del. 1996)). The limitations period begins to run

again when the plaintiff is “objectively aware of the facts giving rise to the wrong, *i.e.*, on inquiry notice.” *Id.* at \*6 (internal citations omitted).

Plaintiffs simply could not have known that Crosspoint participated in the founding of Certive until reviewing the documents produced in May 2004 pursuant to the Court’s § 220 order. Crosspoint’s investment in Certive is not disclosed in *any* Covad filing. Crosspoint alleges that plaintiffs were on “inquiry notice of a potential corporate opportunity claim at least by November 2000” due to the public filing of Covad’s Post-Effective Amendment No. 2 to its Registration Statement (filed as Exhibit A to the Affidavit of Alan J. Stone in Support of Directors’ Motion to Dismiss Amended Derivative and Class Action Complaint (“Stone Aff.,” Ex. A ). Crosspoint Motion to Dismiss, at 8. The only references to Certive in that entire document are the following:

From November of 1999 to October 2000, Mr. McMinn served as Chief Executive Officer and founder of Certive Corporation.

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Mr. McMinn is a member of the Board of Directors of DishnetDSL, a DSL provider in India, and Certive Corporation.

Stone Aff., Ex. A at 69, 72. There is simply nothing in either of these disclosures to even hint at – let alone fully disclose – that Crosspoint was a co-founder of Certive. In fact, the disclosure that McMinn was “Chief Executive Officer and founder of Certive” suggests that *only* McMinn was the founder – it certainly does not say “a founder.” Thus, even if this could serve as inquiry notice about the usurpation claim against McMinn (which it does not), it certainly cannot constitute notice of the claim against Crosspoint. *See Gelfman v Weeden Investors, L.P.*, 859 A.2d 89, 2004 WL 2255391, at 117 n.28

(Del. Ch. 2004) (no inquiry notice where there was no disclosure of facts relevant to particular defendant).

Nor can Crosspoint legitimately allege that Khanna had direct knowledge of Crosspoint's participation in the usurpation. The facts alleged in the Amended Complaint make clear that Khanna was kept in the dark about the self-dealing of the Certive transaction. Khanna was asked to leave the September 22, 1999 Board meeting at which the directors discussed the founding of Certive months prior and purported to retroactively reject the Certive opportunity that was never even offered Covad in the first place.<sup>5</sup> Am. Compl. ¶¶ 53, 54; Documents Bates Labeled LDWK0000131-144 attached to the Declaration of Cynthia A. Calder In Support of Plaintiffs' Answering Briefs ("Calder Decl.") as Ex. I, at LDWK 000138-140. Even if Khanna had been present for that discussion, the minutes reflect a discussion of McMinn's being a founder of Certive but refer to Crosspoint's involvement merely as having made "an investment" in Certive. This is by no means notice of Crosspoint's actively participating in the founding of Certive. At best, Crosspoint has raised an issue which turns on disputed facts, and thus cannot be resolved on a motion to dismiss. *Goldman*, 2002 WL 1358760, at \*2 n.16 (refusing to dismiss claims for laches on undeveloped factual record); *see also Erickson*, 2003 WL 1878583, at \*9 (issues of fact precluded laches defense being granted on motion to dismiss).

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<sup>5</sup> Khanna did not even serve as Secretary for the September 22, 1999 Board meeting. Calder Decl., Ex. I, at LDWK 000142. Barry E. Taylor, Esquire of Wilson, Sonsini, Goodrich & Rosati, Covad's outside counsel and counsel to Certive in the Certive transaction, served as Secretary for that meeting. *Id.*

**B. CROSSPOINT OWED COVAD A FIDUCIARY DUTY.**

Crosspoint next contends that plaintiffs' usurpation claim fails because plaintiffs are unable to establish that Crosspoint owed Covad a fiduciary duty. Crosspoint Motion to Dismiss, at 8-11. Crosspoint, however, has ignored the very factual allegations which demonstrate that its relationship with Covad gave rise to a fiduciary duty.

Not surprisingly, Crosspoint latches on to plaintiffs' allegations of the number of shares Crosspoint owned and tries to morph that into a claim by plaintiffs that Crosspoint was a majority shareholder of Covad. Crosspoint Motion to Dismiss at 8-10. Crosspoint then goes on to argue that the Amended Complaint does not establish when Crosspoint owned that many shares and whether its holdings constituted a majority interest. *Id.* Plaintiffs, however, never contended that Crosspoint was the majority shareholder of Covad when Certive was founded, and certainly never contended that the number of shares Crosspoint owned was what conferred a fiduciary status on Crosspoint.

Rather, plaintiffs alleged that Crosspoint was a "controlling" shareholder, a status which indisputably gives rise to a fiduciary duty. *See, e.g.,* Am. Compl. ¶ 151 ("As a *controlling* shareholder, Crosspoint owed Covad an unfailing duty of loyalty") (emphasis added). A shareholder owes fiduciary duties to the corporation if it "*exercises control* over the business affairs of the corporation." *Kahn v. Lynch Comm. Sys., Inc.*, 638 A.2d 1110, 1113 (Del. 1994) (emphasis in original).

Crosspoint contends that plaintiffs' only allegations with regard to Crosspoint's control of the affairs of Covad are that Covad director Shapero is Crosspoint's Managing

General Partner and that Covad director Hawk is Crosspoint's Special Limited Partner.<sup>6</sup> Crosspoint Motion to Dismiss, at 11. Naturally, Crosspoint has overlooked the majority of the Amended Complaint's allegations which establish Crosspoint's control of Covad. First, Shapero and Hawk were not the only two Covad directors affiliated with Crosspoint. McMinn was a co-investor with Crosspoint, and sought out the Certive opportunity expressly for him and Crosspoint together. Am. Compl. ¶ 43 (excerpt of email from McMinn to Covad CEO Knowling states "[t]he taking of board seats [with Crosspoint affiliates] and coming up with ideas that Crosspoint and I could invest in is what [C]rosspoint wanted me to do and what I thought we had agreed to with me helping them") (emphasis added). Marshall likewise coinvested with Crosspoint on at least one occasion. Am. Compl. ¶ 10.

Crosspoint contends that plaintiffs cannot establish that McMinn and Marshall were under the control of Crosspoint because the Amended Complaint "never alleges – even in a conclusory fashion – that either Mr. McMinn or Mr. Marshall was ever employed by, controlled by, or acting as an agent of, Crosspoint." Crosspoint Motion to Dismiss, at 11 n.10. Plaintiffs dispute the contention that they have not alleged Crosspoint's control of McMinn and Marshall, but even a failure to do so would not be fatal to plaintiffs' claim. Plaintiffs can also establish control through concerted action or conflict of interest on the part of certain directors, which the Amended Complaint indisputably alleges. *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 913 (Del.

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<sup>6</sup> Even if plaintiffs had not directly alleged Crosspoint's control of Covad, the Amended Complaint is replete with factual allegations "sufficient to support an inference that the defendant had actual control of a corporation's conduct." *O'Reilly*, 745 A.2d at 913

Ch. 1999) (control established where two of four directors were conflicted in voting on merger).<sup>7</sup>

Thus, four of eight Covad directors were clearly in the Crosspoint camp on the Certive transaction. Even when one looks only at the directors who voted on the Certive transaction, plaintiffs can still establish Crosspoint's control. Hawk, Crosspoint's Special Limited Partner, Marshall, a Crosspoint-affiliated investor, and Lynch, a director who would benefit from the Certive transaction, constituted 75% of the Board members voting in favor of the transaction. Even the fourth director, Knowling, certainly cannot be considered independent of Crosspoint's control because his salary as Covad's CEO was dependent on remaining on favorable terms with Shapero, one of two members of the Covad Board's Compensation Committee, and Marshall, an alternate member of the Compensation Committee.

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<sup>7</sup> While the events surrounding the Certive transaction certainly establish Crosspoint's control of Covad's business affairs, plaintiffs also point to Crosspoint's complete domination in causing the BlueStar transactions. Crosspoint owned approximately 46% of BlueStar shares, and Hawk and McMinn owned hundreds of thousands of BlueStar's preferred shares. Am. Compl. ¶ 59. Shapero wanted Covad to merge with BlueStar. There simply was no sound business reason for Covad to merge with BlueStar, which overlapped Covad's service areas by 70% and was losing millions of dollars every month. *Id.* ¶¶ 59, 61, 68. Shapero bombarded Knowling with emails over the weekend of May 20-21, 2000 urging Knowling to enter into a merger agreement, and lo and behold, Knowling decided on May 21, 2000 to go forward with the merger. *Id.* ¶ 62. The payment of the earnout was no less egregious. There can be no doubt of Crosspoint's control over Covad in extracting that payment, as Marshall consented to it at the same time he was proclaiming the BlueStar merger "a very costly mistake, probably the worst mistake I have ever seen a company make." *Id.* ¶ 74. While the BlueStar transaction admittedly occurred roughly one year after the Certive transaction, this Court has held that events which occur subsequent to the actions which form the basis of the claim are still probative. *California Public Employees' Retirement System v. Coulter*, 2002 WL 31888343, at \*2 (Del. Ch.); *California Public Employees' Ret. Sys. v. Coulter*, Civ. No. 19191, letter op. at 3 (Del. Ch. January 17, 2003).

**III. PLAINTIFFS HAVE PROPERLY STATED A RESPONDEAT SUPERIOR CLAIM AGAINST CROSSPOINT.**

**A. PLAINTIFFS HAVE ESTABLISHED THE UNDERLYING BREACHES OF FIDUCIARY DUTY OF SHAPERO AND HAWK.**

Crosspoint argues that plaintiffs cannot establish a claim for respondeat superior against Crosspoint because they have not established an underlying cause of action against Crosspoint's employees, Shapero and Hawk. Crosspoint Motion to Dismiss, at 12. Contrary to Crosspoint's selective reading of the Amended Complaint, plaintiffs have more than adequately pled causes of action against Shapero and Hawk for breaches of fiduciary duty to Covad.

**1. The Certive Transaction**

Crosspoint contends that the Crosspoint designees cannot be liable for a breach of fiduciary in connection with the Certive transaction. First Crosspoint contends that any causes of action against them are time-barred. Crosspoint Motion to Dismiss, at 12. These claims are not time-barred, however, because plaintiffs had no way to know what Crosspoint's or its designees' actions were on the transaction until plaintiffs received the § 220 production in May 2004. *See* Section II.A, *supra*.

Second, Crosspoint contends that Certive qualifies for the safe harbor of 8 *Del. C.* § 144 because it was "approved by a majority of Covad's disinterested and independent directors" and because McMinn and Shapero abstained on the vote. Crosspoint Motion to Dismiss, at 12-13. Certive was certainly not approved by a majority of disinterested and independent directors. Crosspoint completely ignores the fact that Hawk voted in favor of the transaction despite his financial interest therein. Document Bates Labeled

LWDK0000100-101 attached to the Calder Decl. as Ex. L. His participation in the vote is enough to create Crosspoint's respondeat superior liability.

The remaining directors who voted on the transaction, Knowling, Lynch and Marshall, were no less tainted. Knowling, Covad's CEO, owed his livelihood (*i.e.*, his considerable compensation package) to Covad's Compensation Committee on which Crosspoint's Shapero sat as one of only two members.<sup>8</sup> *Beam ex. rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 977-978 (Del. Ch. 2003) (finding officer lacked independence due to material interest in continuing to receive compensation package). Because Hawk and Knowling were tainted and constituted 50% of the directors voting on the transaction, there can be no safe harbor from liability under § 144. *See In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 944 n.69 (Del. Ch. 2003) (establishing interest or lack of independence of half of board precludes application of business judgment rule).

Plaintiffs can demonstrate that the remaining directors who voted on the transaction also had reasons to favor Crosspoint's interests over Covad's interests. Lynch owed his position on the Certive Advisory Board to Shapero and therefore lacked independence from Crosspoint. Likewise, Marshall lacked independence from Crosspoint because he had outside business interests with Crosspoint. Thus, all four of the directors voting on Certive were either interested in the transaction (through

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<sup>8</sup> Crosspoint will undoubtedly argue that Shapero, as only one member of the Compensation Committee, could not single-handedly affect Knowling's compensation. The reality is, however, that as one half of the Committee, Shapero could deadlock the Committee. The alternate member of that Committee, Marshall, had his own Crosspoint taint as a co-investor in at least one Crosspoint venture

Crosspoint) or lacked independence from Crosspoint. There simply is no shield from liability for Hawk's breach of fiduciary duty.

As § 144 and the statute of limitations argument were Crosspoint's only advanced grounds for why there could be no liability for its designees, Shapero and Hawk, on the Certive transaction, it has failed to negate plaintiffs' respondeat superior claims.

## 2. The BlueStar Transactions.

Crosspoint begins attacking plaintiffs' BlueStar claims against Hawk and Shapero by contending that this action was filed more than three years after the merger between Covad and BlueStar was approved and announced. Crosspoint Motion to Dismiss, at 13. This is of no moment, however, because the merger was not consummated – and the harm had not befallen Covad – until the merger was consummated on September 22, 2000. This action was filed on September 15, 2003, less than three years from the consummation of the merger. The statute of limitations did not begin to run until the injury was suffered, and the injury was not suffered until the merger was completed. *Dofflemeyer v. W.F. Hall Printing Co.*, 558 F. Supp. 372, 379 (D. Del. 1983) (finding that Delaware three year statute of limitations did not run on claims alleging breach of fiduciary duty in approving merger until merger was consummated); *see Kaufman v. Albin*, 447 A.2d 761, 763-4 (Del. Ch. 1982) (determining that statute of limitations did not begin to run on claims relating to tender offer allowing officers to exchange options for stock until tender offer was completed). Thus, plaintiffs' claim on the BlueStar merger was timely filed.

Crosspoint's brief begins its statute of limitations argument with a challenge to plaintiffs' claims on both the merger and the earnout. Crosspoint Motion to Dismiss, at 13. It then fails to provide any explanation of why the claim on the earnout would be untimely, and the reason is that it simply cannot show any set of circumstances to establish such a fact. Whether the three year statutory period is measured from the beginning of negotiations for the earnout in January 2001 or from the payment of the earnout shares in April 2001, plaintiffs' claim thereon was well within the three year statute of limitations.

As it did with the Certive transaction, Crosspoint contends that the BlueStar transactions qualify for the safe harbor of § 144 because they were approved by a majority of disinterested directors. Crosspoint Motion to Dismiss, at 13-14. The safe harbor of § 144 is unavailable to Crosspoint for a number of reasons.

First it is Crosspoint's burden to establish that the prerequisites of § 144 are met. *Cooke v. Oolie*, 2000 WL 710199, at \*3 n.41 (Del. Ch.) (Once plaintiff establishes interest of even one director in transaction with corporation, burden is on directors to establish requirements of §144 are met). One of those prerequisites is that the "material facts as to the director's...relationship or interest as to the...transaction are disclosed or are known to the board of directors..." 8 *Del. C.* § 144(1). Crosspoint tacitly concedes – as it must – that the BlueStar merger was an interested transaction given that director Hawk owned shares of BlueStar stock. Crosspoint's brief is silent on the issue of whether the voting Board members were informed of Hawk's interest, as are the minutes of the Board meeting where the Board discussed and approved the BlueStar merger.

Document Bates Labeled LDWK0000102-108 (Joint § 220 Trial Exhibit 117) attached to the Calder Decl. as Ex. M. Crosspoint has therefore failed to establish a required element of § 144 and cannot avail itself of its protections.

Even if Crosspoint had made such a showing, Crosspoint's own cited authority demonstrates that the approving directors must not only be disinterested, they must also be independent of the interested directors. Crosspoint does not even address the independence of the voting Board members, most likely because such an examination reveals that the majority of them were woefully lacking in independence. The voting Board members were Knowling, Marshall, Lynch, Runtagh and Dunn. Knowling's lack of independence is undeniable, as his significant compensation as Covad's CEO was controlled by Compensation Committee member Shapero. *See* page 21, *supra*. Lynch served on the Certive Advisory Board at the pleasure of Crosspoint, which was managed by Shapero. Marshall also served on the Certive Advisory Board and co-invested with Crosspoint, and certainly would not cross Shapero's or Hawk's interests. Because Knowling, Marshall and Lynch – each of whom lacked independence – constituted a majority of the voting directors, § 144 does not apply.

Crosspoint also contends that the BlueStar earnout “was approved by Covad's disinterested directors” and that plaintiffs concede this point. Crosspoint Motion to Dismiss, at 14. Plaintiffs concede no such thing. The Amended Complaint is quite specific that the task of negotiating and completing the settlement of the earnout was delegated to Lynch and Lynch alone. Am. Compl. ¶ 74. Crosspoint cannot point to a single fact to contradict this assertion, as Covad certainly did not produce any Board

minutes or resolutions showing approval of the earnout payment by anyone other than Lynch. As demonstrated above, Lynch was anything but independent.

As §144 and the statute of limitations argument were Crosspoint's only advanced grounds for why there could be no liability for its designees, Shapero and Hawk, on the BlueStar transactions, it has failed to negate plaintiffs' respondeat superior claims.

**B. THERE IS NOTHING IN DELAWARE LAW THAT REQUIRES DISMISSAL OF PLAINTIFFS' RESPONDEAT SUPERIOR CLAIMS.**

Crosspoint's final assault on plaintiffs' respondeat superior claims is a convoluted contention that they are barred as a matter of Delaware law based upon the holding of *Emerson Radio Corp. v. Int'l Jensen Inc.*, 1996 WL 483086, at \*20 (Del. Ch.). Crosspoint has distorted the holding of that case, which has no application of the facts of this matter.

Crosspoint contends that *Emerson* stands for the proposition that there can never be respondeat superior liability for the acts of the superior's designees on a Delaware corporation's board. Crosspoint Motion to Dismiss, at 15-17. This is a gross misstatement of the holding in *Emerson*. *Emerson* held only that there could be no respondeat superior liability where the plaintiff had failed to establish that the superior controlled the corporation's business affairs. 1996 WL 483086, at \*20. There, plaintiffs did not plead any facts to show that the shareholder in question, a fund which had a designee on the corporation's board, had any control over the corporation's affairs. *Id.* ("There is no claim or evidence that the Fund has in any way controlled Jensen's affairs."). Plaintiffs then contended that the fiduciary responsibility of the fund's designee on the board should be imputed to the fund. In a footnote, the Court rejected

plaintiffs' claim of imputation as a matter of law. The Court did not rule that respondeat superior could not be applied in a breach of fiduciary duty context. Indeed, the Court was clear in its discussion to merely analogize imputation to respondeat superior. 1996 WL 483086, at \*20 n.18. It in no way adjudicated whether or not a respondeat superior claim could ever be stated against a shareholder with designees on the board.

Even if *Emerson* stood for the proposition Crosspoint claims, the factual differences between this case and *Emerson* demonstrate that it has no application here. First, where the *Emerson* plaintiffs failed in establishing the fund's control of the corporation, plaintiffs here have more than adequately alleged facts establishing Crosspoint's control of Covad's business affairs. See Section II.B, *supra*. Second, the *Emerson* plaintiffs also failed to state a claim for breach of fiduciary duty against the fund's designee on the board. 1996 WL 483086, at \*17-20. By contrast, Plaintiffs here have stated claims for breach of fiduciary duty against Shapero and Hawk. See Sections III.A, *supra*.

In short, there is nothing in Crosspoint's arguments or its cited authorities to support its statement that plaintiffs' respondeat superior claim fails as a matter of law.

#### **IV. PLAINTIFFS HAVE PROPERLY PLED AN AIDING AND ABETTING CLAIM AGAINST CROSSPOINT**

Crosspoint contends that plaintiffs have failed to demonstrate that Crosspoint either knew of the other defendants' breaches of fiduciary duty or participated in them. Crosspoint Motion to Dismiss, at 18-22. Crosspoint is simply wrong, as the allegations of the Amended Complaint amply demonstrate that Crosspoint knew of the fiduciary violations and participated in them.

Crosspoint argues that plaintiffs have not sufficiently alleged that Crosspoint knowingly participated in the breaches of fiduciary duty by Covad's directors. It claims that plaintiffs have not set forth facts "from which the Court could infer that Crosspoint instructed [Shapero or Hawk] to facilitate Covad's approval of the Certive or BlueStar Transactions." Crosspoint Motion to Dismiss, at 20. Of course, this statement is completely illogical because as the General Partner and Managing Partner of Crosspoint, Shapero decides and directs the business affairs of Crosspoint, not vice versa. As plaintiffs demonstrate below, Shapero (and Hawk) knew full well that Covad's directors were breaching their fiduciary duties in approving the Certive and BlueStar transactions.

A court can infer the accused aider and abettor's knowing participation if the corporation's fiduciary breaches its duty in an inherently wrongful manner and the plaintiff alleges specific facts from which the Court could reasonably infer knowledge of the breach. *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 392 (Del. Ch. 1999); *Nebenzahl v. Miller*, 1996 WL 494913, at \*17 (Del. Ch.). The more egregious the breach of duty by the corporation's fiduciary, the more reasonable the inference of knowing participation by the aider and abettor. *In re Telecomm., Inc. S'holders Litig.*, 2003 WL 21543427, at \*2 (Del. Ch.). Delaware courts have found that knowledge of breach of fiduciary duty can be inferred in a variety of circumstances. For example, if there is objective evidence that the transaction benefits the fiduciaries at the stockholders' expense, then knowing participation by a third party might be inferable. *See Rand v. Western Airlines, Inc.*, 1989 WL 104933, at \*5 (Del. Ch.); *see also Gilbert v. El Paso Co.*, 490 A.2d 1050, 1058 (Del. Ch. 1984).

It is beyond peradventure that Crosspoint knew that the directors of Covad owed a fiduciary duty to Covad not to profit personally at Covad's expense and to devote their undivided loyalty to the interests of Covad. *See In re Ebay, Inc. S'holders' Litig.*, 2004 WL 253521, at \*5 (Del. Ch.) (Plaintiffs adequately alleged knowing participation by investment bank where bank knew that directors owed fiduciary duty to shareholders and were personally profiting at company's expense.). Plaintiffs have proffered countless facts and circumstances demonstrating that Crosspoint was a knowing participant in transactions (Certive and BlueStar) which benefited Crosspoint and certain Covad directors at the expense of Covad stockholders.

**A. PLAINTIFFS ADEQUATELY ALLEGE THAT CROSSPOINT KNOWINGLY PARTICIPATED IN THE CERTIVE TRANSACTION.**

The Amended Complaint is replete with facts which support the inference of Crosspoint's knowing participation in the Covad directors' breaches of fiduciary duty. The facts, all of which are ignored by Crosspoint in its brief, are set forth below.

In or about May 1999, McMinn began pursuing investment opportunities on behalf of Crosspoint.<sup>9</sup> Am Compl. ¶ 42 McMinn informed Knowling (Covad's CEO and a director) by email that he was actively pursuing an investment opportunity for himself and Crosspoint. *Id.* ¶¶ 13, 43. He stated that "coming up with ideas that Crosspoint and I could invest in is what [C]rosspoint wanted me to do and what I thought we had agreed to with me helping them." *Id.* ¶ 43. McMinn went on to say that he had

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<sup>9</sup> Crosspoint contends that plaintiffs do not claim that McMinn was an agent of Crosspoint or acted for Crosspoint in the Certive transaction. Crosspoint Motion to Dismiss, at 19 n 15. This is a complete misstatement of the Amended Complaint's allegations, and astonishing given the direct quote from the McMinn email stating that he was actively engaged in finding investment opportunities for Crosspoint. Am. Compl ¶ 43.

attended a Crosspoint partnership meeting the week before and had discussed there the possibility of getting Covad involved in investing in his and Crosspoint's business ventures. *Id.*; see Documents Bates Labeled LDWK 0001874-1883 attached to the Calder Decl. as Ex. N, at LWDK0001877.

The result of this search by McMinn was the Certive transaction. Crosspoint (and McMinn) received Series A shares in Certive at \$1.50 per share. Am. Compl. ¶ 49. Shapero, Hawk and McMinn were present at the September 22, 1999 Covad Board meeting where McMinn's founding of Certive was discussed and approved after the fact. At that same meeting the Board declined to invest in Certive "on the terms and conditions offered to Mr. McMinn and Crosspoint" due to its "seed stage nature" and "risk." *Id.* ¶ 54; Document Bates Labeled LDWK0000139 attached to the Calder Decl. as Ex. O. Hawk, Crosspoint's Special Limited Partner, voted in favor of rejecting an investment by Covad in Certive at \$1.50 per share for Series A shares. *Id.* Just nineteen days later, however, Hawk voted in favor of Covad investing in a lower class of Certive shares (Series B) for three times the price (\$4.50 per share) Crosspoint paid.<sup>10</sup> *Id.* ¶ 55. This investment certainly did not benefit Covad because it could have had a higher class of shares at one third the price if Hawk (and Crosspoint) had not taken that opportunity away from Covad. Only Crosspoint and McMinn benefited from this investment because it put \$5 million in Certive's coffers rather than \$1.6 million (the proceeds had Covad

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<sup>10</sup> Hawk also voted in favor of causing Covad to enter into a shareholders' agreement with Crosspoint and McMinn to obligate Covad to vote for Crosspoint's and McMinn's designees on the Certive board. Am. Compl. ¶ 55

been offered the Crosspoint/McMinn deal). There simply can be no clearer indication of Crosspoint's knowledge and participation in the usurpation of the Certive opportunity.

**B. PLAINTIFFS ADEQUATELY ALLEGE THAT CROSSPOINT KNOWINGLY PARTICIPATED IN THE BLUESTAR TRANSACTIONS.**

As with the Certive transaction, Crosspoint has completely ignored the facts which support an inference of its knowing participation in the Covad directors' breaches of fiduciary duty in approving the BlueStar transactions.

Shapero, through Crosspoint, owned approximately 46% of BlueStar's outstanding shares, and sat on BlueStar's board. Am. Compl. ¶ 59. Hawk, in addition to his interest in Crosspoint's BlueStar shares, personally owned BlueStar shares. *Id.* ¶ 59. Crosspoint does not dispute – as it cannot – that its substantial investment in BlueStar was in serious jeopardy by mid-2000. *Id.* ¶ 61. Crosspoint, through Shapero, turned to Covad for a bail-out – the merger transaction. *Id.* at ¶ 62. Shapero actively lobbied Knowling through lengthy emails on the weekend of May 20-21, 2000 for Covad and BlueStar to merge. *Id.* ¶ 62. Shapero certainly knew that a merger made no business sense from Covad's point of view because the two companies used different sales models and had significant overlap in their service territories.<sup>11</sup> BlueStar was losing millions of dollars monthly, and had failed at its IPO attempt. *Id.* ¶ 61.

These glaring facts did not stop Shapero from pushing hard to get the deal through. *Id.* ¶ 62. There can be no doubt that Shapero took advantage of the influence he had over Knowling by virtue of his control (as half of the Covad Compensation

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<sup>11</sup> This overlap was recognized by McMinn, who had been approached by Crosspoint one year earlier to become "involved" with BlueStar. Am. Compl. ¶ 60; Document Bates Labeled LDWK0001883 attached to the Calder Decl. as Ex. P

Committee) of Knowling's compensation package. In the May 20-21, 2000 email chain, Knowling expressed a concern regarding the overlap between the companies. Document Bates Labeled LDWK0002012-2015 attached to the Calder Decl. as Ex. Q, at LWDK0002013. Shapero responded by sharing an anecdote about an executive whose company was thriving because he had taken chances, and exhorted Knowling to "look[] through the fog into the future and think[] about how we need to change the course of the business..." *Id.* The very day that Shapero sent that email to Knowling, Knowling informed Covad's officers that he had decided to go forward with the BlueStar deal despite their protests about the overlap because it was his job "to look though the fog" and to "make the call." Document Bates Labeled LDWK0002987-2988 attached to the Calder Decl. as Ex. R, at LWDK0002987.

Roughly three weeks later the Board was presented with evidence that the BlueStar merger did in fact contain significant overlap between Covad and BlueStar – Knowling's chief concern about the deal. Am. Compl. ¶ 64. Despite this information, which had been a key concern to Knowling only three weeks prior, the Board (including Knowling) voted to approve the merger. *Id.* ¶¶ 61-62. Both Shapero and Hawk knew that the Covad Board's decision was the product of a breach of fiduciary duty. Shapero and Hawk knew that Bear Stearns, the investment banker that provided a "fairness opinion" on the merger to the Board was conflicted because it had an interest in getting the deal done so that it could be repaid a \$40 million loan it had made to BlueStar. *Id.*

¶ 66.<sup>12</sup> They knew that no committee of disinterested and independent directors was formed to examine and approve the transaction. *Id.* ¶ 65. They knew that a majority of the directors approving the transaction lacked independence from Crosspoint. *See* Section III.A, *supra*.

The facts surrounding the payment of the earnout shares are no less egregious. Crosspoint certainly does not dispute that the EBITDA and revenue targets of the earnout provision were ever achieved. BlueStar's performance was dismal (more than \$100 million in losses), and Covad dissolved BlueStar within nine months of the merger. Am. Compl. ¶¶ 74, 82. The performance was of no concern to the Crosspoint-dominated Board, because just seventeen days into the fiscal year that was to be the benchmark for the earnout the "negotiation" concluded for a settlement of the provision. *Id.* ¶ 74. Lynch conducted all of the negotiations for the Covad Board, and by January 17, 2001 had agreed to give 3.25 million out of the maximum 5 million Covad shares to BlueStar's former shareholders. *Id.* ¶ 74-75. Crosspoint (through Shapero and Hawk) certainly knew that the terms of the earnout were not met – they could not have been met at that time because BlueStar was only seventeen days into the benchmark year. That fact did not stop Crosspoint, Hawk and McMinn from walking away with roughly 1.6 million Covad shares – their proportionate interest in the earnout payment. *Id.* ¶ 80. Just two months after this largesse, Covad caused BlueStar to lay off 400 employees and to begin dissolution proceedings. *Id.* ¶¶ 82, 83.

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<sup>12</sup> Shapero certainly cannot deny knowledge of this loan because he sat on BlueStar's board. Am. Compl. ¶ 60

Taken individually or as a whole, the facts support the inference of Crosspoint's knowing participation in the Covad's directors' breaches of fiduciary duty for both BlueStar transactions.

**CONCLUSION**

For all the foregoing reasons, plaintiffs respectfully request that the Court deny Defendant Crosspoint Venture Partners, L.P.'s Motion to Dismiss Amended Derivative and Class Action Complaint.

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