Success for a Start-Up May Not Fulfill All of Its Founder's Dreams

CAPABILITIES

Business Litigation

Corporate and Business Law

Emerging Companies

05.13.2019

Start-ups are hungry for capital. This can be especially true of medical technology companies that have high research and development costs. But as a recent Delaware Chancery Court decision illustrates, when a company pursues the outside investment necessary for its success, its founders may be left behind.

In *Sheldon v. Pinto Tech. Ventures, L.P.*, No. 2017-0838-MTZ, 2019 Del. Ch. LEXIS 34 (Ch. Jan. 25, 2019), the founders of a successful medical technology company retained only a tiny sliver of the company by the time it sold.

At first blush, the facts of this case can appear jarring to entrepreneurs. Jeffrey Sheldon and Andras Konya, M.D., Ph.D. were early stockholders in IDEV Technologies, Inc., a manufacturer of stents used to treat blocked arteries. Sheldon founded the company in 1999, and served as its first Chief Executive Officer. Konya was a co-inventor of proprietary technology licensed to the company. But according to court filings, when the company was acquired by Abbott Laboratories for more than $300,000,000, Sheldon and Konya would "be fortunate to receive $15,000 and $7,500, respectively, for their shares."

They sued venture capital investors and members of the company's board and management in Texas, where the company's operations are located. In their complaint, they alleged fraud and breach of fiduciary duty. However, the Texas state court dismissed their case because the shareholders had signed a Shareholders' Agreement with a broadly worded choice of venue provision. The agreement required that "any dispute arising out of" the Shareholders' Agreement be filed in Delaware.

After the case was refiled in Delaware Chancery Court, it was dismissed on procedural grounds. The court found that Sheldon's and Konya's claims were derivative and that they failed to comply with the pleading requirements for derivative suits. In other words, they were pursuing claims that belonged to the corporation, but they did not meet the legal requirements for shareholders to bring such claims.

In short, plaintiffs Sheldon and Konya did not get relief from the court and ultimately did not reap substantial financial rewards from the company's success.

The case is a stark reminder that the interests of a company and its founders can sometimes diverge. Between 2004 and the company's eventual sale in 2013, the company underwent a series of financing rounds, raising tens of millions of dollars. The outside investors brought in new management, restructured the sales force, and implemented a new strategic plan. These measures made the company an attractive target for Abbott Laboratories but severely diluted the founders' ownership interests in and control over the company. As a result, Sheldon and

Konya celebrated IDEV's success from the sidelines.

Some key points of this case include:

1. Contract Boiler-Plate Language Matters: The choice of forum clause in the back of the Shareholders' Agreement played a decisive role in the outcome of this case.
2. Dilution Claims Most Often Belong to the Company: The Plaintiffs' complaint did not contain factual allegations to support a claim that they suffered a harm that was independent of the corporation.
3. Sometimes Start-Ups Need to Move Beyond Their Founding to Thrive: A company's founders may not always be the right leaders to take the company from inception to success, and the interests of a company and its founders may diverge. When that divergence leads to conflict or litigation, the documents they signed often control the outcome.