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Chancery Asks If It's Right Venue For Biotech Stock Drop Suit

By **Jeff Montgomery**

Law360 (March 1, 2022, 4:10 PM EST) -- Attorneys sparring in Delaware's Chancery Court over a weeks-long, costly delay in Frequency Therapeutics Inc. stockholder share sales in 2021 while a top officer's transactions moved promptly will first have to show they're in the right court, a vice chancellor ruled Tuesday.

Vice Chancellor Paul A. Fioravanti ordered supplemental briefs on the issue after dismissal arguments on a six-count suit accusing Frequency, its CEO David Lucchino, transfer agent Computershare Inc. and an affiliate of fiduciary breaches, negligence and conversion.

"It's well established that subject matter jurisdiction can be raised sua sponte by the court, and I'm raising it," the vice chancellor said after asking both sides earlier if the result would be money-only damages on some or all counts, potentially putting counts outside the Chancery's equity landscape.

Two revocable trusts sued the company, Lucchino and Computershare in June 2021 in a complaint that accused them of holding up the trusts' efforts to sell their shares of Frequency for seven weeks. The logjam broke only after Frequency's stock had fallen from a high of more than $55 on Feb. 19, 2021, to a low of $7.92 on March 24, 2021, at a cost to the trust of as much as $3.6 million in lost gains.

Lucchino was able to sell $10.5 million worth of shares while the stock was ratcheting up, gaining millions, although the trust's allegations of a possible connection, with Lucchino benefiting from the trusts' stalled shares, were rejected by Frequency's attorney.

"The claims rest entirely on conclusory allegations that the company must have orchestrated a scheme to prevent the plaintiffs from trading their Frequency stock over a seven-week period," Jennifer Burns Luz of Goodwin Proctor LLP, counsel for Frequency and Lucchino, told the vice chancellor. "There are zero actual allegations that actually tie the company or Mr. Lucchino to the plaintiff's requests to transfer stock."

Frequency is a clinical-stage biotechnology company concentrating on treatments to stimulate specific types of cell growth, with current efforts focused on activating inner-ear hair cells that enable hearing and, potentially, combat hearing loss.

The complaint filed on behalf of the Gregory J. Parseghian and Christine M. Parseghian revocable trusts cited claims that a series of Frequency announcements about progress in the research effort ratcheted its stock price up from $18.56 per share in September 2020 to $55.01 on Feb. 19, 2021.

Although key figures "had to be aware" that research had taken a disappointing turn, the trusts argued, Lucchino and others exercised stock award benefits and sold ahead of a steep plummet following a report that the prospective drug had failed to outperform a placebo. Shares fell by 78% in a single day when the full picture emerged.

The trusts, however, were unable to sell before the plunge because of paperwork troubles, said Seth Goldman of Mintz Levin Cohn Ferris Glovsky & Popeo PC, counsel to Computershare.

"There is no dispute that the paperwork that was submitted to Computershare was faulty, and as a result, Computershare had no duty to transfer the shares," Goldman said. He added that Delaware law and Computershare's agreement with Frequency only obliged the transfer when paperwork was properly submitted.

"The fact remains that it wasn't until months after the request was made," with multiple mistakes by the trusts' broker, that the transfer could be executed.

Adam C. Ford of Ford O'Brien LLP, representing the Parseghian trusts, said the complaint made a reasonably conceivable argument that the trusts were victims, with related class Securities Exchange Act litigation pending in Massachusetts federal court naming both Lucchino and Frequency. Although disputed by Computershare, the suit also argued that the transfer company was acting as Frequency's agent at the time.

"On the one hand, we know Computershare is not transferring, and on the other hand we know that Mr. Lucchino is personally profiting and doing much better because shares aren't being sold," Ford said. "When you put those two things together, that supports the reasonable inference that there was some sort of communication."

Vice Chancellor Fioravanti asked Ford, "What shares were not able to be sold during that period of time, other than your client's shares, based on your conspiracy theory?"

Ford said that the complaint focused only on the trusts' shares, and argued that at least one of the counts — seeking a constructive trust based on unjust enrichment claims — falls within the Chancery's jurisdiction. The others, including negligence, could then be pulled along under the court's "cleanup doctrine," allowing it to retain remaining counts that individually might be transferred to Superior Court.

The vice chancellor said he wanted briefs from both sides on the jurisdiction issue before moving ahead on the dismissal motion.

The Parseghian trusts are represented by Samuel T. Hirzel and Jamie L. Brown of Heyman Enerio Gattuso & Hirzel LLP, and Robert S. Landy, Adam C. Ford and Anjula S. Prasad of Ford O'Brien Landy LLP.

Frequency and Lucchino are represented by Elena C. Norman and Peter J. Artese of Young Conaway Stargatt & Taylor LLP, and Deborah S. Birnbach, Jennifer Burns Luz and Matthew White of Goodwin Procter LLP.

Computershare and Computershare Trust Co. NA are represented by Kevin R. Shannon, Jaclyn C. Levy and Callan C. Levy of Potter Anderson & Corroon LLP, and Seth Goldman and Jacob H. Hupart of Mintz Levin Cohn Ferris Glovsky and Popeo PC.

The case is Parseghian et al. v. Frequency Therapeutics Inc. et al., case number 2021-0551, in the Court of Chancery of the State of Delaware.

--Editing by Adam LoBelia.