IN RE MAXXAM — PUTTING THE PLAINTIFF AND DEFENDANT ON EVEN GROUND: DEFINING STANDARDS FOR SETTLEMENT REVIEW AND THE STATUTE OF LIMITATIONS IN SHAREHOLDER ACTIONS

I. INTRODUCTION

The settlement process and the statute of limitations are two distinct aspects of Delaware's legal framework. The term "settlement" generally connotes "an agreement to terminate or forestall all or part of a lawsuit."[1] Thus, a settlement is innately contractual in nature. In sharp contrast, the term "statute of limitations" refers to "the action of the state in determining that, after the lapse of a specified time, a claim shall not be legally enforceable."[2] It, therefore, implies a legislatively mandated prerequisite to relief that exists regardless of the will of the parties. Despite the different meanings, both concepts serve the same function in litigation: promoting the resolution of claims without the burden and expense of a trial.

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[1]Gorman v. Holte, 164 Cal. App. 3d 34, 37 (Cal. Ct. App. 1985); *see also, e.g.*, Ibarra v. Texas Employment Comm'n, 645 F. Supp. 1060, 1067 (E.D. Tex. 1986) ("A settlement agreement is a contract, but becomes a court decree when incorporated into a judgment."); Harding v. State, 603 N.E.2d 176, 179 (Ind. App. 1992) ("A settlement is an agreement to terminate or forestall all or part of a lawsuit . . . ."); Mitchell Properties, Inc. v. Real Estate Title Co., 490 A.2d 271, 276 (Md. App. 1985) ("A settlement agreement is a contract which the parties enter into 'for the settlement of a previously existing claim by a substituted performance.'"); School Dist. of Phila. v. Framlau Corp., 328 A.2d 866, 870 (Pa. Commw. Ct. 1974) ("A settlement of litigation is a compromise agreement comprised of all the traditional elements of a contract.").

[2]South Dakota v. North Carolina, 192 U.S. 269, 288 (1903); *see also, e.g.*, Overfield v. Pennroad Corp., 42 F. Supp. 586, 614 (E.D. Pa. 1941) ("'The statute of limitations is a legislative declaration by the state of the common judgment as to the period within which a suit may be brought without placing the defendant at an unfair disadvantage by reason of lapse of time.'") (quoting Stampalia v. Murphy, 34 F.2d 660, 661 (E.D. Pa. 1929)); Roper v. Markle, 375 N.E.2d 934, 935 (Ill. App. Ct. 1978) ("A statute of limitations is a designated period of time during which a cause of action must be brought or forever barred."); McGuinness v. Cotter, 591 N.E.2d 659, 662 (Mass. 1992) ("A statute of limitations is a procedural measure which 'normally governs the time within which legal proceedings must be commenced *after the cause of action accrues*.'") (quoting Klein v. Catalano, 437 N.E.2d 514, 516 (Mass. 1982)); Tieffenbrun v. Flannery, 151 S.E. 857, 860 (N.C. 1930) ("'Statutes of limitation are such legislative enactments as prescribe the periods within which actions may be brought upon certain claims, or within which certain rights may be enforced.'") (quoting 1 WOOD ON LIMITATIONS § 1); Watters v. Doud, 596 P.2d 280, 283 (Wash. 1979) ("A statute of limitations is defined as the action of the state in determining that, after the lapse of a specified time, a claim shall not be enforceable in a judicial proceeding.").

The Delaware Chancery Court has recently addressed these issues in the corporate context in *In re MAXXAM*.[3] In the *MAXXAM* case, the court rejected a proposed settlement agreement for two basic reasons. First, the court applied its business judgment and found the settlement to be substantively unfair.[4] Second, the court found that the negotiations leading to the agreement were tainted by collusive behavior because certain parties had been completely excluded from the proceedings.[5] As a result, the court vowed to apply higher scrutiny in the future to similar settlement agreements.[6] In other words, the *MAXXAM* decision suggests that the court's consideration of the substantive merit of proposed agreements will be extremely prejudiced without the active and equal participation of all interested litigants.[7]

The court also discussed the role of the statute of limitations and its effect in actions alleging self-dealing by corporate fiduciaries.[8] Reasoning that the plaintiff shareholders did not have a duty to investigate claims of misconduct by their fiduciaries of which they were arguably aware during the requisite limitations period, the court ultimately ruled that the doctrine of equitable tolling had prevented the statute from running.[9]

This comment analyzes these two distinct aspects of *In re MAXXAM*. Part II focuses on the treatment of settlement agreements and the "higher scrutiny" that is now being employed by the Delaware Chancery Court. Part III summarizes recent Delaware cases illustrating the court's application of the statute of limitations defense in actions alleging self-dealing and breach of trust. Part IV presents an in-depth analysis of the court's decision in *In re MAXXAM*. Finally, Part V evaluates the effect of the court's treatment of settlement procedure and the statute of limitations on the roles of shareholders, corporations and the court in shareholder litigation.

This comment accepts the court's holding that procedural unfairness in settlement negotiations need not be tolerated. At the same

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[3] *In re* MAXXAM, Inc., 659 A.2d 760 (Del. Ch. 1995).

[4] *Id.* at 767-76.

[5] *Id.* at 776-77.

[6] *Id.* at 776.

[7] *MAXXAM*, 659 A.2d at 775-77.

[8] *Id.* at 769-71 (construing Kahn v. Seaboard Corp., 625 A.2d 269 (Del. Ch. 1993)). *Cf. In re* USACafes, L.P. Litig., No. 11,146, 1993 Del. Ch. LEXIS 12, at *15-18 (Del. Ch. Jan. 21, 1993), *reprinted in* 18 DEL. J. CORP. L. 1204, 1212-13 (1993) (barring claims under the statute of limitations because the plaintiffs were on notice of the action during the statutory period).

[9] *MAXXAM*, 659 A.2d at 769-70.

time, however, this comment contends that the court erred in reading the statute to relieve shareholders of their duty to investigate possible causes of action in a timely manner. The *MAXXAM* decision enables plaintiffs to ignore the duty of inquiry that the statute of limitations should impose, even when applied in the context of a fiduciary relationship.

II. SETTLEMENT AGREEMENTS IN THE DELAWARE CHANCERY COURT

Historically, the Delaware courts have favored the settlement of derivative suits[10] and class actions.[11] Delaware Chancery Court Rule 23.1[12] requires that the settlement of all derivative actions be approved by the court before taking legal effect.[13] For a proposed settlement

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[10]Derivative actions allow "stockholders to sue on behalf of their corporation where those in control of the corporation refuse[ ] to assert a claim belonging to it." R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 13.6, at 13-14 (2d ed. 1990 & Supp. 1996).

[11]*See, e.g.*, Polk v. Good, 507 A.2d 531, 535 (Del. 1986) ("Delaware law favors the voluntary settlement of contested issues."); Lewis v. Hirsch, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,614 (Del. Ch. June 1, 1994); *In re* MCA Shareholder Litig., 598 A.2d 687, 691 (Del. Ch. 1991)). *See also* Theresa L. Kelly, Comment, J.L. Schiffman & Co. v. Standard Industries, Inc. *and Other Recent Settlement Proposal Cases*, 19 DEL. J. CORP. L. 448 (1994) (discussing holdings of the Delaware Chancery Court in recent settlement hearings). *See generally* Chester B. McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 YALE L.J. 421, 426 (1937) (describing discontinuance and settlement of stockholder actions).

[12]DEL. CH. CT. R. 23.1. Rule 23.1 provides:

> In a derivative action brought by 1 or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort. *The action shall not be dismissed or compromised without the approval of the Court, and notice by mail, publication or otherwise of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the Court directs;* except that if the dismissal is to be without prejudice or with prejudice to the plaintiff only, then such dismissal shall be ordered without notice thereof if there is a showing that no compensation in any form has passed directly or indirectly from any of the defendants to the plaintiff or plaintiff's attorney and that no promise to give any such compensation has been made.

Id. (emphasis added). *See also* BALOTTI & FINKELSTEIN, *supra* note 10, § 13.8, at 13-36 to 13-37 (explaining Rule 23.1 and its application).

[13]Court approval is also required for the settlement of class action suits. DEL. CH. CT.

agreement to be approved, the settling parties must prove that the agreement is both "fair and reasonable" in light of the claims which are being compromised.[14] Objectors to settlement may voice their opposition to the proposed agreement at a settlement hearing.[15] Although the burden of proof rests on the parties advocating settlement, the objectors initially must come forward with evidence tending to show that the claims would be worth more if litigated than the value offered by the settlement proponents.[16] It is in defense of the agreement that the settling parties commonly assert that the plaintiff's claims are barred by the statute of limitations.[17] If accepted, this argument has the effect of shifting the burden to the objectors to establish some reason why the statute of limitations should not extinguish the claims. Therefore, unless the non-settling plaintiffs can successfully persuade the court that the doctrine of equitable tolling[18] should be invoked, the court will generally find the claims to be time-barred, paving the way for the settlement to be approved.[19]

Although the court will not decide the actual merits of the case, it nonetheless must closely examine the claims and defense advanced. Furthermore, the court's decision reflects "the strong policy favoring the settlement of such suits . . . [and] the policy of ensuring that the interests

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R. 23(e). Like their state law counterparts, the Federal Rules of Civil Procedure also dictate that the settlement of shareholder actions must be approved by the court. FED. R. CIV. P. 23.1. *See also* Chickering v. Giles, 270 A.2d 373, 376 (1970) (opining that the "prime purpose of Rule 23.1 is to give the Court meaningful supervision of a derivative settlement and to prevent abuse (such as paying plaintiff and/or his counsel to discontinue)"); William E. Haudek, *The Settlement and Dismissal of Stockholders' Actions — Part II: The Settlement*, 23 SW. L.J. 765 (1969) (tracing the settlement procedure of shareholder actions in the federal courts).

[14]The court will examine the claims and any "possible defenses thereto," while using its "own business judgement . . . [to] determine the overall reasonableness of the settlement." *MAXXAM*, 659 A.2d at 768 (citing Rome v. Archer, 197 A.2d 49, 53-54 (Del. 1964)). *See generally* Michael D. Goldman et al., *A Review of Recent Delaware Cases Relating to the Settlement of Derivative and Class Litigation*, 14 BANK & CORP. GOVERNANCE LAW REP. 789, 790 (Aug. 1995) (discussing settlements under Delaware law).

[15]*See* Haudek, *supra* note 13, at 803-06.

[16]*Id.* at 804.

[17]*See MAXXAM*, 659 A.2d at 769-71.

[18]*See* Christopher R. Leslie, *Den of Inequity: The Case for Equitable Doctrines in 10b-5 Cases*, 81 CALIF. L. REV. 1587, 1589-90 (1993) (discussing the statute of limitations in federal securities actions). The doctrine of "equitable tolling postpones a statute of limitations from running until the plaintiff is aware that she has a cause of action." *Id.* at 1592.

[19]*E.g.*, *MAXXAM*, 659 A.2d at 761 (rejecting a settlement agreement partially due to the fact that the objectors proved that the statute of limitations should be tolled). *See Kahn*, 625 A.2d at 277 (holding that the statute of limitations in derivative actions alleging self-dealing will be tolled until the plaintiff "knew or had reason to know the facts alleged to give rise to the wrong").

of shareholders are properly protected."[20] In light of these competing policies, the settlement hearing has expanded the court's role beyond that of trier of fact.[21] Acting not only as a tribunal, but also as an "independent board of directors,"[22] the court applies its own business judgment to determine the overall fairness of the agreement.[23]

The Delaware Chancery Court implements a six-factor balancing test, commonly referred to as the *Polk* factors,[24] when deciding whether a settlement agreement should be approved.[25] Although this test still

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[20]*See, e.g.*, *MAXXAM*, 659 A.2d at 768 (citing Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1283 (Del. 1989)); *Polk*, 507 A.2d at 535. *See generally* Goldman et al., *supra* note 14, at 790 (commenting on the holdings and reasoning of various Delaware settlement decisions); Kelly, *supra* note 11, at 449 (discussing the factors applied by the Delaware courts to evaluate settlements).

[21]*See generally* Kenneth W. Kossoff, Note, *Director Independence and Derivative Suit Settlements*, 1983 DUKE L.J. 645, 657 (stating that a court "act[s] as if it were an 'independent board of directors' in judging the merits of a proposed settlement") (quoting Haudek, *supra* note 13, at 792); Norman M. Monhait & Pamela S. Tikellis, *Through the Magnifying Glass: The Courts Take a Closer Look at Settlements*, 12 DEL. LAW. 13 (Fall 1994) (noting that "the court has an elevated duty to stand in the shoes of the absent shareholders").

[22]Kossoff, *supra* note 21, at 657 (citing Haudek, *supra* note 13). *See also* Monhait & Tikellis, *supra* note 21, at 13 (noting that the "Court of Chancery has never been a passive participant in the settlement process").

[23]*See MAXXAM*, 659 A.2d at 768-69. *Cf.* Kossoff, *supra* note 21, at 662-63 (discussing the general standards courts employ in evaluating settlements). Kossoff briefly noted that some courts have rejected use of their own business judgment as a "substitute" to that of the parties in the settlement. *Id.* at 622. However, he rejects this approach as an "unrealistic admonition." *Id.* Although a court's decision essentially may "vindicate the business judgment of the parties," Kossoff asserts that the court is the only proper entity that can ensure that all parties are protected from unfair dealing. *Id.* at 663.

[24]*See* Polk v. Good, 507 A.2d 531 (Del. 1986).

[25]*See MAXXAM*, 659 A.2d at 768 (citing *Polk*, 507 A.2d at 536). In deciding whether to approve a settlement, the court considers the following factors:

> (1) the probable validity of the claims; (2) the apparent difficulty of enforcing the claims through the Courts; (3) the collectibility of any judgment; (4) the delay, expense and trouble of litigation; (5) the amount of compromise as compared with the amount and collectibility of the judgment, and (6) the views of the parties involved, pro and con.

Id. Commentators have suggested that the court will also look at other factors in making its decision.

> Other factors considered by the courts in reviewing a proposed settlement include the diligence of counsel for plaintiff up to the time of settlement, whether the proposed settlement will result in a long-term benefit to the corporation, the desirability of terminating litigation which was a "harassment" to the corporation, whether or not the settlement was approved by stockholders who were fully informed, and the probability of success if the issues were litigated.

BALOTTI & FINKELSTEIN, *supra* note 10, § 13.16, at 13-102 to 13-103. *See also* Haudek, *supra* note 13, at 792-801 (discussing various factors used in settlement review).

remains the crux of the court's analysis, commentators and case law alike have recently suggested that the court is evaluating these agreements with increased scrutiny.[26] Although this higher level of scrutiny has not been concretely defined, current decisions indicate that the court's strict evaluation delves, not only into the substantive aspects of the settlement, but the procedural ones as well.[27]

A. *Procedural Evaluation in Settlement Review*

1. The Effect of an Inadequate Record

In order to determine the procedural fairness of a settlement agreement, the court looks, in part, to the record established by the parties.[28] Because the court cannot and does not develop all of the factual issues in the course of a settlement hearing, the record will ultimately serve as the sole basis of comparison between the claims and the proposed agreement.[29] Cognizant of this fact, the Delaware Chancery Court has been reluctant to approve a settlement agreement when an inadequate record is proffered,[30] as exemplified by the recent decision in *Lewis v. Hirsch.*[31]

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[26]*See, e.g., MAXXAM*, 659 A.2d at 760. *See also* Tim Oliver Brandi, Note, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355, 391 (1994) (noting the need "to strengthen judicial oversight of the settlement process"); Goldman et al., *supra* note 14 (highlighting the court's role in settlement review); Monhait & Tikellis, *supra* note 21 (analyzing Delaware cases that have been subjected to enhanced scrutiny). In response to this problem, one commentator has advocated that the courts need to evaluate all settlement agreements with increased scrutiny before approving them, regardless of the absence of objectors, a crowded court docket or the complexity of the case. Brandi, *supra* note 26, at 392-93.

[27]*See* Goldman et al., *supra* note 14, at 799 n.10 (noting that "[t]he Delaware Courts have not explained how the 'heightened' or 'careful' scrutiny differs from the scrutiny that is typically applied to proposed settlements . . . [h]owever, it must be presumed that under the heightened scrutiny standard, little, if any, deference is given to the views of the settling plaintiffs"); Monhait & Tikellis, *supra* note 21, at 13-17 (stating that the Delaware Chancery Court "employs . . . heightened scrutiny from the moment a stipulation of settlement is filed through the final hearing").

[28]*E.g., Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,616 *See also* Goldman et al., *supra* note 14, at 794 (discussing the *Lewis* case and the implications of an insufficient record on settlement agreements).

[29]*Rome*, 197 A.2d at 53 (stating that a settlement hearing cannot serve as a "rehearsal of trial" or the purpose of settlement is defeated); *Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,616.

[30]*See, e.g., MAXXAM*, 659 A.2d at 776; *Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,615-90,617.

[31]*See Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,619. *See*

In April of 1992, Harry Lewis filed a derivative action against United States Surgical Corporation and its directors, alleging the directors had been provided with grossly excessive compensation.[32] Later, Lewis amended the complaint to include claims of insider trading.[33] Before the amended complaint was filed, the parties informally reached a settlement agreement which was tentatively approved by U.S. Surgical's board.[34] However, two groups of shareholders objected to the agreement claiming that the settlement was unfair because, among other things, the plaintiff had not sufficiently investigated the insider trading claims prior to settling.[35] A settlement hearing ensued to resolve these conflicting claims, producing the *Lewis* decision.[36]

Finding that the record was inadequate to justify approval, the court rejected the proposed settlement.[37] The court initially noted that settlement review is less intensive than conclusions reached following a binding trial in that factual determinations are not made by the court.[38] However, "[t]he record . . . must be adequate as to the strengths and weaknesses of the claims as compared to any defenses to those claims in order for the Court to 'sensibly and competently evaluate the value of the claims.'"[39] Applying the foregoing principle, the court found it could neither calculate a value for the claim nor compare the claim to the value that the settlement offered.[40]

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also Goldman et al., *supra* note 14, at 794 (discussing *Lewis v. Hirsch* and other settlement decisions). Goldman noted that certain cases will obviously command a hasty settlement in order to avoid immense litigation costs. *Id.* However, Goldman also asserts that the *Lewis* decision signifies a departure from this haste. *Id.* "As illustrated by the Court of Chancery's decision in *Lewis*, . . . rushing into a settlement, without adequately investigating the merits of the claims, may be fatal to the parties' request for Court approval of the settlement." *Id.*

[32]*Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,614-90,615.

[33]*Id.*

[34]*Id.*

[35]*Id.* at 90,617-90,618.

[36]Lewis v. Hirsch, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,615 (Del. Ch. June 1, 1994).

[37]*Id.* at 90,618.

[38]*Id.* at 90,616 (citing *In re* Amsted, 521 A.2d 1104, 1107 (Del. Ch. 1986)). The court noted that settlement hearings are not meant to replace a trial; however, such hearings must involve "more than a cursory examination of the facts underlying each settlement." *Id.* at 90,615 (quoting *In re* Resorts Int'l Shareholders Litig., 570 A.2d 259, 265-66 (Del. 1990)).

[39]*Id.* at 90,616 (quoting *In re Amsted*, 521 A.2d at 1107).

[40]*Lewis*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,382, at 90,619. The court found the record to be insufficient because Lewis failed to depose witnesses and examine documents relevant to the insider trading claims. *Id.* Goldman states that the adequacy of an investigation or record must be determined on a case by case basis; however, he also notes that "the plaintiff, at a minimum, [must] investigate the 'key issues' involved in the claims" to establish a sufficient record. Goldman et al., *supra* note 14, at 794.

2. The Role of Negotiations and Objectors

In addition to carefully appraising the record set forth, the Delaware Chancery Court has also applied increased scrutiny to the proceedings leading to the proposed agreement.[41] The court has considered throughout such proceedings both who the objectors are and what role they have been afforded in the litigation.[42] Although not expressly part of the six traditional factors announced in *Polk v. Good*,[43] the presence of objectors during settlement has played an increasingly important role in the court's analysis.[44]

In re FLS Holdings, Inc. Shareholders Litigation,[45] a class action suit, is an example of this phenomenon.[46] In this case, preferred stockholders of FLS Holdings sued the corporation's directors over a merger between FLS and Kyoei Steel, Ltd.[47] The plaintiffs claimed that the merger was unfair because (1) the merger consideration had not been equitably allotted among the preferred and common shareholders, and (2) the preferred shareholders had been denied the right to vote on the transaction.[48] Following negotiations, a settlement between the parties was presented for court approval despite the fact that twenty percent of the preferred shareholders objected to the agreement.[49] The court held

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[41]*See In re Amsted*, 521 A.2d at 1108 (stating that negotiations and recommendation of settlement must be made in "good faith" in order for approval to occur). *See also* Goldman et al., *supra* note 14, at 789 (noting that Delaware courts scrutinize the negotiating process); Monhait & Tikellis, *supra* note 21, at 13-17 (discussing how the Delaware courts "have increasingly required plaintiffs and defendants to demonstrate with greater care the procedural and substantive fairness of settlements"). *See generally* Haudek, *supra* note 13, at 770-71 (noting the importance of the integrity of the negotiations surrounding the settlement).

[42]*See MAXXAM*, 659 A.2d at 776 (rejecting a settlement agreement where 14% of stockholders objected); *In re* FLS Holdings, Inc. Shareholders Litig., No. 12,623, 1993 Del. Ch. LEXIS 57, at *18-19 (Del. Ch. Apr. 2, 1993), *reprinted in* 19 DEL. J. CORP. L. 270, 281 (1994) (denying settlement approval where 20% of the "preferred" stockholders objected). *See also* Haudek, *supra* note 13, at 805 (noting that the "weakness [in] the settlement procedure might perhaps be remedied by rendering the objector's part more attractive").

[43]507 A.2d 531 (Del. 1986).

[44]*See, e.g.*, *MAXXAM*, 659 A.2d at 760, 776; *In re* FLS Holdings, Inc., Shareholders Litig., No. 12,623, 1993 Del Ch. LEXIS 57 (Del. Ch. Apr. 2, 1993), *reprinted in* 19 DEL. J. CORP. L. 270 (1994).

[45]No. 12,623, 1993 Del. Ch. LEXIS 57 (Del. Ch. Apr. 2, 1993), *reprinted in* 19 DEL. J. CORP. L. 270 (1994).

[46]*Id.* at *3, *reprinted in* 19 DEL. J. CORP. L. at 273-74. *See also* Kelly, *supra* note 11, at 449-52 (discussing the decision of *In re FLS Holdings*).

[47]*In re FLS Holdings*, No. 12,623, 1993 LEXIS 57, at *2-11, *reprinted in* 19 DEL. J. CORP. L. at 273.

[48]*Id.* at *2, *reprinted in* 19 DEL. J. CORP. L. at 273.

[49]*Id.* at *2-3, *reprinted in* 19 DEL. J. CORP. L. at 273.

that the agreement failed the *Polk* analysis, specifically finding that the claims had substantive merit and the settlement proceeds were "insignificant" in comparison to the value and likelihood of successful adjudication of the claims.[50]

These conclusions were not the court's only basis for denying the agreement.[51] The court further rejected the agreement due to the "objections of very substantial shareholders and the willingness of others to press the claims."[52] Concluding the opinion, the chancellor stated that "the refusal of a large holder of class claims to accept the settlement, combined with its desire to itself facilitate the adjudication of its rights, is a factor I can properly take into account on this motion."[53]

The character of the negotiation from which a proposed settlement emanates also becomes a major consideration in a reviewing court's evaluation of a proposed settlement. The nature of the settlement process creates the danger that the interest of the class members or corporation on whose behalf the action is brought will be subverted by the conduct of the settling parties. The temptation for plaintiff's counsel is that the defendants will offer fat attorneys' fees in exchange for an inadequate settlement and "to obtain a *res judicata* bar to claims against the corporation."[54]

Stepak v. Tracinda Corp.[55] is a case illustrative of the extremes to which such conduct may be taken. In *Stepak*, two actions against the same defendants were proceeding concurrently in the Delaware and California trial courts.[56] The dispute arose when the named plaintiffs of the California action appeared at a scheduling hearing for review of the proposed settlement and objected, seeking a stay until their action in the California courts was resolved.[57] In addition to claiming that the

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[50]*Id.* at *18-19, *reprinted in* 19 DEL. J. CORP. L. at 281.

[51]*In re FLS Holdings*, No. 12,623, 1993 Del. Ch. LEXIS 57, at *4, *reprinted in* 19 DEL. J. CORP. L. at 274.

[52]*Id.*

[53]*Id.* at *18, *reprinted in* 19 DEL. J. CORP. L. at 281.

[54]Kahn v. Occidental Petroleum Corp., No. 10,808, 1989 Del. Ch. LEXIS 92, at *9 (Del. Ch. July 19, 1989), *reprinted in* 15 DEL. J. CORP. L. 654, 660 (1990).

[55]No. 8457, 1989 Del. Ch. LEXIS 95 (Del. Ch. Aug. 18, 1989), *reprinted in* 15 DEL. J. CORP. L. 750 (1990).

[56]*Id.* at *2, *reprinted in* 15 DEL. J. CORP. L. at 754. Although the Delaware action (the "Stepak action") was technically the first filed, no action had been taken in over two years. *Id.* at *11, *reprinted in* 15 DEL. J. CORP. L. at 758. The California action (the "Rudd action"), although filed approximately one month later, began proceeding immediately. *Id.* Class certification in the Rudd action was actually sought over a year before the Delaware plaintiffs began actively pursuing their claims, but an oversight lead to both classes being certified. *Id.*

[57]*Stepak*, No. 8457, 1989 Del. Ch. LEXIS 95, at *3, *reprinted in* 15 DEL. J. CORP. L.

proposed settlement was grossly inadequate, the California plaintiffs also maintained that it constituted "a 'sellout' of the class claims in exchange for a promise by the defendants not to oppose a generous attorneys' fee award . . . ."[58]

The history of the Delaware litigation evoked several instances that piqued the chancellor's concern about collusion in the settlement process. First, the California action had originally been filed in Delaware.[59] Those claims were refiled in California after one of the defendants, Kirk Kerkorian, contested personal jurisdiction in Delaware.[60] Notably, Mr. Kerkorian had remained silent when the Stepak action was later filed, also in Delaware.[61] Second, plaintiffs in the Delaware action had filed for class certification before instituting any discovery.[62] Third, within approximately two months after moving for class certification, the Stepak plaintiffs and the defendants had reached an agreement in principle for settlement of the class claims.[63]

Even at the preliminary stage at which this settlement was considered, the court had little difficulty in characterizing it as one that "engenders disdain that is pronounced and lingers."[64] The chancellor considered the proposed settlement wholly inadequate, both substantively[65] and procedurally. Although the court declined to

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at 755.

[58]*Id.* at *2-3, *reprinted in* 15 DEL. J. CORP. L. at 754-55.

[59]*Stepak*, No. 8457, 1989 Del. Ch. LEXIS 95, at *10-11, *reprinted in* 15 DEL. J. CORP. L. at 761-62.

[60]*Id.* at *11, *reprinted in* 15 DEL. J. CORP. L. at 758. Kerkorian was a resident of California, where the Rudd action was refiled. *Id.*

[61]*Id.* at *12, *reprinted in* 15 DEL. J. CORP. L. at 758.

[62]*Id.*

[63]*Stepak*, No. 8457, 1989 Del. Ch. LEXIS 95, at *12, *reprinted in* 15 DEL. J. CORP. L. at 758.

[64]*Id.* at *19, *reprinted in* 15 DEL. J. CORP. L. at 762.

[65]*Id.* at *2-3, *reprinted in* 15 DEL. J. CORP. L. at 754-55. The compensation provided to the class amounted to 12 or 13¢ per share, only 4.5¢ of which would be received in cash. *Id.* at *14, 17, *reprinted in* 15 DEL. J. CORP. L. at 759, 761. The court also found it ludicrous that videocassettes furnished to the class as part of the settlement package were valued by the settlement proponents at their suggested retail price of $89.95 each. *Id.* at *15, *reprinted in* 15 DEL. J. CORP. L. at 760. With respect to the distribution of videos, the court also commented:

> Under the proposal, former MGM/UA stockholders — pension funds, banks, trusts, mutual funds, IRA's and mom & pop — will each have their choice among: *Poltergeist III, Spaceballs, Moonstruck, Betrayed* or *Child's Play.* The initial distribution is to be one per shareholder regardless of the number of shares held. Were this proposed settlement otherwise worthy of serious consideration, this condition would itself be sufficient to cause a supervising court to question the proposal. The parties have advanced no theory that

expressly accuse the defendants of collusion, it did make the following generalization:

> Where there are two or more attorneys purporting to act on behalf of the same or overlapping classes, there is a special risk that a defendant will seek advantage in choosing the adversary with whom it will negotiate, and a risk that the blessed plaintiff will be accommodating [sic] in exchange for an agreement that includes legal fees.[66]

Furthermore, with respect to this settlement in particular, the court commented:

> would justify the non-*pro rata* distribution of settlement consideration in a shareholder action where the damage was incurred in proportion to share ownership.

Id. at *13 n.3, *reprinted in* 15 DEL. J. CORP. L. at 759 n.3.

[66]*Id.* at *19, *reprinted in* 15 DEL. J. CORP. L. at 761. This was neither the first, nor would it be the last, time the Delaware courts would feel compelled to comment on the potential for abuse in the class action process. Just two months earlier in *Kahn v. Occidental Petroleum Corp.*, then Vice-Chancellor Hartnett reprimanded the settling parties, stating:

> I increasingly suspect that in some cases plaintiffs' counsel seem to be primarily motivated by the huge counsel fees now being generated in class and stockholder derivative actions and that defendant corporations are often willing to pay the fees to obtain a *res judicata* bar to claims against the corporation.
>
> An abuse of the litigation-settlement process cannot be tolerated and this Court must closely scrutinize any proposed settlement which appears to be unfair, not only to the stockholders on whose behalf the suits are allegedly brought, but also other parties or counsel. This Court, as a Court of Equity, has a special historical mandate to prevent unconscionable conduct on the part of any litigant or his counsel.
>
> The acts of defendants in approaching the attorney in the later-filed *Sullivan* action and ignoring the counsel in the first-filed *Kahn* suit concerning possible settlement, and then negotiating a settlement without advising the Kahn counsel, sufficiently raised the spectre of a possible overreaching to justify my scheduling plaintiff's motion for a preliminary injunction and granting limited expedited discovery before the hearing on the motion.

Kahn, No. 10,808, 1989 Del. Ch. LEXIS 92, at *8-10, *reprinted in* 15 DEL. J. CORP. L. at 660 (citations omitted). *See also* Prezant v. DeAngelis, 636 A.2d 915, 922 (Del. 1994) ("The principal criticism of the temporary settlement class procedure is that it facilitates premature, inadequate, and perhaps collusive settlements because plaintiffs' counsel is under strong pressure to conform to the defendants' wishes at the early stages of the litigation."). For a discussion of positions various commentators have taken on the dangers of collusion in the settlement process, see Gregory W. Werkheiser, Note, *Delaware's New Mandate in Class Action Settlements: Expanding the Scope and Intensity of Settlement Review*, 20 DEL. J. CORP. L. 496 (1995).

> [A]pproval of such a proposal would, in my opinion, threaten to hold the class action mechanism up to justifiable scorn and to charges, too frequently made without adequate grounds, that the stockholder class action mechanism represent nothing so much as a device for lawyers to enrich themselves while serving no practical interest of those for whom they are charged to act.[67]

Indeed, the chancellor made it quite clear that collusion represented a procedural taint that would not be tolerated.

As these decisions reveal, the chancery court has become increasingly cognizant of the abuses inherent in the settlement process. To this end, the court has turned an increasingly watchful eye toward proposed settlement agreements.[68] Analysis of subjective objections, employing the *Polk* factors, still occupies the bulk of the court's attention. Yet, its focus on procedural matters has also increased commensurately. First, the court has demanded, in the interest of producing an adequate record for settlement review, vigorous investigation of the claims to be settled. Additionally, the court has given objectors a much enhanced voice in the settlement process. Finally, the court has indicated its willingness to actively monitor the settlement process to minimize the threat of collusive agreements.

III. THE STATUTE OF LIMITATIONS IN SHAREHOLDER ACTIONS

A. Kahn v. Seaboard Corp. — *The Self-Dealing Exception to the Statute of Limitations*

Kahn v. Seaboard Corp.[69] is often cited as the seminal case for the Delaware Chancery Court's treatment of the statute of limitations[70] in shareholder actions alleging self-dealing.[71] The *Kahn* decision is

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[67]*Stepak*, No. 8457, 1989 Del. Ch. LEXIS 95, at *19, *reprinted in* 15 DEL. J. CORP. L. at 762.

[68]*See* Goldman et al., *supra* note 14.

[69]625 A.2d 269 (Del. Ch. 1993).

[70]Section 8106 of the Delaware Code applies a three year limitations period to derivative actions. *See* DEL. CODE ANN. tit. 10, § 8106 (1975) (providing that "no action to recover damages caused by an injury unaccompanied with force . . . shall be brought after the expiration of 3 years from the accruing of the cause of such action").

[71]*Kahn*, 625 A.2d at 271. *See also* Reed v. Delaware Trust Co., No. 12,645, 1995 Del. Ch. LEXIS 69, at *8 (Del. Ch. May 19, 1995) (applying the *Kahn* reasoning to the trustee/beneficiary relationship but barring claims when plaintiffs are on notice of such and fail

significant for many reasons. First, the court reaffirmed the use of the statute of limitations, rather than the traditional equitable doctrine of laches, in equitable suits seeking monetary damages.[72] This ruling permitted defendants to assert the statute of limitations as a defense in self-dealing actions.[73] And, second, the court established that the limitations period may be tolled based on a shareholder's mere ignorance of fact, regardless of whether or not information was actively concealed by the defendants.[74]

In April of 1990, shareholders of Seaboard Corporation derivatively sued the controlling stockholder and its directors for self-dealing in a 1986 transaction.[75] The defendants moved to dismiss the suit based on the statute of limitations defense.[76] Arguing against this defense, the plaintiff contended that the doctrine of laches, not the statute of limitations, should apply to the claim due to the equitable nature of the action.[77]

The mention of the traditional equitable doctrine of laches prompted the court to engage in a comprehensive review of equity's approaches to dealing with issues of timeliness. The court first set about defining the terminology it was considering. The court viewed the doctrine of laches as one which requires the court to "inquire into the

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their duty to inquire); Price v. Wilmington Trust Co., No. 12,476, 1995 Del. Ch. LEXIS 65, at *9-11 (Del. Ch. May 19, 1995) (discussing the *Kahn* holding within the trust context and distinguishing when the statute actually begins to run when faced with similar, multiple wrongful acts); Yaw v. Talley, No. 12,882, 1994 Del. Ch. LEXIS 35, at *18-19 (Del. Ch. Mar. 2, 1994), *reprinted in* 20 DEL. J. CORP. L. 454, 466 (1995) (barring claims because the plaintiffs failed to plead facts sufficient to prove that the statute should be tolled); Litman v. Prudential-Bache Properties, Inc., No. 12,137, 1994 Del. Ch. LEXIS 3, at *7-13 (Del. Ch. Jan. 14, 1994) (rejecting tolling in the absence of facts constituting a claim for self-dealing); *In re* USA Cafes, L.P., Litig., No. 11,146, 1993 Del. Ch. LEXIS 12, at *8 (Del. Ch. Jan. 21, 1993), *reprinted in* 18 DEL. J. CORP. L. 1204, 1209 (1993) (applying *Kahn* but barring claims under the statute of limitations when plaintiffs had notice of such claims within the statutory period). *See generally* Recent Developments, *An Increasing Role for Statute of Limitations in Courts of Equity* — Kahn v. Seaboard Corp. *and* In re USACafes, 19 DEL. J. CORP. L. 493 (1994) (discussing application of the statute of limitations in cases involving a fiduciary relationship); Allen M. Terrell, Jr. & John T. Dorsey, *Laches to the Rescue in Delaware*, 7 INSIGHTS 30 (Mar. 1993) (discussing recent cases applying statute of limitations by analogy in Delaware's equity courts).

[72]*Kahn*, 625 A.2d at 274.

[73]*Id.* at 276-77.

[74]*Id.* at 276. Prior to the *Kahn* decision, it had been held that affirmative acts of concealment by the defendants were necessary to toll the statute of limitations. Halpern v. Barron, 313 A.2d 139, 143 (Del. Ch. 1973).

[75]*Kahn*, 625 A.2d at 270.

[76]*Id.*

[77]*Id.* at 271.

particulars of the matter to determine whether there is such unfairness to the defendant occasioned by a delay in asserting the claim as to disable the plaintiff from pressing the claim."[78] Application of the statute of limitations, however, requires "no such specific inquiry" and is unconcerned with "assessment[s] of fairness or prejudice."[79] The distinction was particularly important in the present suit where the plaintiff was asking the court to consider the facts surrounding a purported incident of self-dealing by corporate fiduciaries as the basis for recognizing a claim asserted more than a year after the statute of limitations had elapsed.[80]

The chancellor dismissed the notion that laches applied to the claim simply by virtue of its properly having been brought in an equity court, noting that laches per se applied only when no limitations statute was available to the court.[81] Instead, the court instructed that application of the doctrine historically had depended on a distinction between claims of equitable origin and legal claims that had found their way to the chancery court because equitable relief had been sought.[82] This approach, in turn, had waned because it was "dependent upon an understanding of the 'nature' of various sorts of jurisdiction that the English Court of Chancery and, by adoption, our own court possesses."[83] Therefore, the court reasoned, a functional approach had been adopted which drew a bright line defining when the statute of limitations would apply by analogy in the chancery court: "[W]hether the claim asserted is legal in nature or equitable, whenever plaintiff seeks money in a derivative suit, her claim is subject to the statute of limitations."[84]

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[78]*Kahn*, 625 A.2d at 272 (citing Gardner v. Panama R.R., 342 U.S. 29 (1951)).

[79]*Id.*

[80]The transaction at issue, one of three raised by plaintiff, was that Seaboard's three member board and its controlling stockholder, Seaboard Flour Corporation (Flour), had caused Seaboard to enter into a contract with Flour that prejudiced and injured Seaboard. *Id.* at 270. The self-dealing component arose because two individuals sitting on the board of Seaboard also were the controlling stockholders of Flour. *Id.* This contract, a charter for seven vessels, had been entered into in 1986, or approximately four years before the suit was filed. *Id.*

[81]*Id.* at 272.

[82]*Kahn*, 625 A.2d at 272. This distinction harked back to an 1845 opinion of Chancellor Kensey Johns, Jr. *Id.* (citing Perkins v. Cartmell's Adm'r, 4 Del. (4 Harr.) 270, 271 (Del. Err. & Apps. 1845)).

[83]*Id.* at 273. As the court remarked, by the mid-twentieth century, knowledge of these arcane matters had been relegated to only a few "professional exotics." *Id.*

[84]*Id.* at 273-74. The chancellor attributed the final break with the traditional distinction to the Delaware Supreme Court's decision in Bokat v. Getty Oil Co., 262 A.2d 246 (Del. 1970). *Kahn*, 625 A.2d at 274.

Emphasizing the fiduciary relationship between a shareholder and corporate director, the court held that the statute of limitations is tolled in self-dealing actions until the shareholder knows or has reason to know of the claim.[85] The court's decision abandoned the prior notion that "an affirmative act of concealment by [the] defendant" is necessary to toll the statute in self-dealing claims.[86] The court stated that the statute of limitations must be applied flexibly when a fiduciary relationship exists so as not to punish the shareholder's "good-faith," "trust," and "reliance" on the business decisions of the corporation.[87] Concluding the opinion, the chancellor recognized that "even an attentive and diligent shareholder relying, in complete propriety, upon the good faith of corporate directors may be completely ignorant" of self-dealing transactions.[88] Applying the foregoing reasoning, the court allowed the plaintiff to amend the complaint to reflect whether the plaintiff was on notice of their claim within the statutory period.[89]

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[85]*Kahn*, 625 A.2d at 276-77; *cf.* Litman v. Prudential-Bache Properties, Inc., No. 12,137, 1994 Del. Ch. LEXIS 3 (Del. Ch. Jan. 14, 1994) (interpreting *Kahn* as not being a per se rule allowing tolling in all self-dealing actions).

[86]*Kahn*, 625 A.2d at 275-76. Aside from the self-dealing exception created in *Kahn*, the fraudulent concealment of claims by the defendant also serves to toll the statute of limitations. *Id.* at 275-77. The fraudulent concealment exception allows tolling to occur when it is proven that the plaintiff's claims were concealed by the defendants through "affirmative acts of misrepresentation or failure to disclose facts where there is a duty to disclose." *Litman*, No. 12,137, 1994 Del. Ch. LEXIS 3, at *10. Under this exception, the statute is tolled "'until the [plaintiff's] rights are discovered or until they could have been discovered by the exercise of reasonable diligence.'" *Id.* at *11 (quoting Ewing v. Beck, 520 A.2d 653, 667 (Del. 1987)).

> Underlying both doctrines [equitable tolling and fraudulent concealment] is the policy that a defendant should not be permitted to use the statute of limitations as a shield where the defendant possesses information critical to the existence of an actionable claim of wrongdoing and prevents the plaintiff from discovering that information in [a] timely fashion.

In re MAXXAM, Inc., [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,860, at 93,163 (Del. Ch. June 21, 1995), *reprinted in* 21 DEL. J. CORP. L. 273 (1996).

[87]*Kahn*, 625 A.2d at 275. Vice-Chancellor Adams eloquently stated the reasoning behind his lenient application of the statute of limitations.

> The corporate shareholder commits capital to the supervision and management of the corporate board. In doing so the stockholder becomes dependent upon the skill and loyalty of those in control of the corporate enterprise. . . . Given the fiduciary duties that the law imposes upon the relationship among those serving as corporate directors, stockholders are entitled to rely on the good faith of the directors when they act with respect to the corporation's property or processes. There is, of course, great social utility in the willingness of some to trust others in this way.

Id.

[88]*Id.* at 276.

[89]*Id.* at 277.

B. *In re* USACafes, L.P. Litigation — *Applying the Kahn Principle and Defining Notice*

One week following the decision in *Kahn*, the chancery court again addressed the statute of limitations issue in *In re USACafes, L.P. Litigation.*[90] Although the court applied the same analysis used in *Kahn*, this class action suit yielded a contrary result.[91] The underlying claim in this suit arose out of the sale of USACafes to Metsa Acquisition Corporation.[92] Subsequent to filing the original class action, the plaintiffs moved to amend their complaint to include a derivative claim, alleging waste and self-dealing in the USACafes sale.[93] In opposition to the plaintiff's motion, the defendants argued that the additional derivative action was barred by the statute of limitations.[94]

Alluding to the rule devised in *Kahn*, Chancellor Allen announced that the statute of limitations in actions alleging self-dealing will be tolled until "a reasonably diligent and attentive stockholder knew or had reason to know the facts alleged to constitute the wrong."[95] Moreover, when a claim is facially barred by the statute, plaintiffs have the burden of pleading facts to establish that tolling is justified.[96] Focusing on the "notice" aspect of the rule, the court found the additional derivative claims fell beyond the limitations period.[97] The court specifically noted

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[90]*In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *7-18, *reprinted in* 18 DEL. J. CORP. L. at 1208-13. *See also* Yaw v. Talley, No. 12,882, 1994 Del. Ch. LEXIS 35 (Del. Ch. Mar. 2, 1994), *reprinted in* 20 DEL. J. CORP. L. 454 (1995) (rejecting the self-dealing exception because the plaintiffs did not plead facts to establish tolling).

[91]*In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *15-18, *reprinted in* 18 DEL. J. CORP. L. at 1212-13.

[92]*Id.* at *1-2, *reprinted in* 18 DEL. J. CORP. L. at 1206-07.

[93]*Id.* at *2-6, *reprinted in* 18 DEL. J. CORP. L. at 1206-07. The self-dealing claims were based on allegations that the directors excessively compensated themselves for minimal services rendered to the corporation. *Id.* The plaintiffs also claimed that a loan made to a friend of the directors constituted waste. *Id.*

[94]Specifically, defendants contended that all of the actions allegedly constituting corporate waste had occurred over three years before the proposed second amended complaint was filed on July 1, 1992. *Id.* at *6-7, *reprinted in* 18 DEL. J. CORP. L. at 1208. The applicable statute of limitations was DEL. CODE ANN. tit. 10, § 8106 (1975). *In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *7, *reprinted in* 18 DEL. J. CORP. L. at 1208.

[95]*In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *8, *reprinted in* 18 DEL. J. CORP. L. at 1209.

[96]*Id.* In other words, the plaintiff must show that he did not have knowledge of the claim during the statutory period or participated in a reasonable inquiry once the facts substantiating the claim were revealed. *Id.* at *17-18, *reprinted in* 18 DEL. J. CORP. L. at 1212-13.

[97]*Id.* at *16-18, *reprinted in* 18 DEL. J. CORP. L. at 1212-13.

that the facts set forth in the defendants' public filings were sufficient to notify the plaintiffs of their claims within the statutory period.[98] Opining that "shareholders . . . need not delve aggressively into the internal affairs of a corporation," the court held that the facts disclosed did "give rise to [an] inquiry," which the plaintiffs failed to undertake.[99]

The decisions in both *Kahn* and *In re USACafes* illustrate the Delaware Chancery Court's flexible application of the statute of limitations in actions resulting from a breach of fiduciary duty. In both cases, the court disfavored a strict reading of the statute of limitations, deferring instead to the good faith reliance which theoretically defines the shareholder-director fiduciary relationship. In practice, this deference arguably lessened the shareholder's duty to investigate possible claims. In its most expansive terms, the holding in *Kahn* may be susceptible to a reading which replaces the duty to investigate with a duty of good faith reliance. *In re USACafes* is not to the contrary. The opinion merely indicates that a duty to act before the running of the limitations period still exists when facts alleged to constitute a wrong have been publicly disclosed.

C. *Recent Statute of Limitations Issues:* Reed v. Delaware Trust Co. *and* Price v. Wilmington Trust Co.

The *Kahn* decision clearly signifies the importance that the Delaware courts attach to the shareholder/director relationship and their willingness to allow this relationship to affect the general rules governing statutes of limitations. Recently, the court has twice revisited the aforementioned reasoning, applying *Kahn* in the breach of trust context. Like *In re USACafes*, these two decisions further refine when a plaintiff knows or should have known of a claim. Moreover, they indicate a more restrictive application of this standard than the broad language of *Kahn* seems to suggest.

In *Reed v. Delaware Trust Co.*,[100] W. Creighton Reed created a revocable trust which named his son, John Reed, and Delaware Trust Company (Delaware Trust) as co-trustees.[101] In 1989, Reed became

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[98] *Id.* at *17, *reprinted in* 18 DEL. J. CORP. L. at 1213. The public filings disclosed both the payments and loans that were being made as well as the terms of the transactions. *Id.*

[99] *In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *16-18, *reprinted in* 18 DEL. J. CORP. L. at 1213.

[100] *Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *1-19.

[101] *Id.* at *2. Aside from the initial establishment of the trust by Delaware Trust, all management and communications regarding the trust occurred between W. Creighton Reed and his son. *Id.*

incompetent, dying later that year.[102] W. Creighton Reed, Jr. was named executor of his father's estate under terms provided that the trust was to be equally apportioned among Reed's four heirs.[103]

In 1990, W. Creighton Reed, Jr. sued his brother, John, alleging that he had exercised undue influence over their father, resulting in the misappropriation of the trust.[104] This suit was settled. On July 19, 1992, however, W. Creighton Reed, Jr. sued Delaware Trust.[105] This suit alleged that Delaware Trust breached its duty as co-trustee by negligently allowing John Reed to misappropriate the trust assets and exert undue influence over his father.[106] Moreover, plaintiff claimed that Delaware Trust had failed to prepare a gift tax return as required by law and had permitted commercial loans out of the trust without proper authorization.[107]

The court's opinion initially reaffirmed the *Kahn*[108] articulation of the standard to be applied in a fiduciary relationship.[109] Further, the court went on to hold that lack of knowledge may be sufficient to warrant tolling when the facts alleged constitute negligence rather than self-dealing.[110] In deciding how the trust relationship should affect the statute of limitations, the court balanced the importance of a trust beneficiaries' reliance on a trustee with an injured beneficiaries' disregard of potentially obvious wrongdoings.[111] Applying the *Kahn* notice standard, the court found that the plaintiff was aware of facts constituting his claim before the limitation period.[112]

In making this decision, the court focused on a letter dated July 22, 1989, from the plaintiff to Delaware Trust which requested detailed information regarding disbursements from the trust account.[113] Based on

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[102] *Id.*

[103] *Id.*

[104] *Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *3.

[105] *Id.* W. Creighton Reed, Jr. was joined by his sister and brother in this suit (hereinafter referred to collectively as plaintiffs). *Id.*

[106] *Id.* at *3-6.

[107] *Id.*

[108] Kahn v. Seaboard Corp., 625 A.2d 269 (Del. Ch. 1993).

[109] *Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *6-10. "A trust oftentimes is established so that a party more capable of responsibly managing assets may do so for the benefit of those without such skills. The trust relationship has utility only if beneficiaries feel at ease confiding in and relying upon the trustee." *Id.* at *8 (citing *Kahn*, 625 A.2d at 275).

[110] *Id.* at *9.

[111] *Id.* "While beneficiaries cannot close their eyes to that which is quite obvious, they should not be expected to monitor the trustee's actions diligently . . . ." *Id.*

[112] *Id.* at *11.

[113] *Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *11-17.

the requests for information in this letter, the court found that the plaintiff at least possessed knowledge about the diminution of the trust before the statutory period, even if he was not aware at that time of specific negligent acts by Delaware Trust.[114] To this end, the court deemed it unfair to hold the defendant liable for the plaintiff's "failure to investigate" possible future claims regarding the trust.[115] As the court explained, "The equitable exception to the running of the statute of limitations only requires that the injured party had good reason to know of the wrongs, actual knowledge is not required."[116] On the facts of this case, knowledge of the injury appears to be sufficient to warrant imputing knowledge of the wrong to the plaintiff.

On the same day the *Reed* decision was issued, the court released its opinion in *Price v. Wilmington Trust Co.*[117] The plaintiffs, a class of trust beneficiaries, alleged that Wilmington Trust had charged additional management fees which were prohibited by their contract and which breached fiduciary duties owed to the class.[118] In its defense, Wilmington Trust moved to dismiss, contending that the claims were barred by the statute of limitations.[119]

The defendant's motion to dismiss was granted with sixty days leave for the plaintiffs to amend the complaint to include facts defining whether or not they knew of their claims prior to the statute's expiration.[120] The court's opinion noted the flexible application of statutes of limitations when a trustee/beneficiary relationship exists:

> The institution of trusts is understandably protective of beneficiaries because trusts are often established when, at least in a settlor's mind, the beneficiary needs a competent and reliable trustee to care for the beneficiary's interests.

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[114] *Id.*

[115] *Id.* at *16.

[116] *Id.*

[117] *Price*, No. 12,476, 1995 Del. Ch. LEXIS 65, at *1-18.

[118] *Id.* at *2. The trust agreement between the parties allowed Wilmington Trust, as trustee, to invest the trust funds into one of the investments it managed. *Id.* The plaintiffs claimed that regulations of the Comptroller of the Currency were implied into the contract which disallowed Wilmington Trust from charging separate fees for management of both the trusts and investments. *Id.* Consequently, the plaintiffs contended that they were charged excessively, violating these regulations. *Id.* Aside from this claim, a smaller group of beneficiaries alleged that Wilmington Trust's fees violated Chancery Court Rule 132, which regulates trustee compensation. *Id.* at *2-3.

[119] *Id.* at *3-4. In the alternative, the defendant also argued that the plaintiff failed to state a claim on the merits. *Id.* at *2.

[120] *Id.* at *4.

> The institution of trusts condones, if not encourages, dependence by the beneficiary on their trustees . . . . Indeed, Wilmington Trust's considerable success in marketing its trust services is due, in part, to the confidence and trust that it is able to instill in trust settlors.[121]

The court's analysis indicated that the plaintiff class had failed to plead facts which "could permit the conclusion that she was reasonably unaware of the claim."[122] Otherwise stated, the statute began to run once plaintiff "knew or had good reason to know of the allegedly wrongful conduct of the trustee."[123] Unlike the *Reed* case, the breach of contract issue here was easily resolved.[124] Either the fees charged by the trustee had complied with the law or they had not. There was no need to delve into the particular facts of the case to determine whether the trust company had been negligent.

IV. ANALYSIS OF *IN RE MAXXAM*

A. *Factual Background*

During the eighties, Federated Development Company (Federated)[125] contacted various investors to obtain additional financing for the development of a California property, known as the Mirada.[126] Dissatisfied with the offers of these investors, Federated approached its

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[121]*Price*, No. 12,476, 1995 Del. Ch. LEXIS 65, at *10. Although the court did not have to decide whether the claims were actually barred by the statute of limitations, the court noted that such a determination would rely on whether or not the plaintiffs "knew or had good reason to know" of their claims. *Id.* at *11.

[122]*Id.* at *11.

[123]*Id.* at *10.

[124]Recall that in *Reed* the plaintiff's contention was that Wilmington Trust had negligently managed the trust such that his brother was able to misappropriate its funds. *See Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *3-6. Thus, the court had to make a more searching investigation to determine when plaintiff should have become aware of the more ephemeral concept of a breach of a duty of care not clearly defined by statute or court rule as in this case. *Id.* at *10-18.

[125]Federated is a "New York business trust" with its principal place of business in Houston, Texas. *MAXXAM*, 659 A.2d at 764. Mr. Charles Hurwitz, along with various family members, is the sole owner of Federated and a defendant in this litigation. *Id.* Hurwitz served as the CEO and chairman of the board of both Federated and MAXXAM, Inc. *Id.*

[126]*Id.* The Mirada consisted of two adjacent land tracts in Rancho Mirage and Cathedral City, California. *Id.* at 763-64. The Rancho Mirage property was being developed for residential purposes, while a golf course was planned for the Cathedral City land. *Id.* at 765.

"controlled subsidiary," MAXXAM, Inc. (MAXXAM).[127] In August of 1987, MAXXAM agreed to loan Federated $20 million.[128] Subsequent to this transaction, a second $5 million loan agreement was signed by the parties.[129] Notably, both of these loans were non-recourse[130] and were secured solely by deeds to the Mirada property.[131] Moreover, the agreement allowed interest to accrue instead of requiring Federated to make any current payments.[132]

Development of the Mirada was plagued with problems, culminating in $34 million of unpaid principal and interest.[133] To relieve its debt, Federated proposed a plan to sell the Mirada to MAXXAM.[134] In 1991, based on recommendations of a special committee[135] and various

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[127]*Id.* at 764. MAXXAM is a Delaware corporation. *Id.* Dr. Barry Munitz, MAXXAM's director and Federated's president, presented the loan proposal to MAXXAM's board of directors. *Id.* In support of the proposal, Munitz presented an appraisal letter which valued the property between $34-$38 million and a market validation study which compared the Mirada to similar properties and projected its success. *Id.*

[128]*MAXXAM*, 659 A.2d at 765. The loans were originally made to Federated by MCO Properties (MCOP), which is a subsidiary of MAXXAM. *Id.* MCOP later assigned its full interest in the loans to MAXXAM. *Id.* The $20 million was actually divided into a $15 million loan and a $5 million line of credit. *Id.* The loan was to be repaid from the sale proceeds of the property, and Federated was allowed to draw directly from those proceeds instead of the line of credit. *Id.* The loan terms restricted the line of credit to be used for further development of the Mirada; however, interestingly, the terms did not limit the $15 million in a similar way. *Id. Cf. In re* MAXXAM, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,860 (Del. Ch. June 21, 1995), *reprinted in* 21 DEL. J. CORP. L. 262 (1996) (discussing how the disclosure of these terms did not serve to put the plaintiffs on notice of potential claims).

[129]*MAXXAM*, 659 A.2d at 765. The terms of this loan were similar to that of the first loan, except the revenue received was not required to be used for further development of the property. *Id.*

[130]*Id.* at 76. A "non-recourse loan" is a "type of security loan which bars the lender from action against other assets of the borrower if the security value of the specified collateral for the loan falls below the amount required to repay the loan." BLACKS LAW DICTIONARY 1057 (6th ed. 1990). *See also* RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE § 26-5, at 665-66 (4th ed. 1991) (providing an example and explanation of the use of a non-recourse loan).

[131]*MAXXAM*, 659 A.2d at 764.

[132]*Id.*

[133]*Id.* at 765. Two main setbacks hindered development of the Mirada project. *Id.* First, Rancho Mirage sought to enjoin Federated from developing the properties. *Id.* In order to continue the construction of the residential area of the property, Federated was forced to allow the city to use the Cathedral City property as a sheep preserve. *Id.* Federated was unable to solicit any buyers or developers for the residential area of the project. *Id.*

[134]*Id.*

[135]*MAXXAM*, 659 A.2d at 765. The special committee consisted of five individuals who were all related to the MAXXAM corporation in some professional capacity. *Id.*

financial and real estate experts, MAXXAM agreed to purchase the property for $43 million.[136]

Thereafter, several derivative shareholder suits were filed against MAXXAM, its directors, and Federated.[137] On May 28, 1991, the first suit was filed.[138] In February of 1992, the suits were consolidated, except for those brought by NL Industries, Inc. (NL),[139] MAXXAM's largest non-management stockholder.[140] The complaints, including that of NL, charged the defendants with breach of fiduciary duties,[141] alleging specifically that development of the property had been mismanaged and that the 1991 purchase of the Mirada was a self-dealing transaction.[142] The plaintiffs asked for rescission of the transaction as well as damages.[143]

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[136] *Id.* at 767. The loan terms were as follows:

> (1) MAXXAM would forgive the $34 million of unpaid principal and accrued interest owed by Federated on the 1987 loans; (2) MAXXAM would assume a $2 million obligation of Federated to a third party, and would advance Federated another $1.4 million to buy out another third party investor; (3) MAXXAM would issue to Federated shares of MCOP preferred stock, valued by First Boston at $3.9 million; and (4) MAXXAM's 25% contingent interest in project profits (valued at $1.3 million) would be extinguished. Thus, the consideration MAXXAM would pay for the Mirada totalled approximately $43 million.

Id.

[137] *Id.* at 763.

[138] *Id.*

[139] *MAXXAM*, 659 A.2d at 763. NL is a New Jersey corporation which owns 14% of MAXXAM's "common stock." *Id.* at 762-63. NL's complaint in the Delaware Chancery Court was dismissed due to lack of jurisdiction; however, they refiled a similar derivative action in Texas state court. *Id.* With their suit still pending in Texas court, NL later became an objector to the settlement proceeding discussed in this comment. *Id.* at 768.

[140] *Id.* at 762.

[141] *Id.* at 771. Federated had a fiduciary relationship with both MAXXAM and NL due to the fact that it was MAXXAM's "controlling shareholder." *Id.* "A shareholder that owns a majority interest in a corporation, or exercises actual control over its business affairs, occupies the status of a fiduciary to the corporation and its minority shareholders." *Id.* (citing Kahn v. Lynch Communications Sys., Inc., 638 A.2d 1110, 1113 (Del. 1994)).

[142] *Id.* at 763. "[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993). "Traditionally, the term 'self dealing' describes the 'situation when a [corporate fiduciary] is on both sides of a transaction . . . .'" Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1169 (Del. 1995) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). The duty of loyalty prohibits self-dealing by directors on terms unfair to the corporation and its shareholders. *See* BALOTTI & FINKELSTEIN, *supra* note 10, § 4.9, at 4-220.

[143] *MAXXAM*, 659 A.2d at 763.

On January 22, 1993, the plaintiffs moved to amend their complaint to include similar claims regarding the 1987 loans.[144] Defendants opposed this motion, contending that the claims based on the 1987 loans were beyond the reach of the statute of limitations.[145] Subsequently, a third amended complaint was filed regarding the 1987 loans, which alleged that the statute should be tolled because the defendants had concealed material facts which they had a duty to disclose.[146] Accordingly, the defendants again moved to dismiss the twice amended complaint based on the statute of limitations defense. Prior to a decision on the motion, however, the parties entered into a settlement agreement.[147]

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[144]*Id.* at 763 (citing *In re* MAXXAM, Inc./Federated Dev. Shareholders Litig., Nos. 12,111 & 12,353, 1993 Del. Ch. LEXIS 63 (Del. Ch. Apr. 13, 1993), *reprinted in* 19 DEL. J. CORP. L. 362 (1994)). The defendants opposed the motion, alleging that the new claims concerning the 1987 loans were barred by the statute of limitations. *Id.* The court did not allow the plaintiffs to amend their complaint to specifically reflect the 1987 claims; however, the court did allow the plaintiffs to plead facts that would serve to toll the statute. *Id.*

[145]*Id.* at 767. Agreeing with the defendants, the court granted their motion to dismiss. *MAXXAM*, 659 A.2d at 763. However, plaintiffs were permitted leave to amend their complaint to plead facts that would avoid the statute of limitations. *Id.*

[146]*MAXXAM*, 659 A.2d at 763.

[147]*Id.* at 763-64. Since the settlement agreement in the *MAXXAM* case was ultimately rejected, the court ruled on the defendant's motion to dismiss. *In re* MAXXAM, Inc., [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,860 (Del. Ch. June 21, 1995), *reprinted in* 21 DEL. J. CORP. L. 262 (1996). In this subsequent case, the defendants argued that the plaintiffs' action regarding the 1987 loans should be dismissed because it was barred by the statute of limitations. *Id.* at 93,162, *reprinted in* 21 DEL. J. CORP. L. at 271-72. In response, the plaintiffs argued that the defendants concealed material facts which caused the statute of limitations to be tolled. *Id.* The defendants anti-tolling argument was based on four contentions. *Id.* at 93,163, *reprinted in* 21 DEL. J. CORP. L. at 274. First, the defendants alleged that a "notice inquiry" standard governed commencement of the statute of limitations, thus, putting the plaintiffs on "notice" of their claims from 1988. *Id.* at 93,162, 93,164, *reprinted in* 21 DEL. J. CORP. L. at 271, 274. Second, the defendants alleged that the plaintiffs were on "notice" of their claims because they challenged the loans in three separate 1991 complaints. *Id.* at 93,163, *reprinted in* 21 DEL. J. CORP. L. at 274. Third, the defendants asserted that the plaintiffs' tolling argument was flawed because it relied on events which occurred subsequent to the loans, rather than on the terms of the loans themselves. *Id.* Lastly, the defendants argued that the doctrine of tolling did not apply to them because the plaintiffs had not charged them with self-dealing or fraudulent concealment. *Id.*

Denying the defendant's motion, the court rejected each of the aforementioned contentions, holding that the statute of limitations did not bar the plaintiffs' claim. *Id.* at 93,163-65, *reprinted in* 21 DEL. J. CORP. L. at 274-79. The court found that the doctrine of tolling did apply because the plaintiffs were not on notice of their claims. *Id.* at 93,163-64, *reprinted in* 21 DEL. J. CORP. L. at 275-76. In making this finding, the court noted that the defendants had misconstrued the plaintiffs' claims by arguing that they conveyed "notice" of potential claims to the plaintiffs by disclosing the terms of the loans. *Id.* Rejecting this assertion, the court stated that the plaintiffs' complaint did not allege that the actual loan terms

The settlement agreement provided that all claims regarding both the 1987 and the 1991 transactions would be released in consideration of $3 million.[148] All of the parties accepted this agreement, except for NL, which raised its objections at the resultant settlement hearing.[149]

B. *The Settlement Hearing*

Contending that the settlement was fair and reasonable, the settling parties advanced two basic arguments to support approval of the agreement.[150] First, the parties contended that the 1987 loan claims were not actionable because they were barred by the statute of limitations.[151] Second, the settling parties asserted that the 1991 claims were substantively without merit.[152] Upon the court's finding that the 1987 and 1991 claims were valid, the settling parties contended that the $3 million settlement amount was comparable to any award that successful adjudication of the claims could achieve.[153]

Objecting to the proposed agreement, NL argued that both the 1987 and the 1991 claims were valid causes of action.[154] First, NL contended

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were unfair, but that the circumstances surrounding the terms were unfair. *Id.* Since these "unfair" circumstances were not disclosed, the court reasoned that the plaintiffs were not on notice of their cause of action nor did they have a duty to further inquire about the loans. *Id.* "To credit the defendants' anti-tolling argument would seriously diminish the stockholders' entitlement to rely on the good faith of their corporate fiduciaries, and create the precise corrosive effect that the Chancellor in *Kahn v. Seaboard Corp.* quite properly held must be avoided." *Id.* Addressing the defendant's additional arguments, the court found that the three previously-filed complaints regarding the loans were insufficient to confer notice on the plaintiffs. *Id.* at 93,165, *reprinted in* 21 DEL. J. CORP. L. at 277. The court also rejected the defendants' third contention finding that there were sufficient facts aside from the post-loan events to toll the statute. Id., *reprinted in* 21 DEL. J. CORP. L. at 278. Finally, the court held that tolling applied to the defendants because the plaintiffs' complaint clearly pled facts to constitute fraudulent concealment. *Id.*, *reprinted in* 21 DEL. J. CORP. L. at 279.

[148]*Id.* at 764. The settlement agreement provided relief from the consolidated actions as well as NL's actions in Delaware and Texas. *Id.* In return, plaintiffs would receive $1.5 million up front and the remainder in quarterly payments spread over five and one-half years. *Id.*

[149]*Id.*

[150]*MAXXAM*, 659 A.2d at 767. By asserting that neither claim had merit, the defendants, in *arguendo*, proposed that the claims had a $0 value, thus making the $3 million settlement amount fair and reasonable. *Id.*

[151]*Id.* The settling parties contended that the plaintiffs were on notice of the 1987 claims from 1988 due to MAXXAM's public filings. *Id.* Thus, a claim filed in 1991 fell beyond the limitations period and should be barred. *Id.*

[152]*Id.*

[153]*Id.*

[154]*MAXXAM*, 659 A.2d at 768.

that the 1987 claims were not barred because the statute of limitations should have been tolled.[155] Second, NL maintained that the 1991 claims were substantively valid because the defendants would not be able to prove that the purchase of the Mirada was "entirely fair."[156]

Applying a six-factor balancing test, the vice-chancellor rejected the settlement proposal.[157] The court framed its holding around two issues: (1) the probable validity of the 1987 and 1991 claims and, (2) the value of the settlement compared to the value of a successful judgment on the claims.[158]

First, the court considered the continued viability of the 1987 loan claims in light of the fact that the plaintiffs' first complaint had not been filed until three years after the alleged wrongful misconduct took place. Defendants took the position that all relevant information had been revealed via a number of disclosures, all of which were available to plaintiffs by February 11, 1988.[159] As characterized by the court, defendants in effect maintained that "MAXXAM's public disclosures made in early 1988 put its shareholders on notice of any potential fiduciary claims arising out of the 1987 loans."[160] Plaintiffs, however, countered that material facts relating to three central aspects of the 1987 loan transaction had never been disseminated to the stockholders.

Plaintiffs alleged that the attendant measure of risk in the Mirada project had been withheld from the stockholders.[161] The complaint also averred that Federated had misrepresented its ability to pay interest on the loan because it did not disclose that "(i) . . . no lots had yet been sold, and that (ii) . . . proceeds from the sale of 15 estate lots had been reloaned to Federated instead of being used to pay interest currently due on the original loans . . . ."[162] Finally, it was contended that, instead of reinvesting a portion of the loan proceeds in the Mirada project as the

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[155] *Id.*

[156] *Id.*

[157] *Id.* at 760; *see supra* note 25 and accompanying text for a discussion of the elements of the balancing test used by the court.

[158] *MAXXAM*, 659 A.2d at 769-71. The court noted that only the first and fifth factors were at issue in the *MAXXAM* case. *Id.* at 768 & nn.8-9.

[159] *Id.* at 770.

[160] *Id.*

[161] *Id.* The facts bearing on the riskiness of the land development scheme included that "the Mirada was a failing project, that after ten years there was not even one recorded estate lot sale, and that there was significant local opposition to the project's completion." *Id.*

[162] *MAXXAM*, 659 A.2d at 770. These omissions were allegedly exacerbated by MAXXAM's publicly filed statements that the lots had already been subdivided for development and that proceeds from sales of these lots would be applied toward interest payments. *Id.*

stockholders expected, this money had been diverted to Federated's controlling stockholder.[163]

Relying on the views it had earlier expressed in *Kahn v. Seaboard Corp.*, the court held that the 1987 loan claims were not barred by the statute of limitations. As it had in *Kahn*, the court again explained that the importance of the fiduciary relationship warranted a flexible application of the statute of limitations.[164] Although the defendants' disclosures had revealed that the loans were "self dealing in character," the court found that these disclosures had failed to put the plaintiffs on notice of the "substantive unfairness" of the loans.[165] Central to this conclusion was the court's view that defendants could not shift their obligation to the plaintiffs:

> [Defendants'] argument rests on an implicit proposition that once the self-dealing character of the loans was publicly disclosed, that disclosure constituted notice sufficient to impose an affirmative duty on the shareholders to investigate further the specific terms, circumstances, and management of the loan agreements. Stated differently, the defendants argue that the statute of limitations began to run once the loan terms were publicly disclosed, and from that point forward MAXXAM's public shareholders were obligated to investigate the transactions for possible unfairness or face the risk of being time-barred from challenging them.

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[163] *Id.* The loan was structured in two parts. In the first term loan $15 million was to be distributed to Federated over five years. *Id.* at 765. This money was not expressly restricted to use exclusively for the Mirada project. *Id.* In contrast, the second part of the loan created a $5 million revolving line of credit which could only be used as financing for the Mirada project. *Id.* Plaintiffs reasoned that, despite the absence of express restrictions on the first part, stockholders would expect the money to be applied to the Mirada project in accordance with what was alleged to be the general practice in such transactions. *Id.* at 770-71.

[164] *Id.* at 770-72. Quoting its earlier decision, the court opined:

> "Given the fiduciary duties that the law imposes upon the relationship among those serving as corporate directors, stockholders are entitled to rely on the good faith of the directors when they act with respect to the corporation's property or processes. . . .
>
> Since trust and good faith are the essence of this relationship, it would be corrosive and contradictory for the law to punish reasonable reliance on that good faith by applying the statute of limitations woodenly or automatically to alleged self-interested violations of trust."

Id. at 771 (quoting *Kahn*, 625 A.2d at 275).

[165] *Id.* at 770-71.

> In my view, *Kahn v. Seaboard Corp.* . . . invalidates that proposition.[166]

Thus, the court essentially concluded that the shareholders did not have a duty to investigate the loans, even though the self-dealing nature of the loans was apparent to the shareholders within the statutory period.

Second, the court considered the substantive validity of both the 1987 and 1991 claims. Applying the entire fairness standard,[167] the court determined that neither transaction was a product of fair dealing[168] or carried a fair price.[169] The plaintiffs had contended that the 1987 loan terms were "economically unfair" in light of the risk and circumstances that surrounded the transaction.[170] Relying on *In re Fort Howard Corp. Shareholders Litigation,*[171] the defendants had claimed that the market check they conducted "presumptively established the fairness of the loans."[172] Aside from finding the defendants' argument lacking in factual support, the court emphasized that the defendants' market check was completely inadequate in light of the standard devised in *Fort Howard.*[173]

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[166]*MAXXAM*, 659 A.2d at 770.

[167]*Id.* at 771-75. The defendant's argued that the business judgment rule was the proper standard of review for evaluation of both the 1987 and 1991 claims. *Id.* at 771. The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). To be sustained under the business judgment rule, the transaction need only be one that could be imputed to a "rational business purpose." *MAXXAM*, 659 A.2d at 771 (citing *Cede & Co.*, 634 A.2d at 361). Rejecting this position, the court applied the entire fairness standard. *Id.* The entire fairness standard applies when a controlling shareholder, owing a fiduciary duty to both the corporation and the minority shareholder, stands on both sides of a disputed business transaction. *Id.* (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)). The court found that Federated stood on both sides of the 1987 and the 1991 transactions. *Id.*

[168]*MAXXAM*, 659 A.2d at 772. The court stated that "[f]air dealing 'embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how [approval] was obtained.'" *Id.* (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983)).

[169]*Id.* In determining fair price, a court will assess the "'economic and financial considerations of [the transaction] . . . .'" *Id.* (quoting *Weinberger*, 457 A.2d at 711).

[170]*Id.*

[171]No. 9991 (Cons.), 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989).

[172]*MAXXAM*, 659 A.2d at 772. The market choice urged by defendants was "their investigation and negotiations with at least two third party lenders." *Id.*

[173]*Id.* at 772-73. The chancery court distinguished the *Fort Howard* case which involved a tender offer to buy the outstanding shares of a corporation. *Id.* at 772. Once an agreement regarding this offer was made, the corporation's special committee conducted a "pre-closing 'market check.'" *Id.* This market check consisted of a press release which declared that the corporation "unanimously endorsed" the agreement made; however, any competing

The court noted that Federated, in fact, had approached various lenders prior to contacting MAXXAM.[174] However, to sufficiently test the fairness of the loans, Federated should have first negotiated an agreement with MAXXAM, which would then be subject to terms offered by subsequent investors.[175]

Focusing again on the negotiations and price of the Mirada purchase, the court also found that the 1991 transaction could withstand neither the fair dealing nor the fair price aspects of the entire fairness test.[176] The court noted that the timing of the purchase was increasingly suspect, in that the purchase was proposed only after it was apparent that the project was unsuccessful and there was a high risk that the original loans would not be repaid.[177] Moreover, the court noted that the Mirada's $43 million price tag was seemingly unfair in light of the conflicting values that the record established for the property.[178]

Upon concluding that both the 1987 and 1991 claims were valid, the court attempted to compare the value of the settlement with the claims to be compromised.[179] The court, however, found that the settlement had been tainted by two procedural defects. First, the court found that the settlement proponents had established an incomplete record.[180] The record contained valuations for the Mirada purchase ranging from $23-$43 million.[181] As a result of these conflicting amounts, the court found

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proposals were welcome for a limited time period. *Id.* The court held that this type of market check was sufficient to show the fairness of the tender offer because it occurred subsequent to negotiations, but prior to the actual closing of the offer. *Id.* Conversely, the directors of MAXXAM approached other lenders prior to negotiating with MAXXAM, presumably receiving the exact loan terms they wanted. *Id.* Thus, the directors knew what terms were commercially available and could exert their influence over MAXXAM to obtain a superior deal. *Id.* at 772-73.

[174] *Id.* at 772-73.

[175] *Id.* at 773.

[176] *Id.* at 775. The defendants also argued that the business judgment rule should be applied when deciding the validity of the 1991 claims because the purchase was agreed upon by a disinterested and independent special committee. *Id.* at 773-75. The court rejected this contention, finding that three out of the five members of the special committee were "'beholden' to Hurwitz" and not independent. *Id.* at 774; *see* Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (discussing the standard for an independent director); Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988) (defining an independent director as not being "dominated or controlled by an individual in the transaction").

[177] *MAXXAM*, 659 A.2d at 775.

[178] *Id.* at 776.

[179] *Id.*

[180] *Id.*

[181] *MAXXAM*, 659 A.2d at 776.

it was unable to assign a present value to the purchase.[182] Without a current value for the Mirada transaction, the court could neither determine the fairness of the settlement amount nor compare the settlement with the claims.[183]

Second, the court concluded that the negotiations which had produced this settlement were tarnished by apparently collusive conduct between the settling plaintiffs and the defendants.[184] Equating the settlement process in this case to an "offensive weapon,"[185] the court conveyed its disapproval with the flawed negotiations that precipitated the agreement.[186] NL had been almost completely excluded from the settlement negotiations.[187] The court explicitly noted that the negotiations in this case had the "unmistakable footprint of an effort by the defendants to negotiate a settlement with an adversary that they preferred, in order to extinguish claims being pressed by the adversary whom they disfavored, and to relegate that disfavored adversary to the status of an objector to the settlement."[188]

The conclusion that the NL plaintiffs had been purposefully excluded from the settlement negotiations arose from several established facts that the court was unable to ignore. The NL plaintiffs comprised fourteen percent of MAXXAM's stockholder class.[189] Further, they had been actively pursuing a derivative action against the defendants in Texas.[190] Similarly, the court discounted defendants' suggestion that the NL plaintiffs had mislead them into believing that the $3 million settlement offer would be acceptable. Even had the NL plaintiff's initially acquiesced, the settling parties were under an obligation to consider their views when they later indicated that the NL plaintiffs were unwilling to go along with the agreement.[191]

Finally, the court considered how to remedy the procedural taint that had permeated the settlement process. Noting that the supreme court's most recent pronouncement in *Prezant v. DeAngelis*[192] provided

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[182] *Id.*
[183] *Id.*
[184] *Id.* at 776-77.
[185] *MAXXAM*, 659 A.2d at 776 (citing Prezant v. DeAngelis, 636 A.2d 915 (Del. 1994)).
[186] *Id.*
[187] *Id.*
[188] *Id.*
[189] *MAXXAM*, 659 A.2d at 776.
[190] *Id.* at 763, 776.
[191] *Id.* at 776.
[192] 636 A.2d 915 (Del. 1994).

precedent for modifying the settlement process to prevent such abuse, the court indicated that "enhanced scrutiny" was warranted and had been applied in its review of this settlement.[193] In any event, the court concluded, "Under any standard of scrutiny, the settlement in this particular case would have been found wanting."[194]

V. EVALUATION

In re MAXXAM sends two conflicting messages to parties engaged in shareholder litigation. At one extreme, the decision demands that litigants conduct themselves above reproach in accordance with the procedures established by the Delaware courts to bring fairness to the settlement process.[195] In this respect, the decision stands for the proposition that the settlement process cannot be used as an "offensive weapon" by defendants to pressure litigants into compromising claims on unfavorable terms.[196] Securing court approval of a settlement procured by such techniques now will present a challenge to even the most willing parties.[197]

At the other extreme, the court has construed the statute of limitations in a manner that encourages litigants to ignore a procedural rule also designed to ensure fairness. By permitting plaintiffs to plead ignorance of their claims even when the self-dealing nature of a challenged transaction is known to shareholders, the *MAXXAM* decision increases the likelihood that defendants will have to try claims under undesirable conditions.[198] While the court has acted to limit the potential for unfairness in the settlement of claims, it has increased the potential for unfairness in shareholder claims that are litigated.

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[193] *MAXXAM*, 659 A.2d at 776 (citing Stepak v. Tracinda Corp., No. 8457, 1989 Del. Ch. LEXIS 95 (Del. Ch. Aug. 18, 1989), *reprinted in* 15 DEL. J. CORP. L. 750 (1990)).

[194] *Id.* at 777 n.16.

[195] *Id.* at 776-77.

[196] *Id.* at 776.

[197] *See Court Denials of Derivative, Class Action Settlements May Signal a Return to Cautious Practices, Dual Hearings*, BNA BUS. CORP. COUNS. WKLY., Apr. 18, 1995, at 1, 6-7 (noting that "'[c]ourts seem to have learned to just say no to settlements'" (quoting Theodore N. Mirvis, of Wachtell, Lipton, Rosen & Katz).

[198] *MAXXAM*, 659 A.2d at 769-71.

A. *Evaluation with a Fine Tooth Comb — Defining Increased Scrutiny in Proposed Settlement Agreement Review*

In re MAXXAM demonstrates that flaws in the settlement process itself may predetermine the approval or denial of an agreement.[199] Before this pronouncement, settling parties knew with certainty only that approval of their agreements required that the settlement be substantively fair and in the best interests of the shareholders.[200] Application of the *Polk* factors,[201] coupled with the court's own business judgment, almost completely occupied the court's analysis in these cases.[202] To be sure, additional considerations, such as the conduct of settlement negotiations, figured into these opinions. But, as yet, increased or "careful" scrutiny remained an ambiguous notion, not expressly defined by the court.[203]

The *MAXXAM* decision has begun to clarify the mystery surrounding this aspect of settlement review. Although the substantive elements of the agreement remain the court's central focus, *MAXXAM* expands this process by considering the negotiations, adequacy of the record, and other procedural matters preceding the actual agreement.[204] Upon reading *MAXXAM*, it is clear that the court will be more inclined to reject a settlement agreement when (1) the negotiations leading to the compromise exclude parties to the litigation and (2) when a substantial number of valid objections are leveled.[205] These factors have been briefly referred to in past court decisions, but *In re MAXXAM* points to the pivotal role that such procedural matters will play in the future of settlement review.

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[199] *Id.* at 776. The vice-chancellor explained that the substantive unfairness of the settlement was actually a product of questionable procedural conduct: "Having expounded at length on the legal reasons why [the settlement must be rejected], the Court would be remiss by not commenting on the underlying factual reason why the parties have come to this pass: the flawed manner by which the settlement was achieved." *Id.*

[200] Traditionally, the chancery court has viewed its role as to "determine whether or not the proposed settlement terms are fair, reasonable and adequate. . . . In other words, the question . . . for decision is whether or not the terms of settlement are fair and reasonable when weighed against the probability of recovery at trial on the asserted claims." Neponsit Inv. Co. v. Abramson, 405 A.2d 97, 100 (Del. 1979). *See also* BALOTTI & FINKELSTEIN, *supra* note 10, § 13.16 (2d ed. 1990 & Supp. 1996) (discussing settlement standards in derivative litigation).

[201] *See supra* note 25 and accompanying text (listing and discussing the *Polk* factors).

[202] *See* Goldman et al., *supra* note 14, at 790 (cases cited therein).

[203] *See* Goldman et al., *supra* note 14, at 799 n.10 ("The Delaware Courts have not explained exactly how the 'heightened' or 'careful' scrutiny differs from the scrutiny that is typically applied to proposed settlements.").

[204] *MAXXAM*, 659 A.2d at 776-77.

[205] *Id.* at 775-76.

This more expansive method of evaluation will affect all parties to shareholder litigation in Delaware. Foremost, the court has given objectors a more meaningful role in the settlement process. Courts have always been required to hear objections in shareholder actions, but these objections generally lacked significant influence over the court.[206] By departing from this rubber-stamp method of approval, Delaware has provided objectors with a more influential voice in settlement proceedings. Moreover, once they became aware of the stringent analysis the court will apply, objectors will be more likely to voice their opposition to agreements. The *MAXXAM* decision doubly strengthens the position of objectors by assuring that both substantive and procedural objections will be weighed by the court.

Defendant corporations and directors will also be affected by the *MAXXAM* decision. As the court stated, defendants will no longer be able to pick and choose the plaintiffs with whom they wish to negotiate a settlement.[207] Instead of forcing "disfavored" adversaries to become objectors, *MAXXAM* encourages all parties to become active participants in the litigation.[208] This requirement, combined with the rising number of objections made to settlements,[209] will make it much more difficult to compromise claims on unfair terms.

From the court's perspective, *MAXXAM* represents another example of the more active role Delaware's courts have taken in the management of shareholder litigation.[210] *MAXXAM* represents one step in the slow but obvious departure from the lenient attitude previously evidenced in the review of settlement agreements.[211] Even read restrictively, the decision stands for the proposition that the court will become more suspect of proposals advanced when a segment of interested stockholders have been excluded from the negotiating process.[212] Read expansively within the

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[206]*See* Haudek, *supra* note 13, at 801-06.

[207]*MAXXAM*, 659 A.2d at 776-77.

[208]*Id.*

[209]*See* Elizabeth M. McGeever, *Recent Delaware Cases Relating to (I) the Demand Requirement in Derivative Suits and (II) Settlements of Class and Derivative Actions*, 2 A.L.I.—A.B.A 743, 755 (June 1995) (noting that "objections to settlements have become increasingly common").

[210]*See generally* Monhait & Tikellis, *supra* note 21 (reviewing the stepped up role of the Delaware Court of Chancery in the settlement process).

[211]*See* Brandi, *supra* note 26, at 391-93 (discussing incentives in the structure of the settlement process that have encouraged reviewing courts to take a hands off attitude towards settlement negotiations).

[212]*MAXXAM*, 659 A.2d at 776-77 ("Although the exclusion of a significant party litigant from the settlement negotiations will not, in and of itself, invalidate a proposed settlement, that approach, because of its inherent potential for abuse, will cause the settlement

framework of other decisions addressing settlement review, the decision indicates that where the settlement process appears materially tainted in any way, "little, if any, deference is given to the views of the settling plaintiffs."[213]

Although settling plaintiffs and defendants may be inclined to criticize the court's substitution of its own views as overreaching, it is well-settled that the approval or denial of a settlement lies solely within the business judgment of the court.[214] In cases of such blatant unfairness as *MAXXAM*, few can seriously challenge a court's decision to take a critical view of both the substantive and procedural aspects of the settlement. However, even in cases where the specter of collusive conduct is not so apparent, close scrutiny of the settlement proposal remains appropriate as a prophylactic rule. As one commentator noted early on, a protective approach is warranted by the unique posture assumed by former adversaries when it comes time for settlement:

> "Discretion of the court" is all too frequently the solution proposed for a difficult problem. But in a stockholder's derivative suit, we have an unusual difficulty; the good faith of all parties before the court is uncertain. Judicial supervision appears to be the best possible means of protecting the rights of other . . . absent parties with definite and substantial interests at stake. True, when a proposed compromise is laid before the court, it is in effect being asked to make a finding on the merits of the stockholder's claim without the thorough investigation of facts supposed to characterize trials. But some legal mechanism for compromising a derivative action must be provided; it seems preferable with so many interests at stake, to give final discretion to the court rather than to remit the parties solely to their own judgment and to rely entirely upon their good faith.[215]

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to be carefully scrutinized.").

[213]Goldman et al., *supra* note 14, at 799 n.10.

[214]*See, e.g.*, Rome v. Archer, 197 A.2d 49 (Del. 1964); *MAXXAM*, 659 A.2d at 760. "Requiring court approval of any compromise gives proper weight to the interest of the corporation in dealing with the claim and in fact merely prescribes the course that would in most instances seemingly be the most beneficial to the corporation." Comment, *Compromise of Derivative Claims by a Corporation Without Court Approval*, 52 VA. L. REV. 342, 351 (1966).

[215]McLaughlin, *supra* note 11, at 435.

Moreover, the broad discretion afforded by the Delaware Supreme Court to the chancery court in making this decision is obvious proof of its competence to make such evaluations.[216]

The *MAXXAM* decision carries on a trend in the Delaware Chancery Court to expand its traditional standards of settlement review. Some may view this decision as contrary to the functions of settlement, possibly resulting in unwanted and costly extension of litigation. However, *In re MAXXAM* is a necessary response to the abuse that the settlement process has been subjected to in corporate litigation.[217]

B. *The Statute of Limitations — Offensive or Defensive in Proposed Settlement Agreements*

The statute of limitations serves certain key purposes for defendants in all concentrations of law.[218] Foremost, these statutes prevent "fraudulent or stale claims" and unfair surprise to defendants.[219] In the business setting, the statute of limitations also "facilitate[s] business planning" by allowing companies to "assess liabilities."[220]

The *MAXXAM* decision, by minimizing a shareholder's duty under the statute of limitations, circumvents each of these functions. By finding that the shareholders were not on notice of their claims arising from the 1987 loans,[221] *In re MAXXAM* does not simply allow the fiduciary relationship to toll the statute, but promotes disregard for the rights of the defendants the statute was intended to protect. Admittedly, the fiduciary

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[216]The supreme court's faith in the ability of the chancery court in this area was evidenced in Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989), wherein the justices stated:

> Because the Court of Chancery is in the best position to evaluate the factors that support a settlement, we will not second-guess its business judgment upon appeal. Rather, if there is evidence in the record to support the Chancellor's findings and if his conclusions are not the product of errors of law, we must affirm the settlement approval.

Id. at 1284.

[217]*MAXXAM*, 659 A.2d at 776 ("This transmutation of the settlement process the settlement process into an offensive weapon has been criticized by our Supreme Court and has resulted in significant changes in the procedures for approving settlements of class actions.") (citing Prezant v. DeAngelis, 636 A.2d 915 (Del. 1994)).

[218]Leslie, *supra* note 18, at 1590-91.

[219]*Id.* at 1590. Leslie also suggests that the statute gives defendants the opportunity to make a "fresh start." *Id.; see also* Christopher A. Ford, Note, *Knowledge and Notice in Section 10(b) Limitations Law*, 103 YALE L.J. 1939, 1950-52 (1994) (commenting on the purposes of the statute of limitations).

[220]Leslie, *supra* note 18, at 1590.

[221]*MAXXAM*, 659 A.2d at 769-71.

relationship should confer a higher duty on directors to deal both honestly and fair with their shareholders.[222] However, the existence of this duty does not warrant decreasing the shareholders' duty of vigilance to a level that enables plaintiffs to remain willfully ignorant of their rights.

"The general rule is that the statute of limitations begins to run at the time of the wrongful act";[223] however, when a fiduciary relationship is present, the statute's commencement is sometimes delayed.[224] The well-settled decision of *Kahn v. Seaboard Corp.* closely reviewed the application of the statute of limitations when self-dealing by a fiduciary is alleged.[225] The chancery court defined the statute quite broadly to create a flexible rule.[226] Foremost, *Kahn* allowed the statute to be tolled in all actions charging self-dealing provided that the plaintiff did not know "facts constituting wrong" during the statutory period.[227] Until *Kahn*, plaintiffs had to show some act of active concealment by the defendant to justify halting the running of the statute.[228] The self-dealing exception created by the court was specifically premised on the good faith reliance of shareholders inherent to the fiduciary relationship.[229]

The main principle first expounded in *Kahn* is obviously both an equitable and well-settled part of Delaware's jurisprudence.[230] The average shareholder, upon investing into a company, should be able to rely on the decisions of a more knowledgeable corporate board.[231] It seems quite remiss for courts of equity to allow wrongs, especially those occurring in the fiduciary context, to remain unpunished due to a strict

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[222]*Kahn*, 625 A.2d at 275. Regarding the importance of the fiduciary relationship, the chancellor observed: "In functional terms there are good reasons why a corporate stockholder ought to be treated differently than a plaintiff who is a stranger to the defendant from whom he seeks compensation. That good reason arises out of the assigned roles of stockholder and director in our corporation law . . . ." *Id.*

[223]*Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *7.

[224]*E.g.*, *Kahn*, 625 A.2d at 275-76. For a full discussion of the *Kahn* holding, *see supra* notes 69-89 and accompanying text.

[225]*Kahn*, 625 A.2d at 275-76.

[226]*Id.*

[227]*Id.* at 276-77.

[228]*Id.*

[229]*Kahn*, 625 A.2d at 275-77.

[230]See *supra* note 71 for a discussion of Delaware cases which have applied the rule devised in *Kahn*.

[231]*See Reed*, No. 12,645, 1995 Del. Ch. LEXIS 69, at *8. This bond is central to Delaware's trust law: "It would contradict the law's general encouragement of such reliance [on the fiduciary relationship] to punish beneficiaries or shareholders for relying on fiduciaries by eliminating their ability to recover damages." *Id.* (citing *Price*, No. 12,476, 1995 Del. Ch. LEXIS 65, at *8).

application of the statute.[232] Furthermore, claims of self-dealing are contradictory to the fiduciary relationship itself and deserving of increased scrutiny when evaluating whether or not the statute should serve as a bar.[233] The inequitable results of a rule which rewards self-dealing defendants are more than apparent.

The *Kahn* court stated that the statute of limitations presents "a very practical question whose answer should make practical sense, while being consistent with our legal traditions."[234] However, striking a balance between tradition and practicality regarding the statute of limitations is really not as simple as the court suggested. Courts must decide whether plaintiffs were on notice of their claims without being unduly influenced by the importance that *Kahn* attaches to preserving the fiduciary relationship. As seen in *MAXXAM*, the failure to adequately consider the conduct of plaintiffs as well as defendants may completely relieve shareholders of any obligation of vigilance when a fiduciary relationship exists.[235]

Several approaches are possible when determining when a plaintiff justifiably may ask a court to invoke its equitable powers on his behalf to stay the effects of the fixed limitations period. These range from permitting plaintiffs to delay until actual notice of actionable wrongdoing has been received, to requiring plaintiffs to act as soon as they, in the exercise of reasonable diligence, should have received facts sufficient to make them suspicious of misconduct on the part of corporate fiduciaries.[236] Not even the lax standard expounded by the court in

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[232]*Kahn*, 625 A.2d at 275.

[233]*See Yaw*, No. 12,882, 1994 Del. Ch. LEXIS 35, at *17, *reprinted in* 20 DEL. J. CORP. L. at 465-66 (stating "[a]s a substantive matter, fiduciaries who benefit personally from their wrongdoing, especially as a result of fraudulent self-dealing, will not be afforded the protection of the statute").

[234]*Kahn*, 625 A.2d at 275.

[235]*MAXXAM*, 659 A.2d at 769-71.

[236]The various permutations on actual and constructive notice was recently discussed in the context of Rule 10b-5 actions under the federal securities laws which have a one year statute of limitations:

> Under an "actual knowledge" standard, the one-year limit would not begin until a plaintiff actually discovers that she has been defrauded. The second interpretation, "constructive knowledge," allows a plaintiff's awareness of fraud to be inferred: the limit runs from the point at which fraud should have been discovered. The third possible view of the one-year limit, "inquiry notice," runs the one-year period from the plaintiff's receipt of information that would have made a reasonable investor suspicious of fraud, whether or not the plaintiff actually became suspicious. Alternatively, courts might apply both the constructive knowledge and inquiry notice standards at the same time, dismissing cases that fit either standard. Finally, a "constructive inquiry

MAXXAM suggests that plaintiffs should be free to dally until unequivocally confronted with director wrongdoing.[237] Such a permissive standard "may encourage strategic gamesmanship by permitting plaintiffs to use the threat of litigation as an insurance policy against bad investing . . . ."[238] Instead the court accepts, as it should, the notion that some level of constructive knowledge must be attributed to plaintiffs.

The main criticism to be leveled at the *MAXXAM* decision arises from the court's conception of when and to what extent constructive notice should be applied to plaintiffs when a fiduciary relationship is present. Under *MAXXAM*'s articulation and application, constructive notice for purposes of tolling only arises when plaintiffs have notice of "all material facts that underlie" their claims.[239] In other words, plaintiffs neither need to act nor even inquire until they have sufficient information in their possession to pursue claims against their corporate fiduciaries.

Such a standard is inconsistent with other Delaware case law both predating and following *MAXXAM*. *In re USACafes* is notable for its recognition that, even in the fiduciary context, "when facts are disclosed that give rise to inquiry, an applicable statute of limitations will require timely action to preserve rights."[240] The decision further suggests that this inquiry is to be made from the perspective of a "reasonably alert interest holder . . . ."[241] These statements by the court indicate the existence of some middle ground between the traditional requirement of some act constituting active concealment of wrongs by corporate defendants[242] and blind reliance by plaintiffs on the supposed good faith of their fiduciaries. Indeed, in applying these standards, the court concluded that the plaintiffs had access to public disclosures regarding the

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> notice" interpretation would apply a constructive notice standard to the facts underlying inquiry notice, beginning the limitations period when the plaintiff should have been aware of fraud or should have received information that would have made a reasonable investor suspicious.

Ford, *supra* note 219, at 1940.

[237]*MAXXAM*, 659 A.2d at 769 ("The Court will also, in appropriate cases, apply the doctrine of equitable tolling under which the running of the limitations period 'is tolled in derivative actions charging actionable self-dealing, until the shareholders knew or had reason to know of the facts constituting the alleged wrong.'") (quoting *Kahn*, 625 A.2d at 276).

[238]Ford, *supra* note 219, at 1957.

[239]*MAXXAM*, 659 A.2d at 771.

[240]*In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *17, *reprinted in* 18 DEL. J. CORP. L. at 1213.

[241]*Id.*

[242]*See, e.g.*, *Halpern*, 313 A.2d at 142 (refusing to toll statute in derivative action absent allegations of actual fraud or fraudulent concealment of facts giving rise to the cause of action).

amounts of the allegedly wrongful compensation paid by the partnership.[243] Such knowledge, the court reasoned, was sufficient to compel the plaintiffs to action.

Similarly, in *Reed v. Delaware Trust Co.*,[244] a decision issued after *MAXXAM*, the court again appeared to return to a more moderate posture in balancing its view of the obligations of plaintiffs relative to their fiduciaries. The plaintiff, one of the beneficiaries of a family trust, sued Delaware Trust alleging negligent administration of the trust which had been co-managed by the defendant and the plaintiff's brother who was a Delaware Trust employee.[245] The court reasoned that it was sufficient to activate the statute of limitations that plaintiff had been informed of extensive disbursements from the trust, even though the record contained no facts specifically pointing to negligence on the part of Delaware Trust.[246] What had been disclosed, however, was adequate to provide the plaintiff with "good reason to know of the wrongs"; actual knowledge on his part was not required.[247]

It is hard to draw any consistent rule representing how far the court will go to find constructive knowledge in these cases. Both of these cases generally stand for the proposition that information which reveals the general character of wrongdoing on the part of a defendant acting in a fiduciary capacity is sufficient to place the plaintiff on constructive notice of his claims. Once such notice may be had, the plaintiff has the obligation to investigate further and advance his claims within the period afforded him by the statute. *In re MAXXAM*, however, departs from this standard in that it marks a wholesale rejection of any duty on the part of complaining shareholders to investigate even after the self-dealing character of a transaction has been revealed. The court rested its analysis on the plaintiffs' contention that they could not be expected to act on such information without knowing the extent of the substantive unfairness of the loans — facts which were not revealed until well within the limitations period. Thus, under the *MAXXAM* court's reasoning, plaintiffs were free to passively wait until both the self-dealing character of the loans and the extent of harm suffered by the shareholders had been revealed to them.[248]

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[243] *In re USACafes*, No. 11,146, 1993 Del. Ch. LEXIS 12, at *17, *reprinted in* 18 DEL. J. CORP. L. at 1213.

[244] No. 12,645, 1995 Del. Ch. LEXIS 69 (Del. Ch. May 19, 1995).

[245] *Id.* at *1-2.

[246] *Id.* at *14-16. This decision seemed premised on the undisputed fact "that plaintiffs knew of their injuries at the time they filed this action . . . ." *Id.* at *16 n.9.

[247] *Id.* at *16.

[248] *MAXXAM*, 659 A.2d at 770.

By formulating a standard that allows plaintiffs to indefinitely await further developments before acting to protect their interests, the court has assumed a position antithetical to the purpose of the statute of limitations. It is important to remember that what the court says in this context applies to situations beyond those in which defendants have intentionally concealed information providing clues to their wrongful actions.[249] Instead, the mere absence of information, regardless of the reasons or motives for it not being provided, has become the basis for increasing a defendant's exposure to stale and potentially fraudulent claims. Such a permissive approach can only increase the danger of "plaintiff gamesmanship and 'strike suits,'"[250] which are already regarded as problems plaguing shareholder litigation.[251]

VI. CONCLUSION

In re MAXXAM examines two aspects of shareholder actions which share the common goal of avoiding undesirable litigation. The settlement process, properly employed, permits litigants to compromise their disputes without the cost and other disadvantages of full-blown litigation. Similarly, the application of the statute of limitations assures claims will not be tried when the passage of time and unwarranted delay have increased the risk of fraudulent claims and made litigation unduly burdensome for defendants. Despite the common goal they share, these two devices have been treated quite differently when addressed by the Delaware Court of Chancery.

In its review of settlements, the recent trend of the Delaware Chancery Court has been to emphasize fairness above all else. *In re MAXXAM* illustrates this point with its focus on preserving the rights of nonsettling plaintiffs. Although the Delaware courts have always maintained that settlements must be substantively fair, this decision highlights the increasing role of procedural fairness in the court's analysis. Particularly, the chancery court again indicated its willingness to closely scrutinize settlements when a substantial number of interested shareholders have been excluded from the negotiations leading to the agreement. In other words, the court has rejected the use of the

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[249]Recall that in *Kahn*, 625 A.2d at 176, the chancellor rejected the notion that affirmative acts of concealment were required before equitable tolling could apply in shareholder derivative actions.

[250]Ford, *supra* note 219, at 1960.

[251]*See, e.g.*, Brandi, *supra* note 26 (discussing incentives for abuse of the settlement process leading to the frivolous shareholder litigation).

settlement process as an "offensive weapon" by the settling parties who otherwise would be free to compromise claims without regard for the interests of the corporation and its shareholders.

Yet, the court seems to have twisted its notions of fairness in considering the application of the limitations statute in shareholder actions alleging self-dealing. *In re MAXXAM* applies the doctrine of equitable tolling more permissively than any recent decision of the Delaware Court of Chancery. Under the guise of preserving the fiduciary relationship, the decision permits plaintiffs to avoid the statute's effect even when the self-dealing nature of the challenged transaction has been revealed to them. The plaintiffs' duty of vigilance has been reduced to nothing more than waiting until both the wrongful conduct and the extent of damages becomes apparent. This is surely unfairness of another kind relocated from the resolution of shareholder litigation to its outset.

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