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Delaware Court Dismisses Misappropriation Claim Against Private Equity Firm for Investing in Competing Company

Recently the Delaware Court of Chancery dismissed claims that a private equity firm and affiliated funds misappropriated trade secrets acquired from their portfolio company via their director designees and then misused the information by investing in a competitor. In *Alarm.Com Holdings, Inc. v. ABS Capital Partners Inc.*, Vice Chancellor Travis Laster held that no reasonable inference of misappropriation could be made, noting that multiple agreements between the company and the private equity firm, as well as provisions in the company's code of conduct and charter, specifically contemplated the possibility that the private equity firm would invest in competitors. The opinion highlights the importance of provisions that address potential conflicts of interest in situations where directors may sit on boards of competing companies, at least as protection against certain Delaware laws.

Background

Defendant ABS Capital Partners (including related funds, "ABS") acquired a controlling interest in plaintiff Alarm.Com Incorporated ("Alarm") in 2009. During the course of this relationship, ABS and Alarm were parties to several agreements that included provisions to address the possibility that ABS and other stockholders would invest in competing companies, as did Alarm's certificate of incorporation and code of business conduct. Also, during this time, various ABS partners were designated to the board pursuant to agreements with Alarm, including one partner who served as chairman. By 2016, a year after Alarm's initial public offering, no ABS director remained on the Alarm board. Then in 2017, ABS acquired a stake in Resolution Products, Inc., a direct competitor of Alarm. In conjunction with its investment, ABS received the right to appoint one member to the Resolution board. As with Alarm, ABS appointed one of its partners, though not from among the individuals who had served on the Alarm board.

Subsequent to ABS's investment in Resolution, Alarm filed suit claiming that ABS had acquired confidential information from Alarm, including trade secrets, through the ABS partners' service on the board, that ABS then misused the information by investing in a competitor (Resolution) and that together this constituted a misappropriation of trade secrets under the Delaware Uniform Trade Secrets Act ("DUTSA"). Alarm also asserts a claim for common law misappropriation of confidential information.

Analysis

In granting defendant's motion to dismiss, the Court of Chancery concluded that it is not reasonably conceivable, based on the facts alleged, that ABS engaged in misappropriation under DUTSA because Alarm's complaint relies only on ABS's investment in Resolution as a basis for inferring the

misappropriation. The court points to numerous agreements between Alarm and ABS and provisions in Alarm's Code of Business Conduct (the "Code") and Amended and Restated Certificate of Incorporation (the "Amended Charter") as evidence that the parties understood that ABS could be free to invest in a competitor of Alarm, including the following:

- In 2008, during negotiations for ABS's investment in Alarm, ABS and Alarm entered into a confidentiality agreement, which provided, among other things, that assuming ABS's compliance with the confidentiality and other obligations therein, nothing in the agreement would prevent ABS from evaluating, collaborating with or entering into transactions (including any investments) in a competitor and acknowledged that ABS engages in competitive activities with the company.
- In 2009, concurrent with ABS's investment in Alarm, the parties entered into a stockholders agreement, which anticipated that Alarm stockholders might own equity in competing companies. For example, the agreement stated that 5% or more holders could appoint a board observer unless they invested in competing businesses (although this limitation did not apply to ABS).
- In 2012, concurrent with a restructuring transaction, Alarm replaced the earlier stockholder agreement with a new agreement that included, among other things, typical confidentiality provisions and an agreement that ABS and another investor could invest in any other company (whether or not competitive with Alarm), as long as they did not disclose or otherwise make use of any proprietary or confidential information of Alarm in connection with such activities.
- In 2012, again, concurrent with the restructuring, Alarm adopted the Amended Charter, which included a provision exempting stockholders from any duty not to pursue corporate opportunities that otherwise might belong to Alarm. The provision also stated that the company acknowledged that stockholders have no duty (contractual or otherwise) not to, directly or indirectly, engage in the same or similar business activities or lines of business as Alarm including those deemed to be competing with Alarm or to communicate or present a corporate opportunity to Alarm and are not liable to Alarm for breach of any duty (contractual or otherwise) if the stockholders pursue or acquire the opportunity for themselves, direct the opportunity to another person or do not present the opportunity to Alarm.
- In 2015, Alarm completed an initial public offering and adopted the Code, which addressed conflicts of interest that might arise as a result of funds like ABS having representatives on the board. The Code stated that if any such fund designee "acquires knowledge of a potential transaction (investment transaction or otherwise) or other matter other than in connection with such individual's service as a member of the Board (including, if applicable, in such individual's capacity as a partner or employee of the Fund or the manager or general partner of a Fund) that may be an opportunity of interest for both the Company and such Fund. . . , then, provided that

such director has acted reasonably and in good faith with respect to the best interests of the corporation, such an event shall be deemed not to be a ‘conflict of interest’ under this policy.”

Although not all of the provisions discussed above were in effect at the time of ABS’s investment in Resolution, the court nevertheless found them dispositive of the understanding between the parties as to ABS’s ability to invest in other competing companies. Further, while the court noted that it was not opining on the validity of a broad and general renunciation of corporate opportunities as was in the Amended Charter (as opposed to a more tailored provision addressing a specified business opportunity of a well-defined class or category of business opportunities), the court nevertheless noted that the charter provision was important in the context of this particular litigation because having included the provision in its charter, Alarm had waived its claim for breaches of fiduciary duty of loyalty based on usurpation of a corporate opportunity, giving up the “most powerful remedial tool that a court of equity possesses” and that it would be “counterintuitive” to permit it to pursue lesser theories that could be asserted against a non-fiduciary, such as a misappropriation claim under DUTSA. Because the court also found that DUTSA preempts a claim for common law misappropriation, the court dismissed that claim as well.

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