

Court of Chancery Finds Officer Liable for Competing With Corporation and Misappropriating Trade Secrets

Contributors

Arthur R. Bookout / Counsel

Farai Vyamucharo-Shawa / Associate

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On September 1, 2023, Vice Chancellor Paul A. Fioravanti, Jr. of the Court of Chancery delivered a decision finding that the president of a plaintiff company and a second business the president had formed and served simultaneously were liable for his misappropriation of trade secrets, breach of contract and breaches of his fiduciary duty of loyalty to the plaintiff.

In *Sorrento Therapeutics, Inc. et al. v. Anthony Mack et al.*, C.A. No. 2021-0210-PAF (Del. Ch.) (Sept. 1, 2023), the court rejected former Scilex Pharmaceuticals Inc. President Anthony Mack’s defenses that his work for his other company that also operated in the pain-management space, Virpax Pharmaceuticals Inc. (Virpax), did not breach both a non-compete clause in a Restrictive Covenants Agreement (RCA) and his duty of loyalty to Scilex as an officer of the company.

The court also held that documents Mack downloaded from Scilex servers for use by Virpax constituted misappropriation of trade secrets. Additionally, the court found Virpax liable for interfering with the RCA, aiding and abetting Mack’s breaches of his fiduciary duties and misappropriation of trade secrets.

Background

Defendant Mack founded and served as president of Scilex. Following its November 2016 acquisition, Scilex became a subsidiary of Sorrento Therapeutics, Inc. Mack agreed to stay on as president of Scilex, and entered into the RCA with Sorrento. The RCA restricted Mack from “directly or indirectly” engaging in activities that competed with Scilex in developing pain-management products for a two-year period.

On the same day that Mack signed his offer letter to remain as president of Scilex, he formed Virpax Pharmaceuticals, LLC (Virpax LLC). Several months later, he formed Virpax, the defendant in this case. Virpax LLC owns a 20% interest in Virpax, which went public in 2021.

As president of Scilex, Mack was tasked with identifying products for licensing and commercialization. In November 2016, Scilex was working on approvals for a pain-management product called ZTlido.

After trial, the court found that, through Virpax, Mack pursued development and obtained licenses for three different pain-management products that had first been offered to Scilex. The evidence also showed that Mack pursued these opportunities while simultaneously excluding Scilex from discussions, yet he used Scilex assets to benefit Virpax in its efforts. Mack also downloaded and kept for Virpax more than 1,000 Scilex documents prior to resigning from Scilex.

Following Mack’s resignation from Scilex, the plaintiffs brought suit arguing, among other things, that Mack had breached both the RCA and his fiduciary duty of loyalty, and misappropriated trade secrets when he pursued the development of pain-management products on behalf of Virpax instead of Scilex. The plaintiffs also sued Virpax alleging tortious interference with the RCA, and aiding and abetting Mack’s breaches of fiduciary duty and misappropriation of trade secrets.

Claims Against Mack

Breach of Contract

Applying California law, the court found that Mack breached the non-compete provisions in the RCA. While California law broadly prohibits non-compete agreements, there is an exception for agreements executed in connection with the sale of a business. The court found that the sale of Scilex to Sorrento fell squarely within this exception, and that Mack's efforts to license pain-management products for Virpax violated the RCA.

Breaches of the Fiduciary Duty of Loyalty

The court also addressed the plaintiffs' claims that Mack violated his fiduciary duty of loyalty by usurping Scilex's development opportunities and by misappropriating Scilex's corporate assets for the benefit of Virpax.

The court rejected Mack's argument that the fiduciary duty claims were simply duplicative of the breach of RCA claims, finding that the fiduciary duty claims depended on additional facts, were broader in scope and involved different considerations in terms of a potential remedy.

The court also rejected Mack's argument that he did not usurp a corporate opportunity because Scilex and Sorrento would not have been able to commit resources to new development projects. The court explained that, while it may have been unlikely that Scilex would pursue new projects, the issue here was the company's ability to pursue the opportunity, not the board's likelihood of actually deciding to do so.

Regarding Mack's misappropriation of Scilex's assets to benefit Virpax, the court characterized Mack's conduct as "inapposite to the standard of conduct for a corporate fiduciary."

Claims Against Virpax

Virpax was found liable for both tortiously interfering with Mack's RCA with Sorrento, as well as aiding and abetting Mack's breaches of fiduciary duty.

Applying Delaware law, the court imputed Mack's knowledge of the RCA and the development of Scilex's products to Virpax. The court rejected Virpax's argument that it possessed an "interference privilege" because its business interests were aligned with Mack's. Virpax was not a "stranger" to the RCA or the business relationship between Mack and Scilex as a result of being imputed with Mack's knowledge, the court said. Thus, Virpax's "general business interest in competing in the pain management marketplace," was outweighed by Mack's contractual obligations to Scilex.

For the same reasons, the court also held Virpax liable for aiding and abetting Mack's breaches of fiduciary duty to Scilex. Because Mack's knowledge could be imputed to Virpax, the company was deemed to have "knowingly participated" in the breaches of duty.

Misappropriation of Trade Secrets

Both Mack and Virpax were also found liable for misappropriation of Scilex's trade secrets. While the plaintiffs originally sought to establish that each of the more than 1,000 Scilex documents downloaded by Mack were protected trade secrets, they presented only a handful of those documents at trial, and the court ultimately found that only five fit the criteria.

The court rejected the defendants' argument that Scilex's knowledge of the existence of the defendants' competitive activities meant it acquiesced in Virpax's use of Scilex's trade secrets because the plaintiffs lacked full knowledge as a result of Mack's active concealment of his ventures with Virpax from key Scilex and Sorrento personnel.

The court reserved ruling on an appropriate remedy pending additional submissions from the parties.

Key Points

- Corporate directors and officers who are planning to provide assistance or services to a second entity should consult with an attorney to understand the interplay between the new roles and duties that they wish to undertake and their current contractual obligations and fiduciary duties to their existing employer or affiliates.
- It is vital that companies be aware of and understand the outside business pursuits of their corporate officers. Companies should consult with counsel to ensure officers maintain appropriate focus on, and loyalty to, the company, and to implement disclosure requirements in the event of potential competing interests.

Contacts

Litigation

Cliff C. Gardner

302.651.3260
cliff.gardner@skadden.com

Paul J. Lockwood

302.651.3210
paul.lockwood@skadden.com

Edward B. Micheletti*

302.651.3220
edward.micheletti@skadden.com

Jenness E. Parker

302.651.3183
jenness.parker@skadden.com

Jennifer C. Voss

302.651.3230
jennifer.voss@skadden.com

Mergers & Acquisitions

Faiz Ahmad

302.651.3250
faiz.ahmad@skadden.com

Steven J. Daniels

302.651.3240
steven.daniels@skadden.com

Allison L. Land

302.651.3180
allison.land@skadden.com

Richard H. West

302.651.3178
richard.west@skadden.com

Corporate Restructuring

Joseph O. Larkin

302.651.3124
joseph.larkin@skadden.com

*Editor

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One Rodney Square / 920 N. King St. / Wilmington, Delaware 19801 / 302.651.3000

One Manhattan West / New York, NY 10001 / 212.735.3000