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 HOLDINGS, L.L.C., Defendants, v. GULFPORT ENERGY CORPORATION, Nominal Defendant.	)	Civil Action No. 3128-VCN

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS PLAINTIFF'S SECOND AMENDED VERIFIED CLASS ACTION AND DERIVATIVE COMPLAINT

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Table of Contents

Page

Table of Authorities

PAGE

Cases

Statutes

Other Authorities

Rules

NATURE AND STAGE OF PROCEEDINGS

Plaintiff Robotti & Company, LLC ("Plaintiff" or "Robotti") has brought this action against Gulfport Energy Corporation ("Gulfport" or the "Company") and three former and two current directors challenging anti-dilution adjustments to certain Gulfport warrants and options made in connection with a Gulfport rights offering (the "Rights Offering") that occurred four and a half years ago. Robotti's sole "claim" is that the subscription price in the Rights Offering was unreasonably low and resulted in the anti-dilution adjustments causing "dilution" to the outstanding shares of Gulfport.

Plaintiff filed this suit on July 27, 2007 as a purported class action on behalf of holders of Gulfport shares as of August 20, 2004, the date the Rights Offering concluded. Because Gulfport is a public company listed on NASDAQ, most of the class Robotti purports to represent are probably no longer Gulfport stockholders. Through its Second Amended Verified Class Action Complaint (the "Second Amended Complaint" or "SAC"), filed December 22, 2008, Robotti belatedly sought to add a derivative claim on behalf of Gulfport, more than four years after the Rights Offering. In short, the Second Amended Complaint purports to assert conflicting claims on behalf of (i) a class of largely former stockholders from four and half years ago and (ii) the current stockholders, most of whom bought their shares after the Rights Offering, who benefited from the purported dilution and would get a windfall from any relief flowing to the corporation. The only remedial relief plaintiff seeks is unspecified damages for the class and unspecified damages for the corporation.

As shown below, the Second Amended Complaint fails to state any claim, class or derivative, and should be dismissed because plaintiff's dilution allegations have no factual basis and are legally insufficient. Plaintiff's purported class claim must also be dismissed because it is a derivative claim based on alleged dilution resulting from options and warrants. The new and

untimely derivative claim plaintiff has added to the Second Amended Complaint fails because Robotti made no demand on the Gulfport Board and has not alleged with particularity why demand would have been futile.

This is Defendants' Opening Brief in support of their motion to dismiss.

STATEMENT OF FACTS

A. Parties

Plaintiff alleges it is a stockholder of Gulfport and has been such since at least July 1, 2003. SAC ¶1. At the time of the Rights Offering, Robotti held approximately 90,000 Gulfport shares.[1] Robotti exercised its full subscription and oversubscription rights, purchased in the market and exercised additional rights. SAC ¶35; *Robotti,* 2007 WL 2019796, at *1. Thus, the Rights Offering did not dilute Robotti. *Robotti,* 2007 WL 2019796 at *3.

Defendant Gulfport is a Delaware corporation and an independent oil and gas production company. SAC ¶2. In 2004, Gulfport was in the business of oil and gas exploration and production. *Id.* ¶35. The individuals named as defendants (Mike Liddell, Robert E. Brooks, David L. Houston, Mickey Liddell and Dan Noles) served as Gulfport directors in 2004 at the time of the Rights Offering. *Id.* ¶¶3-7. The Second Amended Complaint concedes that Brooks, Noles and Mickey Liddell were no longer on the board when the Second Amended Complaint was filed. SAC ¶¶4, 6-7.

B. The Options and Warrants

The Second Amended Complaint alleges that at the time of the Rights Offering, Gulfport had 2.4 million warrants and 627,000 options outstanding.[2] The exercise price for the warrants was $4.00 per share, and the exercise price for the options was $2.00 per share. SAC ¶39. The Second Amended Complaint (¶39) acknowledges that "[t]he options were management-owned and board-owned, while Gulfport's controlling shareholder beneficially owned the majority of

[1] SAC ¶35; *Robotti v. Gulfport Energy Corp.,* 2007 WL 2019796, at *1 (Del. Ch.). The Court's publicly available opinion in plaintiff's prior action pursuant to 8 *Del. C.* § 220 is referenced in the Second Amended Complaint (SAC ¶¶43, 46).

[2] SAC ¶39; *Robotti*, 2007 WL 2019796, at *1. Plaintiff has rounded off the actual number. The Prospectus shows there were 2,431,517 warrants and 1,245,612 options outstanding as of June 1, 2004. DX A, p. 22. All references to "DX _" refer to exhibits attached to the Transmittal Certificate of Laina M. Herbert filed herewith.

the warrants."[3] The Second Amended Complaint does not and could not allege that the Gulfport directors had any material interest with respect to the warrants.[4]

The conclusory assertion in ¶8 of the Second Amended Complaint that the Individual Defendants were option-holders contains no facts showing that their interest in the Gulfport options gave them any material financial interest in the Rights Offering. The Second Amended Complaint alleges that Mike Liddell, the Company's Chairman and CEO, held 457,270 options and that the four other directors each held only 20,000 options.[5]

The subscription price in the Rights Offering was $1.20 per share. (SAC ¶¶15a, 15b, 34, 41, 44, 46, 47, 50, 52c, 62). Because the subscription price of the rights was below the exercise prices of the warrants and the options, the anti-dilution provisions protecting the holders of the warrants and the options were triggered by the Rights Offering. SAC ¶39; *Robotti*, 2007 WL 2019796, at *1. The Second Amended Complaint acknowledges that the anti-dilution adjustments did not change the aggregate exercise price of the options (*i.e.* $1,254,674) or the warrants (*i.e.* $9,726,068). SAC ¶¶15, 39. The anti-dilution provisions merely enabled the warrant holders and option holders to purchase additional shares "to maintain their positions after the Offering." *Id.* ¶39. Therefore, the adjustment did not "dilute" existing Gulfport stockholders. Moreover, the anti-dilution adjustments did not automatically give the option holders and warrant holders additional shares--they still had to pay the adjusted per-share

[3] *See also Robotti*, 2007 WL 2019796, at *1. The Second Amended Complaint alleges that at the time of the Rights Offering Gulfport's "indirect controlling stockholder, Charles Davidson . . . who through various entities principally CD Holding and Wexford was reported to have beneficial ownership of approximately 2/3's of the Company stock." SAC ¶37. However, neither Mr. Davidson nor Wexford Management, LLC is named as a defendant in the action, and Plaintiff dismissed the CD Holdings entity it had named in the Amended Complaint. Plaintiff has not served the CD Holding entity named in the Second Amended Complaint. SAC ¶9.

[4] Similarly, the Second Amended Complaint alleges no facts showing that any of the directors had a material interest in or was not independent concerning the Backstop Agreement.

[5] SAC at ¶15b.

exercise price (and the same aggregate exercise price) for the warrants and options in order to receive Gulfport shares. Significantly, the Second Amended Complaint contains no allegation that any of the options or warrants were actually exercised.

C. The Rights Offering

1. The Rights

In the Rights Offering, all Gulfport stockholders received one transferable subscription right to buy a share of Gulfport common stock for $1.20 per share for every 1.0146 shares of Gulfport common stock owned. SAC ¶34; *Robotti*, 2007 WL 2019796, at *1. To the extent the offer was undersubscribed, shareholders exercising their rights had oversubscription rights to purchase any remaining shares. *Id.*

The Rights Offering was made pursuant to a July 22, 2004 Prospectus. SAC ¶33; *Robotti*, 2007 WL 2019796, at *1.[6] The Second Amended Complaint specifically incorporates the Prospectus by reference.[7] Plaintiff admits that it is relying on the Prospectus not only for the purpose of identifying the disclosures of the Company related to the Rights Offering but also to establish "certain admissions of the defendants."[8] While plaintiff claims it is not relying on the Prospectus "for the truth of all the matters asserted herein," the Second Amended Complaint plainly does rely on the Prospectus as the basis for numerous allegations, including:

(i) The identity and option holdings of the director defendants.[9]

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[6] The Second Amended Complaint asserts that "the Company first announced a rights offering" in the Prospectus and that the Prospectus was "filed with the Securities and Exchange Commission and first available to stockholders on July 27, 2004." SAC ¶ 33. However, documents Plaintiff has filed with the Court show that Registration Statements for the Rights Offering, including preliminary prospectuses, were filed with the SEC on May 12, 2004, June 21, 2004 and July 22, 2004. Plaintiff's Memorandum In Opposition to Defendants' Motion to Stay Discovery, Ex. B, p. 2.

[7] SAC ¶33.

[8] *Id.*

[9] SAC ¶15.

(ii) The terms of the Rights Offering, including the $1.20 per-share exercise price, the issuance of one subscription right for each 1.0146 shares of outstanding common stock and the Board's right to amend the Offering.[10]

(iii) Gulfport's limited cash reserves at the time of the Rights Offering and the Offering's purpose of funding part of Gulfport's proposed seismic and drilling programs.[11]

(iv) The reasons for selecting the $1.20 per-share exercise price, including the factors the Board considered.[12]

(v) Numerous statements concerning the purpose of the Rights Offering, use of proceeds, determination of the Subscription Price, potential dilution, the revolving credit facility, the revolving line of credit and the potential sale of one of Gulfport's oil and gas fields.[13]

(vi) The financial statements attached to the Prospectus.[14]

Numerous other allegations of the Second Amended Complaint, while not explicitly citing the Prospectus, are obviously based on information contained in the Prospectus.[15] Given plaintiff's extensive reliance on the Prospectus, both as to disclosures and as to purported "admissions" by defendants and other "facts," the defendants are entitled to present on their Motion to Dismiss the actual text of the Prospectus in order to show the inaccuracies in plaintiff's characterizations thereof and the complete content of portions of the Prospectus plaintiff partially and misleadingly discusses.[16]

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[10] SAC ¶¶33-34.
[11] *Id.* at ¶38.
[12] *Id.* at ¶41.
[13] SAC ¶52a-g.
[14] *Id.* at ¶54.
[15] *See, e.g., Id.* ¶¶37, 39, 45, 55, 59.
[16] *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *5 (Del. Ch.) (Rights Offering prospectus properly considered on motion to dismiss where complaint repeatedly referred to it and claim was based on it). *See also NAMA Holdings, LLC v. Related World Market Center, LLC*, 922 A.2d 417, 422 & n.3 (Del. Ch. 2007).

2. Use of Proceeds

The Prospectus disclosed that the purpose of the Rights Offering was to fund part of Gulfport's proposed seismic and drilling programs. SAC ¶38; *Robotti*, 2007 WL 2019796, at *1. At the time of the Rights Offering, Gulfport had only $580,000 in cash. SAC ¶ 38; *Robotti*, 2007 WL 2019796, at *1. However, Gulfport was seeking to pursue a significant expansion of its drilling portfolio. SAC ¶38. Gulfport's 10-Q for the quarter ending September 30, 2004, reported that CD Holdings had applied a $500,000 balance Gulfport owed it under an existing credit facility toward the exercise of subscription rights in the Rights Offering. *Id.*[17] The 10-Q also disclosed that $11.1 million of the net proceeds from the Rights Offering had been used to fund ongoing operations in Gulfport's WCCB and East Hackberry Oil Fields. *Id.* An additional $2.2 million from the proceeds of the Rights Offering was to be applied to an outstanding balance with the Bank of Oklahoma. *Id.*

3. The Gulfport Board's Consideration of the Rights Offering

The Second Amended Complaint repeatedly asserts that the records of Gulfport's Board of Directors, including minutes and documents considered by the Board, do not show consideration of various matters.[18] For example, in ¶44 of the Second Amended Complaint, plaintiff alleges:

> The minutes of the meetings and the documents considered by the Board in approving the transaction contain absolutely no information received by the Board regarding current market price of the common stock, the availability of financing alternatives, the level or volatility of commodity prices for the ability to secure a backstop agreement. In fact, the records of the Company are totally devoid of anything which would show the Board had any level of participation (sic) obtaining or considering the backstop agreement, or financing alternatives. Neither the minutes of the

[17] DX B. The 10-Q is referenced in the SAC and is properly before the Court on the motion to dismiss. *Deephaven*, 2004 WL 1945546, at *5.
[18] SAC ¶¶44, 46-48, 52a-g, 54.

> Board of Directors' meetings nor any document which any Board member considered in connection with approving this transaction reveals a single basis for selecting the subscription price of $1.20 per share.

Because plaintiff has specifically referenced the minutes of Board meetings and documents considered by the Board in the Second Amended Complaint, defendants are entitled to put those minutes and documents into the record on their Motion to Dismiss in order to show what the documents actually contained. First, as shown below, the minutes and other records referenced by plaintiff do show the Board considered these matters. Second, the absence of specific mention in director consents summarizing the details of reports and discussions does not mean that such discussions and consideration never happened.[19]

Contrary to the unsupported allegations of the Second Amended Complaint that the Board minutes and documents considered by the Board reflect no consideration concerning the selection of the subscription price, alternatives to the Rights Offering and other matters, the documents themselves show there was such discussion. The minutes of Gulfport's November 14, 2003 Board of Directors meeting[20] show that in connection with the Operations Report the Board discussed "Capital Constraints" and a "Possible Offering."[21] The April 14, 2004 minutes show discussion of "CAPITAL REQUIREMENTS" for "10 wells to drill," "Workovers" and "Seismic Hackberry."[22] The minutes also reflect that there was discussion of numerous topics related to the "RIGHTS OFFERING," including:

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[19] Delaware law permits the use of unanimous director consents to approve actions and contains no requirement that such consents must reflect the details of reports to the board or discussions by the board that led the board to take the action by consent. 8 *Del. C.* § 141(f).

[20] Gulfport's minutes are in an agenda format without a detailed summary of the reports given and discussions held. Of course, there is no requirement under Delaware law that minutes be kept in a particular format. Board actions are generally reflected in accompanying unanimous director consents, a procedure specifically authorized by 8 *Del. C.* § 141(f).

[21] DX C at GULFPORT 037.

[22] DX C at GULFPORT 034.

A. Discussion of terms.
B. Discussion of backstop and commitment obligations.
C. Fairness.
1. Registered rights, freely tradeable.
2. Discussion of advisability of fairness opinion. Discussion included the cost of such opinion. Board determined that since the rights will be registered with the SEC and freely tradeable that the offering price is fair.
D. Increase in authorized shares.[23]

The minutes also reflect that the Board passed resolutions approving the Rights Offering and the increase in authorized shares.[24] There is an unanimous director consent dated April 14, 2004 reflecting the Board's approval for the increase in authorized shares, the filing of an Information Statement related to the increase in authorized shares, and the authorization of the Rights Offering, Backstop Agreement and draft Registration Statement for the Rights Offering.[25]

On May 17, 2004, the Gulfport Board met and, according to minutes, received an "OPERATIONS REPORT" that included a drilling report and a report on the seismic shoot at Hackberry.[26] The Board also received a further report on the Rights Offering.[27]

Further consideration of the Rights Offering by the Gulfport directors is reflected in minutes dated July 12, 2004, which indicate that at a meeting on that date, after a discussion of operations, including a drilling report and report on the seismic shoot at Hackberry, there was an "Update on Rights Offering."[28] In an accompanying consent dated July 12, 2004, the Board resolved that it was fair and in the best interests of the Company and its stockholders for the

[23] *Id.*
[24] *Id.*
[25] DX C at GULFPORT 016-027. Gulfport also produced the April 15, 2004 Written Consent of Stockholders to the certificate amendment increasing Gulfport's authorized shares. DX C at GULFPORT 031-033.
[26] DX C at GULFPORT 012.
[27] *Id.*
[28] DX C at GULFPORT 002. Thus, the Second Amended Complaint's assertion (¶¶47, 52b) that the Board did not review the status of the drilling program is false. *See also* DX C at GULFPORT 034; DX C at GULFPORT 012; DX C at GULFPORT 001.

Company to issue 10 million shares upon the exercise of the Rights at a subscription price equal to $1.20 per share.[29] In resolutions that were approved at the July 12, 2004 meeting, the Board confirmed that the pricing of the Rights at a subscription price of a $1.20 per share was fair and in the best interests of the Company and its stockholders.[30] The resolutions also set the record date for the Rights Offering as July 16, 2004.[31]

According to minutes dated August 16, 2004, at a Board meeting on that date, the Gulfport Board received an "OPERATIONS REPORT" that included a drilling update, a Hackberry Seismic update, a production update and a pricing update.[32] The directors also received a "FINANCIAL REPORT," which included an update on the Rights Offering and a discussion of the Company's financials.[33]

The Board minutes and documents considered by the Board repeatedly referred to in the Second Amended Complaint show that the Rights Offering was discussed during at least five separate Board meetings from November 2003 to August 2004. The documents show there was discussion of the Company's capital needs and alternatives to the Rights Offering, including a possible sale of the West Cote field.

4. The Subscription Price of the Rights

The Prospectus described the factors the Gulfport board considered in setting the subscription price at $1.20 per share, including the market price of Gulfport's stock, the availability of financing alternatives and the ability to get CD Holding to backstop the offering at that price.[34] The Board also considered that the rights were registered with the SEC and freely

[29] DX C at GULFPORT 003-009.
[30] DX C at GULFPORT 010-011.
[31] *Id.*
[32] DX C at GULFPORT 001.
[33] *Id.*
[34] SAC ¶41.

tradeable.[35] The Prospectus specifically disclaimed that the offering price represented the actual value of Gulfport or its stock.[36] As discussed above, the Board discussed the terms of the Rights Offering, including the subscription price, at multiple Board meetings.[37] The Board reconfirmed on July 12, 2004 that the $1.20 per-share subscription price was fair.[38]

Robotti's argument that "[m]anagement, the Defendants and the Company's controlling stockholder were the principal beneficiaries of the decision to price the rights offering well below the book value and market trading value of the Company" is belied by Robotti's own conduct.[39] Robotti exercised its subscription rights, oversubscription rights and purchased rights in the market, thereby benefiting from the discount to market price it complains about.[40] All Gulfport shareholders, including Robotti, were invited to buy shares at the $1.20 price through subscription rights, oversubscription rights and the ability to purchase rights and shares in the open market.

5. The Need for Capital and Financing Alternatives

The Second Amended Complaint asserts that the Board minutes and documents considered by the Board are totally devoid of anything showing Board exploration or consideration of financing alternatives. SAC ¶¶44, 47-48, 50, 52c. It also suggests that the minutes and other documents do not show that in 2004 Gulfport needed any capital for financing its drilling program. *Id.* ¶¶47-48, 50, 52a, 57, 60. Once again, the minutes and other documents are to the contrary. The Board discussed capital constraints at its November 14, 2003 meeting.[41]

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[35] SAC ¶45; DX C at GULFPORT 034.
[36] DX A at p. 8.
[37] DX C at GULFPORT 034; GULFPORT 016-027 at 018; GULFPORT 035; GULFPORT 003-009 at 003; GULFPORT 010-011 at 010.
[38] DX C at GULFPORT 003-009, 010-011.
[39] *Id.*
[40] SAC ¶36; *Robotti*, 2007 WL 2019796, at *1.
[41] DX C at GULFPORT 037.

At its April 14, 2004 meeting, the Board discussed the capital requirements for new wells, workovers and seismic studies.[42] The April 14, 2004 Board consent indicates that the Rights Offering is needed to finance capital expenditures.[43] Gulfport's documents and SEC filings also show consideration of financing alternatives, including in particular a sale of the West Cote Blanche Bay field.[44] Gulfport also disclosed that $2.2 million of the proceeds of the Rights Offering would be applied to an outstanding balance with the Bank of Oklahoma.[45] Plaintiff concedes that prior to the Rights Offering, Gulfport had only $580,000 in cash and cash equivalents.[46]

Robotti makes conclusory assertions that "by the time the rights offering closed, the Company's drilling program, which the proceeds of the Rights Offering were purportedly needed to finance, were well on their way if not virtually completed" and "[t]he results of that drilling program were so successful that rather than drill 12 wells, the Company decided to drill just eight."[47] These broad statements are unsupported by specific facts, which is not surprising because the statements are factually incorrect. As the Court found in the § 220 action, Robotti's contentions are based on a misinterpretation of a press release stating that eight new wells were drilled and completed and four existing wells were recompleted in the third quarter, which ended September 30, 2004.[48]

Gulfport's 10-Q for the quarter ended September 30, 2004 (filed November 12, 2004), which is referenced in the Second Amended Complaint (SAC ¶38) stated that Gulfport

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[42] DX C at GULFPORT 034.
[43] DX C at GULFPORT 016-027 at 018.
[44] DX C at GULFPORT 035; DX A, p. 30 (Prospectus).
[45] SAC ¶ 38 (citing DX B (Gulfport's Form 10QSB for period ended 9/30/04)); DX A, p. 30 (Prospectus).
[46] SAC ¶38; *Robotti*, 2007 WL 1029796, at *1.
[47] SAC ¶57.
[48] *Robotti*, 2007 WL 2019796 at *3 & n.24.

commenced an eight well drilling program in July, 2004, also recompleted four existing wells, was permitting six additional wells, began a five well workover and eight well recompletion program in November, 2004 and was planning to workover and recomplete six to ten wells in the first quarter of 2005.[49] Thus, at the time the Rights Offering was completed in August 2004, the drilling program was not "virtually completed." Gulfport's 10-Q for the quarter ended September 30, 2004 reported that CD Holding had applied toward the exercise of rights the $500,000 Gulfport had borrowed under the credit facility to fund a part of the drilling program.[50] It further disclosed that the $11.1 million of net proceeds from the Rights Offering "were and will be used to fund the Company's seismic and drilling programs at WCCB and East Hackberry Field and to repay in full the outstanding principal balance of approximately $2,200,000 on the Company's line of credit with the Bank of Oklahoma."[51]

6. The Backstop Agreement

Robotti claims the Backstop Agreement was unnecessary.[52] However, it concedes it is not unusual to have a Backstop Agreement for a rights offering.[53] Plaintiff alleges that the minutes of Board meetings and other records of the Company concerning the Board approval of the Rights Offering "are totally devoid of anything which would show the board had any level of participation [in] obtaining or considering the backstop agreement." SAC ¶44. In fact, the April 14, 2004 minutes show a specific "discussion of backstop and commitment obligations."[54] The April 14, 2004 Consent discusses and approves the Backstop Agreement and commitment fee,

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[49] DX B, p. 16.
[50] DX B p. 22; *see* SAC ¶ 38; *Robotti*, 2007 WL 2019796, at *1.
[51] DX B at 23; SAC ¶ 38; *Robotti,* 2007 WL 2910796, at *1. As the Prospectus disclosed (DX A, p. 11), $4.5 million of the Rights Offering proceeds was budgeted for the seismic survey. *See also* DX B, p. 17.
[52] SAC ¶59.
[53] SAC ¶56.
[54] DX C at GULFPORT 034.

noting that the Board reviewed a draft of the agreement.[55] The handwritten changes to the Backstop Agreement itself show that there was consideration of its terms.[56] Most importantly, Plaintiff concedes that no shares were ever purchased pursuant to the Backstop Agreement.[57]

[55] DX C at GULFPORT 016-027 at 018-019, 022.
[56] DX C at GULFPORT 035.
[57] SAC ¶59.

ARGUMENT

I. THE SECOND AMENDED COMPLAINT FAILS TO STATE A CLAIM

The Second Amended Complaint should be dismissed pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

A. Standards on a Motion to Dismiss

In considering a motion to dismiss under Rule 12(b)(6), the well-pleaded allegations of the complaint are presumed to be true.[58] The Court need not, however, "blindly accept as true all allegations."[59] Plaintiff is required to plead facts that state a claim, rather than mere conclusions.[60]

B. Plaintiff's Claims

Count I of the Second Amended Complaint (¶¶62-63) attempts to state a breach of fiduciary duty claim by a class of former Gulfport stockholders against the five directors of Gulfport at the time of the Rights Offering. Count I asserts that:

> In particular, the setting of the rights offering at $1.20 in light of the other circumstances facing the Company, including the existing warrants and stock options, the Company's financing alternatives and the value of the Company was unreasonably and inappropriately low, either deliberately triggering and benefiting themselves and the Company's controlling stockholders or triggering them without having giving (sic) consideration of the consequences of such action, and without providing any benefit to the Company by selecting an exercise price so unreasonably low.

Count I alleges plaintiff and the class were damaged by the low exercise price "in devaluing their shares at the expense of the controlling stockholder and management."[61]

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[58] *See Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).
[59] *Id.* at 187.
[60] *In re Tyson Foods Inc. Consol. S'holders Litig.*, 919 A.2d 563, 582 n.36 (Del. Ch. 2007).
[61] SAC ¶63.

Count II is a purported derivative claim which does not identify the legal theory of the claim. Paragraph 65 alleges:

> By selecting an (sic) rights offering price of a $1.20 and triggering the anti-dilution provisions applicable for the warrants and options the Defendants caused the Company to issue stock to the warrant holders and option holders, which including the Defendants, at a price far below the trading price and at a fraction of the true value of the stock. In addition, the price available to the warrant and option holders, including Defendants, was below the price available to all other stockholders generally as a result of the Offering. Thus, (sic) effect of the Offering was to dilute the interest of the public stockholders. Even were a shareholder to have purchased additional rights sufficient to maintain the shareholder's relative voting control, the price of maintaining that would have been at a minimum $1.20 per share (for the exercise of subscription rights issued directly to the stockholder) and, to the extent the stockholder needed to go into the market and purchase additional subscription rights, the price would have been $1.20 per share plus the cost of those subscription rights.

Paragraph 66 asserts that the public stockholders experienced value dilution because the Rights Offering price was $1.20 per share, but the Rights Offering was raising money at an average price of $.70 per share. Paragraph 67 alleges Gulfport was injured because it would have raised more capital "[h]ad the shares been issued and sold at a price equal to or, even more closely related to their actual value."

C. The Attack On the Subscription Price Fails to Overcome Plaintiff's Burden Under 8 *Del. C.* § 153 and the Presumption of the Business Judgment Rule

Plaintiff's assertion that the $1.20 subscription price was unreasonably low fails as a matter of law. Under 8 *Del. C.* § 153, the Gulfport Board had broad discretion to determine the consideration for which shares of Gulfport stock would be issued in the Rights Offering.[62] The directors' discretion in determining the consideration for the issuance of stock is conclusive

[62] *Leung v. Schuler*, 2000 WL 264328, at *9 (Del. Ch.) ("Leung I").

absent fraud.[63] Particularly where a corporation such as Gulfport is in financial distress and needs to raise capital through issuance of stock, the Board is given great latitude in fixing the price for issuance.[64] Under the business judgment rule, a board's good faith in determining the consideration for issuing stock is presumed and cannot be overcome unless the complaint pleads specific facts showing that the board's decision is beyond the bounds of reasonable judgment.[65] Plaintiff's Second Amended Complaint falls far short of that standard.

While plaintiff alleges that the $1.20 subscription price was below the trading price of Gulfport's stock,[66] he fails to allege conduct constituting fraud, of which there was none. Further, the fact that the stock was sold below market value does not show that the Board went beyond the bounds of reasonable judgment.[67] Market price is not a guide for fixing the price for issuing a significant number of shares because large quantities of stock cannot be sold without collapsing the market price.[68] Rather, to challenge the Board's fixing of the consideration for issuing stock, the particularized pleaded facts must show that the consideration received for the stock was so minimal that issuance of the stock was the functional equivalent of making a gift.[69] Plaintiff's Second Amended Complaint does not plead that the $1.20 subscription price was the

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[63] *Sandler v. Schenley Indus., Inc.*, 79 A.2d 606, 610 (Del. Ch. 1951); *Bodell v. General Gas & Elec. Corp.*, 140 A. 264, 267 (Del. 1927); *Leung I*, at *9; *Leung v. Schuler*, 2000 WL 1478538, at *4 (Del. Ch.) ("*Leung II*"), *aff'd*, 783 A.2d 124 (Del. 2001); D. Drexler, L. Black, A.G. Sparks, III, *Delaware Corporation Law & Practice* §17.02; 1 R. Ward, E. Welch, A. Turczyn, *Folk on the Delaware General Corporation Law* §153.1 ("Folk").

[64] *Savin Business Machine Corp. v. Rapifax Corp.*, 1978 WL 2498, at *5 (Del. Ch.).

[65] *Leung I*, 2000 WL 264328, at *11; *Leung II*, 2000 WL 1478538, at *6.

[66] SAC ¶¶34-35, 59, 65.

[67] *Leung I*, 2000 WL 264328, at *10; *Leung II*, 2000 WL 1478538, at *4.

[68] *Bodell v. General Gas & Electric Corp.*, 132 A. 442, 449-50 (Del. Ch. 1926), *aff'd*, 140 A. 264 (Del. 1927).

[69] *Leung I*, 2000 WL 264328, at * 10.

functional equivalent of giving Gulfport shares away or allege that the Board irrationally gave away those shares for essentially no consideration.[70]

Also unavailing are plaintiff's allegations that the $1.20 exercise price was below the fair value of Gulfport's stock.[71] Delaware law does not require that shares be issued for fair value--which given market realities would be an impossible asking price. The consideration for issuing stock can be far below the actual value of the stock.[72]

C. The Second Amended Complaint Fails to Allege a Material Financial Interest on the Part of a Majority of the Directors

To establish that a board of directors was interested, a plaintiff must allege facts showing a majority of the directors had a material financial interest in the transaction.[73] The Second Amended Complaint fails to allege any facts establishing that a majority of the Gulfport Board was materially interested in or not independent with respect to the Rights Offering.

Analysis of plaintiff's allegations concerning the directors' options disproves plaintiff's theory that the directors received a special benefit as a result of the Rights Offering. Prior to the Rights Offering, the four directors other than Mike Liddell each held options to purchase 20,000 shares for $2 per share (a total of $40,000) in a company which had 10,146,566 shares outstanding (and with the exercise of options would have 10,166,566 shares outstanding). As the Second Amended Complaint concedes, after the issuance of 10 million shares in the Rights Offering, the directors still had to pay the same total consideration ($40,000), but the exercise price was reduced to $1.01 per share, so they each could purchase 39,604 shares (*i.e.* $40,000 ÷ $1.01) in a company which after the exercise of the 39,604 options would have approximately 20,186,170 shares outstanding (*i.e.* 10,146,566 + 10,000,000 + 39,604 = 20,186,170). Prior to

[70] *Id.*
[71] SAC ¶¶34-35, 59-60, 65, 67.
[72] *Bodell*, 140 A. at 267-68.
[73] *President & Fellows of Harvard College v. Glancy*, 2003 WL 21026784, at *21 (Del. Ch.).

the Rights Offering, the directors could purchase approximately a 0.00196% equity interest in Gulfport for $40,000. After the Rights offering, the directors could purchase approximately a 0.00196% equity interest in Gulfport for $40,000. In short, the directors did not gain any benefit from the anti-dilution adjustment but merely could purchase the same small equity interest in Gulfport for the same $40,000 in consideration. Plaintiff correctly points out that the directors could exercise more options at a lower exercise price, but ignores that each share purchased would represent about half as much equity in Gulfport.[74]

Plaintiff also concedes that the directors at the time of the Rights Offering did not own any warrants. Gulfport's controlling stockholder held most of the warrants at the time of the Rights Offering. Plaintiff's failure to allege facts showing that a majority of the Board was materially interested or not independent at the time of the Rights Offering means that Robotti's complaint must be dismissed for failure to state a claim under Court of Chancery Rule 12(b)(6).

D. Because of Erroneous Factual Premises, the Second Amended Complaint Fails to State a Claim

Because the factual foundation for Plaintiff's dilution claim is faulty, the claim itself cannot be sustained.

1. There Was No Dilution

Plaintiff's contention that the anti-dilution adjustments to the options and warrants caused dilution to Gulfport's stockholders is contrary to the factual allegations of the Second Amended Complaint and the law relating to anti-dilution provisions. Under 8 *Del. C.* § 157, the Gulfport Board had the authority to determine the terms of warrants and options for Gulfport stock. The Second Amended Complaint contains no allegation that the warrants or options were improperly

[74] While Mike Liddell held considerably more options, the same analysis applies to his holdings. He received no material benefit because the anti-dilution adjustments just kept him in the same situation after the Rights Offering as before.

issued or that their anti-dilution terms were improper. It does not allege that the anti-dilution adjustments did not comply with the terms of the warrants and options. Nor does Plaintiff deny that the anti-dilution provisions of the options and warrants had been known for several years. Anti-dilution provisions are customary features of a wide variety of corporate securities.[75] Such provisions do not dilute existing stockholders, but protect the holders of options and warrants from being diluted by subsequent stock issuances.

Plaintiff alleges that as a result of the anti-dilution adjustments caused by the Rights Offering, the option holders were entitled to buy almost double the number of shares after the Rights Offering. This allegation is based on the description of the anti-dilution adjustment to the options in the Prospectus:

> As of June 1, 2004, there were outstanding options to purchase 627,337 shares of our common stock at an exercise price of $2.00 per share. The agreements covering these options have anti-dilution provisions that will be triggered by this rights offering. The number of shares of common stock for which options may be exercised will be increased and the exercise price per share will be decreased based upon the subscription price per share of the rights issued in this rights offering, the number of shares issuable in this Rights Offering and the current market price of our common stock. The aggregate exercise price applicable to the options will remain unchanged. After giving effect to this offering, there will be outstanding options to purchase 1,245,612 shares of our common stock at an exercise price of $1.01 per share.[76]

Thus, the Prospectus confirms that after the Rights Offering, the option holders simply retained their same right to purchase the same small fraction of Gulfport's outstanding stock for about $1.2 million.[77]

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[75] *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1352 (Del. 1985); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 165 & n.79 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006).

[76] DX A at p. 22. The Prospectus also described the effect of the Rights Offering on the anti-dilution provisions of the warrants. *Id.*

[77] Plaintiff's dilution claim also ignores such obvious facts as that the options were already in the money based on Gulfport's stock price compared to the $2.00 per share option exercise price. Absent the anti-

Plaintiff acknowledges that the options had a $2.00 per-share exercise price and that the Rights offering price of $1.20 per share resulted in a contractual anti-dilution adjustment which merely "permitted [the option holders] to purchase additional shares at the same total price."[78] Plaintiff concedes that the anti-dilution adjustments simply gave the option holders the ability to purchase enough additional shares "to maintain their positions after the Offering."[79] Thus, the Second Amended Complaint recognizes that all the anti-dilution adjustments did was allow the option holders to buy more shares for the same total price in order to have the same minor equity position after the Rights Offering as the options would have entitled them to buy before the Rights Offering. The Second Amended Complaint alleges that the anti-dilution adjustments had the effect of nearly doubling the number of shares the directors could receive upon exercising their options "at the same total price" thereby decreasing their net cost per share. [80] However, plaintiff ignores that there were nearly double the number of outstanding shares after the Rights Offering. It is true that an anti-dilution adjustment that merely enables the option holder to purchase twice as many shares at half the prior exercise price mathematically increases the number of shares the holder could receive and decreases his net cost per share. However, because 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. Thus, there was no "dilution" of the other stockholders as a result of the anti-dilution adjustment to the options.

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dilution adjustments, the option holders would have been unfairly deprived of a significant part of the in-the-money value of their options.

[78] SAC ¶15b.

[79] SAC ¶39.

[80] SAC ¶15a & b.

The Second Amended Complaint (¶37) alleges that the controlling stockholder and Mike Liddell owned about 78% of Gulfport's stock at the Rights Offering. Thus, if there had been any dilution to the pre-offering outstanding shares of Gulfport as a result of the anti-dilution adjustments to the warrants and options, most of that dilution was to shares held by the controlling stockholder and Mike Liddell.[81] In essence, plaintiff is making the nonsensical assertion that the controlling stockholder and Liddell were deliberately diluting their substantial existing equity.

2. Plaintiff's False $.70 Per-Share Analysis

The cornerstone of plaintiff's purported dilution claim is that because of the anti-dilution adjustments resulting from the Rights Offering, Gulfport issued approximately 16.2 million shares to raise only $12 million in capital, representing only $.70 per share.[82] Plaintiff again has its facts and its math wrong.

Plaintiff alleges that prior to the Rights Offering, there were 2.4 million warrants outstanding with a $4 per-share exercise price and 627,000 outstanding options with a $2 exercise price.[83] Plaintiff asserts that the $1.20 offering price in the Rights Offering caused Gulfport to issue approximately 16.2 million shares (on a fully diluted basis) to raise only approximately $12 million in capital, effectively equating to a share price of approximately $.70 per share.[84] The Second Amended Complaint does not explain how plaintiff arrived at this calculation, but upon analysis plaintiff's fuzzy math is plainly wrong.

The $12 million in capital raised represents the proceeds from the sale of 10 million Gulfport shares in the Rights Offering at the $1.20 per-share offering price. The 16.2 million

[81] *See Bodell*, 132 A. 442, 450 (Del. Ch. 1926), *aff'd*, 140 A. 264 (Del. 1927).
[82] SAC ¶¶40, 55, 66.
[83] SAC ¶39.
[84] SAC ¶¶40, 66.

shares "issued" includes the 10 million shares issued in the Rights Offering. The Second Amended Complaint fails to explain directly what the other 6.2 million shares represent, how plaintiff arrived at that figure, how it is that Gulfport "issued" such shares (it plainly did not issue them at the time of the Rights Offering) or how additional shares were issued, but no additional consideration was received.

The Second Amended Complaint alleges that as a result of the anti-dilution adjustments, the number of shares issuable upon exercise of the options nearly doubled.[85] This reflects the disclosure in the Prospectus that after the adjustments, 1,245,612 shares would be issuable upon the exercise of the options at $1.01 per share, compared to 627,337 shares issuable upon exercise of options at $2 per share.[86] Thus, upon payment of the same $1,254,674 in exercise consideration, an additional 618,275 shares (*i.e.* 1,245,612 - 627,337) would be issued. The Second Amended Complaint alleges that as a result of the anti-dilution adjustments, the number of shares issuable upon the exercise of the warrants more than tripled.[87] This reflects the disclosure in the Prospectus that the warrants exercisable for $4 per share to purchase 2,431,517 shares before the Rights Offering would reflect the right to purchase 8,105,057 shares at $1.20 per share after the Rights Offering (*i.e.* 2,431,517 ÷ $1.20 x $4.00).[88] Thus, as to the warrants, upon payment of the same $9,726,068 in exercise consideration, an additional 5,673,540 shares (*i.e.* 8,105,057 - 2,431,517) would be issued. Therefore it appears that the extra 6.2 million shares referenced in the Second Amended Complaint beyond the 10 million Rights Offering shares represents the additional shares issuable upon exercise of the options and warrants (*i.e.* 618,275 + 5,673,540 = 6,291,815).

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[85] SAC ¶55.
[86] DX A at p. 22.
[87] SAC ¶55
[88] DX A at pp. 22-23.

The fallacy of plaintiff's 16.2 million shares for $12 million or $.70 per-share calculation is that it assumes that these additional 6,291,815 shares would be issued without payment of the exercise price of the options and the warrants. In other words, plaintiff fails to attribute any portion of the exercise consideration to these additional shares. Stated differently, plaintiff's position is that after the Rights Offering, the warrant holders should have been expected to pay the same $9,726,068 in exercise consideration for the same 2,431,517 shares they could have purchased before the Rights Offering, even though Gulfport would have substantially more shares outstanding. Similarly, plaintiff essentially says that after the Rights Offering, the option holders should have had to pay the same $1,254,674 in exercise consideration for the same 627,337 shares they could have purchased before the Rights Offering, even though Gulfport would essentially have twice as many shares outstanding.

The correct analysis is that, first, Gulfport issued 10 million shares in the Rights Offering to raise $12 million in capital, which had the effect of almost doubling the outstanding shares. Second, when and if all the options were exercised post-Rights Offering, Gulfport would receive $1,254,674 in additional capital for issuance of 1,245,612 shares. Third, when and if all the warrants were exercised post-Rights Offering, Gulfport would receive $9,726,068 in exercise consideration for issuing 8,105,057 shares. Overall, assuming exercise of all options and warrants, Gulfport would issue approximately 19,350,669 shares in the Rights Offering and upon exercise of the warrants and options and receive approximately $22,980,742 in capital, or approximately $1.20 per share. In short, plaintiff's assertion about Gulfport issuing 16.2 million shares for $.70 per share is simply wrong.

The Second Amended Complaint also repeatedly, erroneously and misleadingly suggests that because of the anti-dilution adjustments additional Gulfport shares were "distributed" at the

time of the Rights Offering or that the Rights Offering caused Gulfport to "issue" additional shares.[89] In fact, no shares were issued or distributed with respect to the warrants or options at the time of the Rights Offering. Shares would have only been issued when and if warrants and options were exercised. But the Second Amended Complaint does not allege whether, when and on what terms warrants and options were exercised or how many shares were issued upon any such exercise. Plainly, no shares were issued with respect to the warrants and options at the time of the Rights Offering, and no shares would be issued without the payment of the same total exercise price for the warrants ($9.6 million) and for the options ($1,254,000). Plaintiff erroneously disregarded the consideration Gulfport would receive when the warrants and options were exercised. Consequently, plaintiff's $.70 per-share calculation is bogus.

3. Plaintiff's Faulty Premise That the Subscription Price Could Be Above the Warrant Strike Price

Plaintiff repeatedly alleges that the exercise price in the Rights Offering was set at $1.20 per share in order to trigger the anti-dilution provisions of the warrants and options when the price could have been set below the market price of Gulfport's stock but above the exercise price of the warrants and options.[90] However, as the Second Amended Complaint acknowledges, the strike price of the warrants was $4 per share,[91] which was significantly above the trading price of Gulfport's stock.[92] Plaintiff also admits that a rights offering must be priced at a discount to the market price.[93] Thus, plaintiff's contention that the exercise price for the Rights Offering could and should have been set at a level which was a discount to market but would not have triggered

[89] SAC ¶39.
[90] SAC ¶¶15a-b, 16, 39, 41, 47, 59, 53.
[91] SAC ¶¶39, 49.
[92] SAC ¶¶34, 41.
[93] SAC ¶56.

the anti-dilution provisions of the warrants[94] is nonsense. Because the strike price of the warrants was well above the trading price of Gulfport stock, there was a simple reason:

> Why the price of the Offering could not have been at a discount to market that still would have been sufficient to allow it to be higher than the anti-dilution strike prices?[95]

In short, plaintiff's claim is premised on a mathematical impossibility.

4. Plaintiff's Assertion of a 60% Discount to the Market Price of Gulfport's Stock Is Factually Incorrect and Legally Irrelevant

Plaintiff has conceded that rights offerings must be done at below-market prices.[96] However, plaintiff asserts that the $1.20 price for the Gulfport Rights Offering represented a 60% discount to the market price of Gulfport's stock.[97] Plaintiff's opinion that the size of the discount was "unusual" is not supported by any facts.[98] More importantly, Robotti's purported 60% discount is based on plaintiff's misrepresentations concerning the market price of Gulfport stock at the time of the Rights Offering.

The Second Amended Complaint repeatedly refers to the market price of Gulfport shares being $3.10 on the bulletin board and misleadingly implies that $3.10 per share was the "prevailing market price" at the time of the Rights Offering. SAC ¶¶34, 41, 59. The Prospectus (DX A at p. 3) states that on April 13, 2004, the last trading day before the Board decided to proceed with the Rights Offering, the closing bid for Gulfport stock on the OTC Bulletin Board was $3.10. It further states that on July 21, 2004, just before the Rights Offering commenced, the closing price was $2.19 per share.[99] Plaintiff's allegations regarding the $3.10 trading price

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[94] SAC ¶¶47, 51(2)(3), 52d, 53.
[95] SAC ¶53.
[96] SAC ¶56; *Robotti*, 2007 WL 2019796, at *1 & n.3, *2.
[97] SAC ¶¶ 40, 56.
[98] SAC ¶56.
[99] DX A.

are misleading because publicly available records of Gulfport's trading prices[100] show the $3.10 price actually represented only one 500 share trade on April 12, 2004.[101] The trading price of Gulfport stock on the bulletin board during 2004 is a matter of public record. Those public trading prices reflect that during 2004 prior to the Rights Offering Gulfport's stock frequently traded well below $3.10. Thus, one of the central premises underlying Plaintiff's "claim" (*i.e.* that the $1.20 Rights Offering price was way below the market price of Gulfport's stock) is faulty. Thus, Plaintiff's reliance on a "prevailing market price of the stock [of] $3.10 per share"[102] is misleading and indicative of the lack of any valid claim.[103]

E. The Second Amended Complaint Fails to Allege a Claim For Damages

The Second Amended Complaint seeks damages on behalf of a "class" consisting of persons who held Gulfport shares as of August 20, 2004, the date the Rights Offering closed (excluding defendants and their affiliates).[104] The "damages" consist of "devaluing their shares" as a result of the $1.20 per share exercise price of the Rights Offering being unreasonably low. However, all stockholders were granted rights to purchase shares at $1.20 in the Offering, and plaintiff admits it exercised rights and purchased shares.[105] Thus, plaintiff and the purported

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[100] *County of York Employees Ret. Plan v. Merrill Lynch & Co., Inc.*, 2008 WL 4824053, at *7 & n.36 (Del. Ch.) (citing cases) (court may take judicial notice of the state of the markets and share price of company's stock); *Weiss v. Samsonite Corp.*, 741 A.2d 366, 376 & n.26 (Del. Ch.), *aff'd*, 746 A.2d 277 (Del. 1999) (judicial notice of the trading price of a listed stock).

[101] DX D, p. 12. A 24,000 share trade on March 26, 2004 occurred at $2.83, and the day before 5,300 shares traded at $2.80. *Id.*

[102] SAC ¶ 41.

[103] Prior to the Rights Offering, trading was sporadic and frequently involved only a few shares; on some days, the stock did not trade at all. DX D pp. 10-13. The additional shares that became part of the public float as a result of the Rights Offering improved the liquidity and trading volume in the market. *Id.*, pp. 9-10. After the Rights Offering, it was rare for no shares to trade, and there was trading volume above 10,000 shares on most days. *Id.* Moreover, the trading price of Gulfport's stock after the Rights Offering was actually higher than prior to the offering. *Id.*

[104] SAC ¶¶10, 62-63, Prayer for Relief ¶d.

[105] SAC ¶¶34, 36.

class did not suffer any damages or devaluing of their shares as a result of the Rights Offering itself.

To the extent plaintiff alleges damages to itself and the class of August 20, 2004 holders based on the anti-dilution adjustments to the warrants and options, no such damages occurred on August 20, 2004. While the Second Amended Complaint misleadingly suggests that additional shares were issued at the time of the Rights Offering, in fact, the adjustments simply gave the holders of the warrants and options the right to buy more shares in the future.[106] No shares were issued to warrant or option holders on August 20, 2004 so there was no "selling [of] extremely inexpensive shares" to the holders of warrants and options on that date.[107] Thus, the allegation that the "net cost" of the warrant and options holders was "below the net cost to the Class"[108] is based on the false assumption that warrants and option holders purchased shares on August 20, 2004. The Second Amended Complaint contains no such allegation. Indeed, it contains no allegation that the warrants and options were ever exercised.

As of August 20, 2004, no warrants and options had been exercised, and it was possible none would ever be exercised and no "low cost" shares would ever be issued. In any event, it is clear that no warrants and options were exercised, and no shares were issued on August 20, 2004. Therefore, no damages from issuance of low cost shares occurred on the class date.

F. The Defendants Did Not Conceal Improper Actions

In the Second Amended Complaint, plaintiff continues to vacillate as to whether it is alleging disclosure violations. Paragraph 52 states that this action "seeks no damages as a result

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[106] *Compare* SAC ¶39 (alleging "shared distributed under the anti-dilution provisions raised no capital for Gulfport") and ¶40 ("Because of the anti-dilution provisions, the Offering price caused Gulfport to issue approximately 16.2 million shares") with SAC ¶15a & b (recognizing that anti-dilution adjustments merely increased the number of shares option holders "could" receive upon exercise of options).
[107] *Cf.* SAC ¶40.
[108] *Id.*

of improper disclosure." Thus, plaintiff concedes it has no disclosure claim and seeks no relief for any such claim. Because plaintiff asserts no disclosure claim and seeks no disclosure related relief, the allegations of paragraphs 52a-g concerning the disclosures in the Prospectus are mere surplusage. Nevertheless, plaintiff asserts that "the disclosures reveal an effort by defendants to conceal their improper actions and purpose."[109] Plaintiff's disclosure allegations are without factual and legal basis. The supposedly misleading statements or omissions in the Prospectus largely track Plaintiff's erroneous factual assertions.

Plaintiff asserts that the statement in the Prospectus that the purpose of the offering is to provide a portion of Gulfport's capital requirements is misleading because the board minutes and documents considered by the Board do not reveal that the Board considered the Company's capital expenditure requirements.[110] In fact, the November 14, 2003 minutes and April 14, 2004 minutes show the Board considered Gulfport's capital constraints and needs, and determined that the Rights Offering was an appropriate method for funding Gulfport's capital requirements.[111] Similarly, the Board minutes and consents show that the Board reviewed and authorized the filing of drafts of the Prospectus (*i.e.* the Registration Statement) which contained the Rights Offering, and approved the offering and the Prospectus.[112]

Plaintiff alleges in ¶52b of the Second Amended Complaint that the statement in the Prospectus that the net proceeds of the Rights Offering will be used to fund a portion of Gulfport's proposed seismic and drilling programs is misleading because there is no Board resolution to that effect and the "records of the corporation" contain "absolutely no evidence" that the Board received any analysis of the proposed seismic and drilling programs and the

[109] SAC ¶52.
[110] SAC ¶52a.
[111] DX C at GULFPORT 037; DX C at GULFPORT 034.
[112] DX C GULFPORT 016-027 at GULFPORT 018-020; DX C at GULFPORT 003-009; DX C at GULFPORT 003-004; DX C at GULFPORT 010-011 at GULFPORT 010.

funding needs therefore. To the contrary, the minutes and other Board records plaintiff references in its Second Amended Complaint reveal that the Board received regular reports on the seismic and drilling programs.[113]

Paragraph 52c is a counterfactual laundry list that is contradicted by the "actual records of the company" which the Second Amended Complaint repeatedly references. The assertion that the "records of the company" demonstrate that there is "absolutely no validity" to the description in the Prospectus of the factors used to set the subscription price is simply an argumentative mischaracterization of the facts.[114] The Board initially considered the subscription price at its April 14, 2004 meeting, then specifically reconsidered the pricing of the subscription rights on July 12, 2004 and determined that the Rights Offering at a $1.20 per-share subscription price was fair to, and in the best interest of, the Company and its stockholders.[115] Indeed, even plaintiff's pejorative misdescription of the Board having rubberstamped "management and the controlling stockholder's predetermined Subscription Price"[116] actually admits the Board considered and set the offering price. In determining the subscription price, the Board, in fact, considered the various factors cited in the Prospectus.[117]

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[113] DX C at GULFPORT 034; DX C at GULFPORT 012; DX C at GULFPORT 002; DX C at GULFPORT 001. Under 8 *Del. C.* § 141(e), a report or analysis can be oral and does not have to be in writing. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1142 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995); *Smith v. Van Gorkom*, 488 A.2d 858, 874-75 (Del. 1985).

[114] The Board minutes and consents show that the Board approved the various registration statements containing the preliminary prospectuses and the final prospectus. This reinforces that the Board had considered the factors, made the determinations and granted the approvals reflected in the Prospectus. The disclosure in the Rights Offering that the controlling stockholder would backstop the Offering told the stockholders the controlling stockholder was willing to put $10 million more of its own money into Gulfport and that the opportunity to buy Gulfport shares for $1.20 was an attractive investment opportunity. *In re Nantucket Island Assocs. Ltd. Partnership Unitholders Litig.*, 810 A.2d 351, 374-75 (Del. Ch. 2002).

[115] *See* DX C at GULFPORT 010-011, 016-027.

[116] SAC ¶ 52c.

[117] Plaintiff's assertion that the Board did not have before it "any analysis of the current market price of the stock" is absurd. SAC ¶52c. Gulfport's market price was published every day. As discussed above,

The assertion in ¶52d of the Second Amended Complaint that there was no discussion or consideration of the dilution which would result from the Rights Offering subscription price triggering the anti-dilution requirements of the options and warrants is also untrue. The Board approved the preliminary and final prospectuses which specifically describe the impact of the operation of the anti-dilution provisions of the options and warrants.[118]

The Board specifically did consider and approve the $3 million revolving credit facility entered into on April 30, 2004.[119] Therefore, the allegations of ¶52e and ¶52f are false. Similarly, the Board did determine that it was in the Company's best interest to undertake the Rights Offering if a sale of the West Cote Blanche Bay field was not consummated. Therefore, the allegations of ¶52g of the Second Amended Complaint are false. Because defendants engaged in no improper conduct, plaintiff's claims fail.

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the Board considered financing alternatives, and the Prospectuses discussed the level and volatility of commodity prices.

[118] As discussed earlier, there actually was no "dilution" because, as the Second Amended Complaint admits, the operation of the anti-dilution provisions simply permitted the option holders to purchase the same percentage interests in the Company for the same amount of money.

[119] DX C at GULFPORT 021.

II. DEFENDANTS' MOTION TO DISMISS SHOULD BE GRANTED BECAUSE THE SECOND AMENDED COMPLAINT FAILS TO COMPLY WITH RULE 23.1

Court of Chancery Rule 23.1 preserves the board's authority over ordinary business decisions by requiring that before asserting derivative claims, a stockholder either demand that the corporate board initiate the litigation itself, or, in the alternative, demonstrate in the complaint why such demand would have been futile.[120] A plaintiff who asserts demand futility must "comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings governed solely by Court of Chancery Rule 8(a)."[121] Vague or conclusory allegations are not sufficient.[122] Merely raising an inference that a board would refuse demand or alleging the board would refuse demand is not sufficient.[123] To establish demand futility under *Aronson*,[124] plaintiff's complaint must raise a reasonable doubt about the directors' disinterest and independence.[125] For example, a plaintiff must allege a specific director is interested by stating facts showing that the director personally benefited from the challenged transaction, or show that a particular director is dominated by or is beholden to an interested director.[126] This requires a detailed, fact-intensive, director-by-director analysis.

A. Plaintiff's Dilution Claims are Derivative

Plaintiff's Second Amended Complaint does not allege that plaintiff made a pre-suit demand before it filed its first complaint on July 27, 2007, before it filed its Amended Complaint on January 15, 2008 or before it filed its Second Amended Complaint on December 22, 2008.

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[120] *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 984-85 (Del. Ch. 2007).
[121] *infoUSA*, 953 A.2d at 985 (quoting *Zimmerman v. Braddock*, 2002 WL 31926608, at *7 (Del. Ch.)).
[122] *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).
[123] *Postorivo v. AG Paintball Holdings, Inc.*, 2008 WL 553205, at *5 (Del. Ch.).
[124] *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).
[125] *infoUSA*, 953 A.2d at 985.
[126] *Orman v. Cullman*, 794 A.2d 5, 25, n.50 (Del. Ch. 2002); *infoUSA*, 953 A.2d at 985; *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004) (quoting *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996)).

For the first time, Plaintiff's Second Amended Complaint alleges that demand is excused. Plaintiff, also for the first time admits in its Second Amended Complaint that its dilution claim *may be* derivative.[127] Under Delaware law, Plaintiff's claim that stockholders were diluted by options and warrants plainly is a derivative claim.

Plaintiff acknowledges as it must,[128] that Robotti was not diluted by the Rights Offering. Instead, the alleged dilution supposedly occurred when the anti-dilution provisions protecting the holders of the warrants and options were triggered by the Rights Offering. This Court has recognized since *Elster v. American Airlines*,[129] that:

> [a]ny injury which plaintiff may receive by reason of the dilution of his stock would be equally applicable to all the stockholders of defendant, since plaintiff holds such a small amount of stock in proportion to the amount of stock outstanding that the control or management of defendant would not be affected by the granting of these options, and, further, since there is no averment that the pre-emptive rights of plaintiff as a stockholder are affected by their issuance.

The Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,[130] stated that the analysis to determine a derivative, as opposed to a direct, claim should focus on "the nature of the wrong and to whom the relief should go. The stockholder's claimed direct injury must be independent of any alleged injury to the corporation." After *Tooley*, the Delaware courts have continued to hold that dilution claims are derivative.[131] Dilution claims are derivative

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[127] SAC ¶13.

[128] SAC ¶36 (acknowledging that Robotti exercised its full subscription rights and purchased additional rights in the open market). *See also Robotti*, 2007 WL 2019796, at *1.

[129] *Elster v. American Airlines*, 100 A.2d 219, 222 (Del. Ch. 1953) (seeking to enjoin the grant and exercise of stock options because they would result in a dilution of her stock personally).

[130] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004).

[131] *See, e.g., Conrad v. Blank*, 940 A.2d 28, 34 (Del. Ch. 2007)(stockholder derivative action where complaint challenged amendment to exercise price of option grants); *FS Parallel Fund v. Ergen*, 879 A.2d 602 (Del. 2005), *aff'd* C.A. No. 19853 (Del. Ch. July 28, 2003); *Feldman v. Cutaia*, 956 A.2d 644, 656 & n.36 (Del. Ch. 2007), *aff'd*, 951 A.2d 727 (Del. 2008); *Oliver v. Boston Univ.*, 2006 WL 1064169,

because the alleged injury resulting from the dilution claim "is to the corporation because 'it falls upon all shareholders equally and falls only upon the individual shareholder in relation to his proportionate share of stock as a result of the direct injury being done to the corporation.'"[132] In particular, claims of dilution premised on the issuance of additional equity or options reducing the value of the complaining stockholder's shares continue to be derivative claims.[133] Robotti's Second Amended Complaint attempts to state a general dilution claim, which under Delaware law has been considered a derivative claim for more than fifty-five years. Because Robotti did not make a demand on the board, and its Second Amended Complaint fails to allege sufficiently that demand was excused, Robotti's derivative claim should be dismissed.

B. Plaintiff Fails to Allege Sufficiently That the Current Board is Interested or Not Independent

In the context of a motion to dismiss under Rule 23.1, the Court considers the board in place at the time the plaintiff brings the complaint.[134] The Second Amended Complaint does not allege sufficiently that a majority of the directors in office at the time of the original Complaint, or when the Second Amended Complaint was filed[135] were interested, not independent or incapable of exercising independent judgment with respect to Robotti's claims.[136]

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at *17 (Del. Ch.); *Gatz v. Ponsoldt*, 2004 WL 3029868, at *7 (Del. Ch.)("Mere claims of dilution, without more cannot convert a claim, traditionally understood as derivative, into a direct one.").

[132] *Feldman*, 956 A.2d at 656 (quoting *In re Berkshire Realty Co., Inc.*, 2002 WL 31888345, at *4 (Del. Ch.)).

[133] *Feldman*, 956 A.2d at 655-659.

[134] *In re Tyson Foods, Inc.*, 919 A.2d 563, 582 (Del. Ch. 2007); *see also Braddock v. Zimmerman*, 906 A.2d 776, 784-86 (Del. 2006) (discussing when plaintiff must make demand upon new board when amended derivative complaint is filed).

[135] The directors in place at the time Robotti filed its Second Amended Complaint were Mike Liddell, James D. Palm, David L. Houston, Scott E. Streller and Donald L. Dillingham.

[136] Plaintiff insists that the futility of demand should be determined as of the filing of the original complaint. Even accepting plaintiff's position, demand is not excused.

C. The Second Amended Complaint Fails to Demonstrate That the Directors at the Time of the Original Complaint Were Not Disinterested or Independent

The Second Amended Complaint fails to demonstrate that a majority of the Gulfport directors at the time of the original complaint were not disinterested and independent. The Second Amended Complaint acknowledges that two of the five Director Defendants (Mickey Liddell and Dan Noles) had left the Gulfport Board before the original Complaint in this action was filed.[137]

Contrary to plaintiff's allegations, the three directors from the time of the Rights Offering who still remained on the Gulfport Board when the original Complaint was filed (Mike Liddell, Robert E. Brooks and David L. Houston)[138] did not have a material financial interest conflicting with that of the corporation's stockholders. Plaintiff does not allege, let alone with particularity, that any benefit received from the Rights Offering was material or substantial to any of the individual director defendants. As this Court recognizes,

> it is not enough to establish the interest of a director by alleging that he received any benefit not equally shared by the stockholders. Such benefit must be alleged to be *material* to that director. Materiality means that the alleged benefit was significant enough "*in the context of the directors' economic circumstances*, as to have made it improbable that the director could perform [his] . . . duties . . . ."[139]

All the shareholders had equal opportunity to participate in the Rights Offering. None of the directors held warrants.[140] Brooks and Houston held a nominal number of options.[141] Moreover, as shown above, the anti-dilution adjustment to the options only put the directors (including Mike Liddell) in the same position after the Rights Offering as before it. In short,

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[137] SAC ¶¶6-7, 17.
[138] SAC ¶18.
[139] *Glancy*, 2003 WL 21026784, at *21 (quoting *Orman v. Cullman*, 792 A.2d 5, 23 (Del. Ch. 2002) (emphasis in original)).
[140] SAC ¶ 39.
[141] SAC ¶ 15b.

these three directors did not receive any material financial benefit from the Rights Offering. In addition, Plaintiff fails to allege particular facts, let alone establish, that any of the directors at the time of the Rights Offering based their decision to approve the Rights Offering on anything other than the merits of the transaction.

Plaintiff also attacks the independence of Scott Streller, who joined the Gulfport Board in August 2006 (*i.e.* two years after the Rights Offering) by alleging that he received $15,638 in 2006 and $40,231 in 2007 from Gulfport in directors' fees. Plaintiff's allegations regarding the payment of directors' fees does not establish any financial interest on behalf of these directors.[142] Receipt of routine directors' fees in such modest amounts does not render a director interested or not independent.[143] Similarly, the allegations that Streller is a nominee for a directorship of Diamondback Energy Services, Inc. and if elected would receive $12,000 in director fees, $500 per board meeting and 6,667 shares of stock in 2008[144] do not establish interest or lack of independence. There is no factual support for plaintiff's assertion that these modest amounts he might receive would be material to Mr. Streller.[145] In fact, the Second Amended Complaint alleges that Mr. Streller operates an insurance and financial services agency and derives his "principal income" from these activities,[146] not from directors' fees. The Second Amended Complaint is silent concerning the amount of income Mr. Streller derives from his agency. However, such an agency can be very profitable. For similar reasons, the Second Amended

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[142] *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 359-60 (Del. Ch. 1998), *aff'd in part, rev'd in part*, 746 A.2d 244 (Del. 2000) (quoting *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988)).
[143] *Folk* §327.4.2.4.4.
[144] SAC ¶¶22, 28.
[145] *Id.* ¶28.
[146] *Id.*

Complaint's allegations concerning Mr. Houston and Mr. Dillingham fail to show a lack of independence or material financial interest.[147]

Plaintiff's allegations regarding the payment of directors' fees do not establish any material financial interest on the part of any of Gulfport's current directors.[148] The allegations regarding Mr. Streller, Mr. Dillingham and Mr. Houston's allegedly having "substantial ties"[149] also fall short of raising a reasonable doubt about their ability to properly consider a demand.[150] These generalized allegations, without specific factual support, fail to suggest that they receive a benefit that "is of such subjective material importance that its threatened loss might create a reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively."[151] Moreover, Plaintiff fails to create a reasonable doubt as to their independence. In fact, Plaintiff's generalized allegations ask this Court to disregard the presumption that the directors were faithful to their fiduciary duties,[152] and believe that these directors would sacrifice their professional reputation based on unarticulated and unfounded suggestions that Gulfport's directors might be inappropriately swayed by the controlling stockholder's wishes or interests.

D. Plaintiff Fails to Demonstrate that the Rights Offering Was Not the Product of a Valid Exercise of Business Judgment.

Plaintiff does not satisfy Court of Chancery Rule 23 and the second prong of *Aronson* because it fails to raise reasonable doubt that the Rights Offering was not the product of a valid

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[147] *Id.* ¶¶22, 27, 29.
[148] *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 359-60 (Del. Ch. 1998) (quoting *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988), *aff'd in part, rev'd in part*, 746 A.2d 244 (Del. 2000).
[149] SAC ¶¶ 22, 27, 29.
[150] *See Beam v. Stewart*, 845 A.2d 1040, 1051 (Del. 2004).
[151] *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 985 (Del. Ch. 2007) (quoting *Telxon Corp. v. Meyerson*, 802 A.2d 257 (Del. 2002)). The similar allegations regarding current director Donald Dillingham (SAC ¶¶22, 29) are also inadequate to establish interest or lack of independence.
[152] *Aronson*, 473 A.2d 805, 812 (Del. 1984).

exercise of the directors' business judgment.[153] Plaintiff fails to allege particularized facts creating a reasonable doubt that the "informational component of the directors' decision making process, *measured by concepts of gross negligence*, included consideration of all material information reasonably available."[154] As discussed below, plaintiff's erroneous factual assertions ignore information contained in the minutes and board documents that is directly contrary to plaintiff's characterization of events and its conclusion that the Board did not inform itself concerning the Rights Offering.[155] Plaintiff acknowledges that the board considered that the rights were registered with the SEC and were freely tradable,[156] and factors such 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 Holdings to backstop this rights offering."[157] Arguments that the board did not consider factors such as financing alternatives, the need for financing, and the current market price,[158] are nonsense in light of the minutes and consents referenced in the Second Amended Complaint which show there was such Board consideration. The fact that the board did not retain an outside representative to evaluate the transaction or get a fairness opinion does not show the board did not exercise its business judgment. It is well settled that the board is not required to rely on outside advisors or obtain a fairness opinion and is fully protected by the business judgment rule in relying in good faith upon the reports of Gulfport's management.[159]

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[153] Of course, this theory has no application to the directors who were not on the Board at the time of the Rights Offering, *i.e.* Messrs. Palm, Streller, Dillingham. Moreover, contrary to the allegations in the Second Amended Complaint (¶19), the fact that current director James Palm is also an officer does not render him interested or not independent.
[154] *Brehm*, 746 A.2d at 259.
[155] SAC ¶ 21.
[156] SAC ¶ 45.
[157] SAC ¶ 41.
[158] *See, e.g.*, SAC ¶¶ 47-50, 52a-52g, 54.
[159] *Van Gorkom*, 488 A.2d at 876.

CONCLUSION

For the foregoing reasons set forth herein, Defendants' Motion to Dismiss should be granted.[160]

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DATED: February 20, 2009

[160] Plaintiff's claims are also subject to other defenses, including laches, 8 *Del. C.* § 102(b)(7) and acquiescence. These defenses are generally determined on summary judgment, and defendants in no way waive such defenses.

CERTIFICATE OF SERVICE

I, Michael Hanrahan, do hereby certify that on this 20th day of February 2009, I caused a copy of the foregoing **Defendants' Opening Brief In Support of Their Motion to Dismiss Plaintiff's Second Amended Verified Class Action and Derivative Complaint** to be served via LexisNexis File and Serve on the following counsel of record:

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