# Unreported Cases

## INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

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BERGER v. INTELIDENT SOLUTIONS, INC.

No. 1527-N

*Court of Chancery of the State of Delaware, New Castle*

November 30, 2005

Ronald A. Brown, Jr., Esquire, of Prickett, Jones & Elliott, P.A., Wilmington, Delaware, for plaintiff.

Michael R. Laskowski, Esquire, and Matt Neiderman, Esquire, of Duane Morris LLP, Wilmington, Delaware; and Stewart D. Aaron, Esquire, Veronica E. Rendon, Esquire, and J. Alex Brophy, Esquire, of Arnold & Porter LLP, New York, New York, of counsel, for defendants.

LAMB, *Vice Chancellor*

The plaintiff, a minority stockholder in a Florida corporation, filed suit for breach of fiduciary duty in connection with a freeze-out merger. The sole defendants are a Nevada limited partnership that is the ultimate controlling entity of the Florida corporation and a Delaware corporation it formed to serve as an intermediate holding company in connection with the merger. The defendants moved to dismiss the complaint on grounds of forum non conveniens, arguing, *inter alia*, that all of the potential witnesses and pertinent documents are located in Florida and that the case predominantly deals with novel issues of Florida law that should be resolved by the Florida courts. This court concludes that the record demonstrates, with particularity, that this is one of those rare cases where the defendants would be subject to overwhelming hardship if required to litigate in Delaware. Therefore, dismissal is warranted on the ground of forum non conveniens in order that the litigation may proceed in Florida.

## I.

### A. The Parties

Coast Dental Services, Inc. is a Florida corporation that provides dental practice management services to an affiliated group of 106 dental

centers located in Florida, Georgia, Virginia, and Tennessee.[1] On or about April 7, 2004, Coast Dental deregistered and became a private company.[2] Thereafter, the company's stock traded sporadically in the pink sheets.

Prior to the July 11, 2005 cash-out merger at issue in this case, one of the defendants in this action, the Diasti Family Limited Partnership ("DFLP"), was the majority stockholder of Coast Dental, owning approximately 67% of its outstanding shares of common stock.[3] DFLP is a Nevada limited partnership controlled by Coast Dental's board chairman, Terek Diasti, Coast Dental's president and director, Adam Diasti, and Coast Dental's director, Tim Diasti.[4]

The other defendant, Intelident Solutions, Inc., is a Delaware corporation formed by DFLP to effectuate the merger.[5] Intelident, in turn, formed a wholly owned Florida corporation named Intelident Merger Corp. to function as the acquisition vehicle to merge into Coast Dental. Coast Dental survived the merger as a wholly owned subsidiary of Intelident Solutions.[6] DFLP remains the majority stockholder of Intelident. As a result of the transaction, 13 members of Coast Dental's management obtained minority ownership positions in Intelident.

The plaintiff, Stephen M. Berger, is a former minority stockholder of Coast Dental who was cashed out in the merger.[7] Berger's complaint names only Intelident Solutions and DFLP as defendants. Berger's counsel conceded at oral argument that he did not assert claims against any of the directors of Coast Dental because this court lacks personal jurisdiction over them. Jurisdiction is alleged to exist over DFLP, a Nevada limited partnership, solely as a result of its action in forming Intelident Solutions in Delaware.

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[1]Compl. ¶ 2. The affiliated group of 106 dental centers in Florida, Georgia, Virginia, and Tennessee are collectively referred to as Coast P.A. The entities comprising Coast P.A. are all owned by Adam Diasti. Coast P.A. provides dental services to patients and employs dentists and dental hygienists. Coast Dental handles office staff, dental supplies and lab fees, occupancy, advertising, acquisition of property and equipment, leasing and improvement of facilities, and related administrative costs for Coast P.A. Coast Dental's revenue consists primarily of fees paid by Coast P.A.

[2]Compl. ¶ 3.

[3]Compl. ¶ 4.

[4]*Id.*

[5]Compl. ¶ 5.

[6]Compl. ¶ 6.

[7]The court notes that this plaintiff has two other lawsuits pending in the Court of Chancery. *See Stephen M. Berger v. John C. Loring, et al.*, Del. Ch., C.A. No. 1798-N and *Stephen M. Berger v. HB Fairview Holdings LLC*, Del. Ch., C.A. No. 997-N.

B. The Freeze-Out Merger

In April of 2005, DFLP, along with certain members of Coast Dental's management, proposed to cash-out the company's minority stockholders for $6 per share.[8] The company formed a Special Committee consisting of two purportedly independent directors, Peter M. Sontag and Richard T. Welch, to evaluate this proposal.[9] The Special Committee retained legal counsel and Capitalink L.C. as its financial advisor. Capitalink performed a preliminary analysis and concluded that the proposed $6 per share was not a fair price.[10] DFLP bargained with the Special Committee and increased its bid price to $9.25 per share. Capitalink issued a fairness opinion at this price, and the Special Committee and the board of directors approved the merger.

On Thursday, June 30, 2005, the company mailed out a disclosure statement discussing the details of the transaction. The stockholder meeting to vote for the transaction was noticed for Monday, July 11, 2005. Therefore, due to the July 4 holiday, the stockholders had only five business days to receive and review the material and decide whether to vote for the transaction or seek an appraisal remedy.[11] Allegedly, the Special Committee members approved this unfair schedule because they were offered the chance to continue as directors of the acquiring company.[12] At the stockholder meeting, DFLP voted its shares in favor of the transaction, and the minority stockholders were cashed out at $9.25 per share.[13]

The plaintiff filed this individual and purported class action on July 29, 2005, against DFLP and Intelident Solutions. The complaint alleges that DFLP breached its fiduciary duties in connection with the freeze-out merger. Specifically, the plaintiff claims that the merger was unfairly timed so as to "keep minority shareholders in the dark as long as possible and to prevent anyone else from having time to make a better offer."[14] According to the complaint, the merger was the product of unfair dealing which led to an inadequate merger price. Allegedly, the $9.25 per share price was approximately half of Coast Dental's book value.[15] In addition, the complaint alleges that the disclosure document omitted and

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[8]Compl. ¶ 5.
[9]Compl. ¶ 7.
[10]*Id.*
[11]Compl. ¶ 13.
[12]*Id.*
[13]*Id.*
[14]*Id.*
[15] Compl. ¶ 21.

misstated material facts about the transaction.[16] Ultimately, the plaintiff seeks damages of the difference between the $9.25 per share merger price and the fair value of the company.

On September 22, 2005, the defendants filed a motion to dismiss the complaint based on, *inter alia*, forum non conveniens. The defendants claim that Florida is the more appropriate forum to adjudicate this case, arguing, among other things, that this action is controlled by Florida law and that the only nexus this case has with Delaware is that Intelident, the intermediate holding company, is incorporated in Delaware. Both parties submitted briefs on this motion, and oral argument was held on November 21, 2005.

## II.

The Delaware Supreme Court has held that to prevail under the forum non conveniens doctrine a defendant must meet a heavy burden of showing that the traditional forum non conveniens factors weigh so severely against suit in Delaware that the defendant will face overwhelming hardship if the suit proceeds in this forum.[17] This onerous burden is justified by the fact that the dismissal results in the defeat of the plaintiff's choice of forum.[18]

The defendants here can meet this exacting standard by convincing the court that this is one of the rare cases where the drastic relief of dismissal is warranted based on a strong showing that the burden of litigating in Delaware is so severe as to manifest undue hardship and inconvenience.[19] While the overwhelming hardship standard is difficult for

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[16]Compl. ¶¶ 4-16. For example, the plaintiff alleges that the disclosure document "repeatedly touts the $9.25 freeze-out price as being a large premium to Coast Dental's recent stock price," but omits that the company's stock had a very minimal trading volume. In addition, it is alleged that the proxy statement failed to disclose the company's projections, causing stockholders to be unable to make a fair and reasonable assessment of the $9.25 per share merger price. Lastly, the plaintiff alleges that the proxy statement was materially incomplete in its disclosure relating to Capitalink's comparable company and comparable acquisition valuation analysis.

[17]*See Warburg, Pincus Ventures, L.P. v. Schrapper*, 774 A.2d 264, 267 (Del. 2001); *Ison v. E.I. duPont de Nemours & Co.*, 729 A.2d 832, 837-38 (Del. 1999); *Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1199 (Del. 1997); *Chrysler First Bus. Credit Corp. v. 1500 Locust Ltd. P'ship*, 669 A.2d 104, 108 (Del. 1994); *Williams Gas Supply Co. v. Apache Corp.*, 594 A.2d 34, 37 (Del. 1991); *Kolber v. Holyoke Shares, Inc.*, 213 A.2d 444, 447 (Del. 1965).

[18]*Chrysler First*, 669 A.2d at 107 (explaining that the plaintiff's choice of forum should rarely be disturbed); *Mar-Land Indus. Contrs., Inc. v. Caribbean Petroleum Ref., L.P.*, 777 A.2d 774, 778 (Del. 2001) (holding that "a plaintiff seeking to litigate in Delaware is afforded the presumption that its choice of forum is proper.").

[19]*Ison*, 729 A.2d at 842; *Candlewood Timber Group v. Forestal Santa Barbara SRL*,

a defendant to overcome, "it is not preclusive"[20] and "can be satisfied in an appropriate case."[21]

In evaluating whether or not the defendants have met their burden, Delaware courts employ an analysis predicated upon the six so-called "*Cryo-Maid*" factors, which are (1) the applicability of Delaware law; (2) the relative ease of access to proof; (3) the availability of compulsory process for witnesses; (4) the possibility of a need to view the premises; (5) the pendency or nonpendency of a similar action or actions in another jurisdiction; and (6) all other practical considerations that would make trial of the case easy, expeditious, and inexpensive.[22] In *Chrysler First*, the Delaware Supreme Court explained that these factors:

> provide the framework for an analysis of hardship and inconvenience. They do not, of themselves, establish anything. Thus, it does not matter whether only one of the *Cryo-Maid* factors favors [the] defendant or all of them do. The issue is whether any or all of the *Cryo-Maid* factors establish that [the] defendant will suffer overwhelming hardship and inconvenience if forced to litigate in Delaware.[23]

The application of this forum non conveniens standard is one of sound discretion for the trial court, to be determined "in light of all the facts and circumstances and in the interest of the expeditious and economic administration of justice."[24] However, the trial court is not permitted to

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2004 Del. LEXIS 458, at *25 (Del. Oct. 4, 2004) (stating that the heavy burden of establishing "overwhelming hardship and inconvenience" will be met "only in a rare case"); *United Phosphorous, Ltd. v. Micro-Flo, L.L.C.*, 2002 Del. LEXIS 450, at *10 (Del. July 24, 2002) (noting that a party seeking to avoid litigation in Delaware bears a "heavy burden of establishing overwhelming hardship").

[20]*Ison*, 729 A.2d at 842; *Warburg*, 774 A.2d at 267-268.

[21]DONALD J. WOLFE, JR. AND MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 5-2 at 5-27 (2005) *citing Trinity Inv. Trust, L.L.C. v. Morgan Guar. Trust Co.*, Del. Super. Ct., C.A. No. 01C-03-005 (Sept. 28, 2001), Mem. Op. at 14 (finding that the defendants met their burden of proving "one of those rare cases in which the complaint should be dismissed" on forum non conveniens grounds); *IM2 Merch. & Mfg., Inc. v. Tirex Corp.*, 2000 Del. Ch. LEXIS 156 (Del. Ch. Nov. 2, 2000) (holding that forum non conveniens factors balanced overwhelmingly in favor of dismissal).

[22]*Taylor*, 689 A.2d at 1198-1199. All but the fifth factor listed above were set forth in the *Cryo-Maid* decision, *General Foods Corp. v. Cryo-Maid, Inc.*, 198 A.2d 681 (Del. 1964), *overruled on other grounds*, *Pepsico, Inc. v. Pepsi-Cola Bottling Co.*, 261 A.2d 520 (Del. 1969). The fifth factor originated in *Parvin v. Kaufmann*, 236 A.2d 425, 427 (Del. 1967).

[23]669 A.2d at 108.

[24]*Cryo-Maid*, 198 A.2d at 685; *Williams Gas Supply Co. v. Apache Corp.*, 594 A.2d 34, 37 (Del. 1991) (holding that a motion to stay or dismiss on the ground of forum non conveniens is addressed to the sound discretion of the trial court).

dismiss the case simply on a finding that the alternative forum is a more appropriate location for the dispute to be heard.[25] Rather, the trial court must decide whether or not the defendants show with particularity that one or more of the *Cryo-Maid* factors impose an overwhelming hardship on the defendants.[26]

A. The Applicability Of Delaware Law

The first of the forum non conveniens factors deals with "whether the controversy is dependent upon the application of Delaware law which the courts of this state more properly should decide than those of another jurisdiction."[27] Here, it is undisputed that this case involves no substantive issues of Delaware law. Rather, since Coast Dental is incorporated in Florida, the internal affairs doctrine prescribes that Florida law governs the corporate law claims asserted in this action.[28] While this court often applies the law of other jurisdictions, the central legal issues in dispute in this case present novel questions of statutory interpretation under Florida law that are best decided by the Florida courts.[29]

The defendants argue that under Florida law the statutory appraisal process is the exclusive remedy for the plaintiff's claims. Specifically, the defendants contend that Section 607.1302(4) of the Florida appraisal statute bars the plaintiff's breach of fiduciary duty claims. The Florida statue provides:

> A shareholder entitled to appraisal rights under this chapter may not challenge a completed corporate action for which appraisal rights are available unless such corporate action:
>
> (a) Was not effectuated in accordance with the applicable provisions of this section or the corporation's articles of incorporation, bylaws, or board of directors' resolution authorizing the corporate action; or

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[25] *Ison*, 729 A.2d at 838 (holding that it was error to predicate dismissal on a finding that another court would be a more appropriate forum).

[26] *Mar-Land*, 777 A.2d at 778; *Candlewood Timber Group, LLC v. Pan Am. Energy, LLC*, 859 A.2d 989, 994 (Del. 2004).

[27] *Cryo-Maid*, 198 A.2d at 684.

[28] *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1112 (Del. 2005) (holding that "only one state should have the authority to regulate a corporation's internal affairs—the state of incorporation.").

[29] *Tuckman v. Aerosonic Corp.*, 1982 Del. Ch. LEXIS 452, at *22 (Del. Ch. May 20, 1982) (applying Florida law to a breach of fiduciary duty claim).

(b) Was procured as a result of fraud or material misrepresentation.[30]

The defendants maintain that Coast Dental complied with Florida law and offered appraisal rights to any stockholder who dissented from the merger. They interpret Section 607.1302(4) to provide that Berger and other stockholders who failed to dissent from the transaction may only maintain an action against the defendants if either they properly allege that the merger was not effectuated in compliance with Florida statutory law, or the merger was procured as a result of fraud or material misrepresentation. The defendants argue that the plaintiff has failed to properly allege either of these factors, and thus the complaint should be dismissed for failure to state a claim under Florida law.

The plaintiff argues, in response, that the defendants misread this statutory provision, contending that the statute's plain language only limits "challenges to corporate action" and does not purport to bar remedies against fiduciaries for breach of fiduciary duties.[31] Berger claims that, although he is not seeking to unwind the merger or otherwise "challenge" the merger, he is entitled to bring a suit for monetary damages against the controlling stockholder for breach of fiduciary duty in connection with the transaction. The plaintiff bases this interpretation on the official comment to Section 13.02(d) of the Revised Model Business Corporation Act, which he claims the Florida statute was modeled after.[32]

The court finds that both arguments present plausible interpretations of Section 607.1302(4). As the parties agree, however, there are no Florida cases construing the statute this court can turn to for guidance. Therefore, the decision for this court—whether appraisal is the exclusive remedy for a breach of fiduciary duty claim made in connection with a freeze-out transaction—involves a novel and substantial issue of Florida corporate law that is best resolved by the Florida courts.[33] For this reason, the court concludes that this *Cryo-Maid* factor weighs heavily in favor of dismissing the case here to allow for litigation in Florida, given Florida's strong interest in interpreting and applying novel and important issues of its own corporate law. In this regard, the court notes that Berger chose to be

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[30]Fla. Stat. § 607.1302(4) (2005).

[31]*Id.*

[32]3 MODEL BUS. CORP. ACT § 13.02 cmt 5 at 13-27 (2002) ("Since section 13.02(d) is concerned with challenges only to the corporate action, it does not address remedies, if any, that stockholders may have against directors or other persons as a result of the corporate action.").

[33]*Mt. Hawley Ins. Co. v. Jenny Craig, Inc.*, 668 A.2d 763, 769 (Del. Super. Ct. 1995) (suggesting that a Delaware court might defer to a court of another state when "cutting edge or unsettled issues of law" from that state are involved).

governed by Florida law when he purchased stock in a company incorporated in Florida.[34]

B. The Relative Ease Of Access To Proof

The second *Cryo-Maid* factor, the relative ease of access to proof, requires the court to evaluate the proximity of potential witnesses, documents, and other evidence in relation to the Delaware forum.[35] Coast Dental is a Florida corporation, its corporate offices are located in Florida, and the members of its Special Committee, Sontag and Welch, as well as its officers and other directors, are all residents of Florida.[36] Coast Dental does not conduct any business in Delaware.[37] Several of the company's law firms and financial advisors, including the Capitalink analysts who prepared the fairness opinion involved in the transaction, reside in Florida.[38] Moreover, DFLP is a Nevada entity whose partners are principally Florida residents.[39] Thus, presumably all of the relevant evidence in this case, including the company's books, records, and witnesses related to the transaction in issue, is in Florida.[40]

The only connection between Delaware and the present lawsuit is that Intelident, the company created solely to act as a holding company in the merger, is incorporated in Delaware. This is a particularly weak connection. First, this case primarily concerns the actions taken by Florida fiduciaries in Florida. The fact that Intelident is incorporated in Delaware has no significance to this dispute. Second, Intelident maintains its principal executive offices in Florida, and thus it is reasonable to assume that the relevant evidence regarding the merger is in Florida.[41] Accordingly, the court finds that the defendants have demonstrated with particularity that specific witnesses and pertinent documents are located in Florida, potentially causing them considerable hardship if forced to litigate in Delaware. Therefore, this factor weighs in favor of dismissal.

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[34]The court recognizes and does not mean to suggest that it may dismiss the case "merely because an issue of foreign law is presented." *Taylor*, 715 A.2d at 842.

[35]*Texas Instruments v. Cyrix Corp.*, 1994 Del. Ch. LEXIS 31, at *13-14 (Del. Ch. Mar. 22, 1994).

[36]Merrick Aff. ¶¶ 4-5, 7. The other members of the board of directors that approved the transaction, Millard and Woody, are residents of Georgia.

[37]*Id.*

[38]*Id.* at 8.

[39]*Id.* at 6.

[40]*Id.* at 11.

[41]*Id.* at 3.

C. The Availability Of Compulsory Process For Witnesses

As discussed above, the defendants correctly argue that most of the witnesses likely to be called to testify at trial reside in Florida and none of them live or work in Delaware.[42] Those witnesses would be subject to compulsory process in Florida, but would not be subject to compulsory process in Delaware. Thus, it is clear that it would be more convenient to obtain the trial testimony of potential witnesses in Florida. Therefore, the compulsory process factor also weighs in favor of dismissing this action.

D. The Possibility Of A Need To View The Premises

This factor is not relevant to this dispute since there is no indication that the inspection of Coast Dental's premises will be necessary.[43]

E. The Pendency Or Non-Pendency Of An Action Elsewhere

There is no litigation pending elsewhere among the parties to this action. Therefore, "there is no risk of overlapping proceedings that would result in imposing the burdens of duplication on the defendants."[44] However, since this case is at an early stage in the litigation and no discovery has been undertaken, the plaintiff will not be unduly burdened by having to refile his suit in Florida.[45]

F. Other Practical Considerations

The final forum non conveniens factor involves evaluating any other consideration that would serve to "make the trial of the case easy, expeditious and inexpensive."[46] The court notes that, due to the remoteness of this venue from the real center of the dispute, the complaint asserts only a fragment of the possible claims arising out of the challenged merger. Most strikingly, Berger's complaint foregoes asserting claims against Coast Dental's directors, including the members of the Special Committee, over whom this court is unable to assert personal jurisdiction. In effect, by bringing this action in Delaware, the plaintiff has closed off the possibility of a single complete adjudication of all the claims arising out of this

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[42] *Id.* at 11.

[43] *Friedman v. Alcatel Alsthom*, 752 A.2d 544, 554 (Del. Ch. 1999) (holding that this factor is not applicable to the suit and is therefore is given no weight).

[44] *IM2*, 2000 Del. Ch. LEXIS 156, at *40.

[45] *Id.*

[46] *Cryo-Maid*, 198 A.2d at 684.

transaction. In contrast, if the plaintiff refiles in Florida, he will be able to bring all related claims in the same forum.

## III.

The court finds that the defendants have met the exacting standard applied in assessing forum non conveniens motions by demonstrating that one or more of the *Cryo-Maid* factors weigh heavily in favor of dismissal.[47] The defendants have demonstrated that this is one of those rare cases where they would be subjected to overwhelming hardship and inconvenience if required to litigate in Delaware. In particular, the court finds that this controversy raises important issues of unsettled Florida law, which can only be answered authoritatively by a Florida court. Additionally, the fact that all of the evidence and witnesses are located in Florida and the fact that the only connection to Delaware is that the holding company created to transact the merger is incorporated here weigh heavily in favor of litigating the dispute in Florida.

Therefore, for the reasons stated herein, the defendants' motion to dismiss on the ground of forum non conveniens is GRANTED. IT IS SO ORDERED.

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## BLACKMORE PARTNERS, L.P. v. LINK ENERGY LLC

No. 454-N

*Court of Chancery of the State of Delaware, New Castle*

October 14, 2005

Norman M. Monhait, Esquire, and Jessica Zeldin, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; and Stephen T. Rodd, Esquire, Stephanie D. Amin-Giwner, Esquire, and Rebecca A.

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[47] *Chrysler First*, 669 A.2d at 108 (explaining that it does not matter if only one of the *Cryo-Maid* factors establishes that the defendant will suffer overwhelming hardship and inconvenience if forced to litigate in Delaware).

Scheinberg, Esquire, of Abbey Gardy LLP, New York, New York, of counsel, for plaintiff.

Srivinas M. Raju, Esquire, and Elizabeth C. Tucker, Esquire, of Richards, Layton & Finger, P.A., Wilmington, Delaware; and David D. Sterling, Esquire, Samuel W. Cooper, Esquire, Rebeca Aizpuru, Esquire, and Brooke Geren, Esquire, of Baker Botts LLP, Houston, Texas, of counsel, for defendants.

LAMB, *Vice Chancellor*

Blackmore Partners L.P., instituted this action against Link Energy LLC and the members of its board of directors, alleging, *inter alia*, breaches of the defendants' fiduciary duties, arising out of a completed sale of Link' s operating assets at a price likely to yield zero value to Link' s equity owners. On November 1, 2004, this court denied the defendants' motion to dismiss, holding that the complaint alleged sufficient facts that, if true, would support a claim of disloyal conduct.[1] Following the conclusion of discovery, the defendants now move for summary judgment. Construing all evidence in favor of the plaintiff, the court nevertheless concludes that there are no material issues of fact in dispute, and that the defendants are entitled to the entry of judgment in their favor.

## I.

### A. Link's Emergence From Bankruptcy

The facts of this case, as developed in discovery, are largely uncontested. In October 2002, EOTT Energy Partners, L.P. filed for bankruptcy protection pursuant to Chapter 11 of the United States Bankruptcy Code.[2] On March 1, 2003, Link emerged from that reorganization as successor in interest to EOTT, planning to engage in the same business of purchasing, gathering, storing, transporting, processing and reselling crude oil, refined petroleum products, natural gas liquids, and other related products.[3]

As part of the plan of reorganization, Link issued $104 million in senior unsecured 9% notes ("Notes"), in lieu of $235 million of 11% senior

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[1]*Blackmore Partners, L.P. v. Link Energy LLC*, 864 A.2d 80 (Del. Ch. 2004).
[2]Matthews Dep. 13: 5-6, April 1, 2005.
[3]Matthews Dep. 35-37, April 1, 2005.

notes owed to a range of EOTT creditors.[4] In addition, those same creditors received 95% of the newly issued common equity units in Link ("Units").[5] Three percent of the Units were distributed to the former holders of EOTT's common units, one of whom is the plaintiff in this case.[6] While these exchanges resulted in a reduction in debt, Link remained relatively highly leveraged when it emerged from bankruptcy. In addition, Link had access to working capital through a credit facility with Standard Chartered Bank, which provided $290 million in funding until August 2004, subject to liquidity requirements waivable by that bank in its discretion.[7]

The instrument governing the Notes contained a restrictive covenant requiring any purchaser of substantially all of Link's assets to assume the Notes.[8] The provision was designed to ensure creditors that any such purchaser would honor the Notes, or at least ensure that the Note holders had a seat at the negotiating table in any post-bankruptcy acquisition of Link. In contrast to this power given to the Note holders, the Link operating agreement empowered the Link board of directors to authorize a sale of all or substantially all of Link's assets without a vote of the Unit holders.

Link was headed by CEO Thomas Matthews, who was joined on the board of directors by six persons appointed by EOTT's former note holders pursuant to EOTT's Restructuring Plan.[9] Of the six additional directors, none except J. Robert Chambers (a managing director at Lehman Brothers, which held the same 19.1% share of both Units and Notes) had any affiliation or connection with any of EOTT's former note holders or with holders of the newly issued Notes.[10]

The plan of operations devised by Link management hinged on its ability to attract a $100 million infusion of new equity into the company, which could be used to lower Link's debt levels and reduce its cost of credit. Link therefore entered the capital markets to search for an equity partner. Its efforts, however, were unsuccessful. Despite hiring Lehman Brothers in December 2003[11] to act as its financial adviser to assist the

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[4] *Id.* at 19.

[5] *Id.* at 18-20.

[6] *Id.*

[7] Defs.' Answering Br. In Opp. To Pl.'s Motion for Class Action Determination, Ex. 1, 58.

[8] Defs.' Opening Br., Ex. 13, Section 4.1b.

[9] Matthews Dep. 22, April 1, 2005.

[10] Ogle Dep., 8-9, April 28, 2005; Tidwell Dep., 10-14, April 7, 2005; Vanloh Dep., 6-13, May 9, 2005; Zaloudek Dep., 4-10, May 13, 2005.

[11] Defs.' Opening Br., Ex. 21.

company in searching for new money, discussions failed with one investment group during the summer and early fall of 2003,[12] and with another by February 2004.[13]

Link attempted to improve its financial state by selling some non-strategic assets during its search for equity, disposing of its West Coast natural gas liquids process, transportation, and marketing assets on June 26, 2003; certain crude oil marketing and transportation assets on October 1, 2003; and its remaining natural gas liquids assets on December 31, 2003.[14] Link also entered into a Crude Oil Joint Marketing Agreement with ChevronTexaco, effective as of January 1, 2004, allowing the company to reduce its letter of credit cost for oil by leasing a pipeline to ChevronTexaco in return for a fixed margin.[15] All these efforts, however, were insufficient to offset losses caused by a worsening business environment. Thus, Link's board of directors determined to explore new ways of reducing the company's debt to the Note holders.[16]

B. The Plains Transaction

This determination, combined with threats by the provider of Link's credit facility to force the company into bankruptcy,[17] caused Link to consider an acquisition offer by Plains All American Pipeline, L.P. of substantially all of the company's assets, first made in December 2003. In January 2004, the Link board of directors formed a Special Committee, consisting of all directors other than Matthews and Chambers to consider potential transactions. Plains initially appeared willing to assume the Notes as required by the bonds' restrictive covenant. If it had done so, the market value of the Notes, which were then trading at a discount, would have increased substantially as a result of Plains's substantially stronger credit rating.[18] Plains ultimately made clear, however, that it would only assume the Notes upon a substantial, and probably prohibitive, discount to the purchase price for Link's assets. The company therefore began negotiating conditions under which the Note holders would be willing to waive their veto rights over potential transactions.[19]

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[12]Defs.' Opening Br., Ex.15.
[13]Defs.' Opening Br., Ex. 26; Matthews Dep. 51: 7-12 April 1, 2005.
[14]Defs.' Opening Br., Ex. 19.
[15]Vanloh Dep. 93, May 9, 2005.
[16]*Id.* at 93-94.
[17]Chambers Dep. 167: 1-12, April 6, 2005.
[18]Vanloh Dep. 60:1-9, May 8, 2005.
[19]Rodd Aff., Ex. 33.

In February 2004, Plains made an indication of interest of $310 million for Link's assets.[20] At this figure, there might have been some recovery for Unit holders, though such a desirable result was by no means assured.[21] That price, however, was not Plains's final offer. Rather, as Plains conducted due diligence on Link, the price that Plains was willing to offer for Link's assets dropped repeatedly.[22] The figure finally agreed upon after due diligence and negotiations between Link and Plains was $290 million.[23] At the same time, Note holders agreed to waive the restrictive covenant, in return for a commitment by Link to repay the Notes at par plus accrued interest, and to pay the Note holders their proportionate share of up to $25 million from any funds remaining after the company wound up its affairs, but before any distribution to Unit holders. As the press release announcing the finalized deal made clear, the transaction at $290 million was likely to provide no recovery at all for Unit holders, given the demands of Link's debt and the deal struck with the Note holders.[24]

On March 16, 2004, Link announced that it was in advanced negotiations with a potential buyer, that sale proceeds would be used to retire the company's debt, and that Unit holders were likely to receive a minimal amount after the payment of all Link's liabilities, obligations, and contingencies.[25] On the heels of that announcement, the market price of Link Units collapsed, dropping from over $5 to roughly $1. Nonetheless, over the next two weeks, negotiations with Plains progressed to completion, and the deal was ready to close by the beginning of April. With the board of directors agreement that the sale was the best available option for Link, the company's Special Committee met on March 30, 2004 to consider the Plains transaction. At that meeting, the investment bank Petrie Parkman presented supporting information for its fairness opinion on the Plains transaction.[26] The Special Committee also heard an update to the fairness opinion presented by Lehman Brothers to the board of directors on March 29.[27] Upon a report by the board's counsel, and a full discussion of the Plains transaction, the Special Committee recommended the sale on March 30, 2004.[28] The transaction closed on April 1, 2004, and Link has now begun the process of winding up operations.

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[20]Defs.' Opening Br. Ex. 32.
[21]Matthews Dep. 141-142, April 1, 2005.
[22]*Id.* at 139: 7-12.
[23]Defs.' Opening Br. 12.
[24]*Id.* at Ex. 12.
[25]Rodd Aff., Ex. 16.
[26]Defs.' Opening Br., Ex. 39.
[27]*Id.*
[28]*Id.*, Ex. 39.

C. Link's Insolvency

The factual question of whether Link was insolvent or in the zone of insolvency during the contested period is an important one for the court's final disposition in this case, as it controls whether the board of directors owed fiduciary duties to the Note holders. The uncontraverted expert report of M. Freddie Reiss, introduced by defendants during discovery, examined Link's continued viability under three independent tests.[29] The first of these techniques, the so-called "balance sheet test," is "concerned with the relative value of a company's equity."[30] Under this test, a company's value can be determined either by individual asset valuation, in which each asset is valued on a going concern basis, or by business enterprise valuation, a more commonly used method which assumes that all assets are sold together, along with the business as a whole.[31] The second technique used by Reiss is known as the "cash flow test," and examines whether a company can "reasonably meet its anticipated fixed (on-balance sheet and contingent) obligations as they become due."[32] Finally, Reiss examined Link under the unreasonably small capital test, "which relates to whether a company has enough capital to finance its planned future operations."[33] If a company's capital is inadequate under the "unreasonably small capital test," then it is insolvent unless it can (1) successfully issue new equity or (2) restructure existing debt.[34]

Reiss came to the conclusion that Link was insolvent during the period relevant to this case under all three of these tests. The fair value of the company's assets on a going concern basis was less than the fair value of the liabilities, which means that Link failed the individual asset valuation prong of the balance sheet test.[35] After using two methods of business enterprise valuation, moreover, Reiss came to a negative figure for the value of Link's equity.[36] Nor could Link meet its obligations as they became due, suffering from strained liquidity, negative cash flow, and operating losses.[37] Finally, Reiss concluded that Link had too little capital to finance its future operations, and could not rely on issuing new equity or

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[29]Defs.' Opening Br., Ex. 28.
[30]*Id.* at 34.
[31]*Id.*
[32]*Id.* at 58.
[33]*Id.* at 68.
[34]*Id.*
[35]*Id.* at 45.
[36]*Id.* at 57.
[37]*Id.* at 61.

refinancing existing debt.[38] The plaintiffs have produced no evidence at all contradicting Reiss's report, or presented any evidence of their own suggesting that Link was not insolvent. The Reiss report, therefore, is the only piece of evidence in the record directly on point of Link's insolvency.

D. The Plaintiff's Allegations

The plaintiff makes three key allegations. First, the plaintiff argues that because the Plains transaction deprived the Unit holders of consideration that would have gone to them but for the actions of the board in agreeing to the demands of the Note holders, the actions of the Link board of directors should be subject to enhanced scrutiny. Second, the plaintiff argues that even if enhanced scrutiny does not apply, the presumption of the business judgment rule should be rebutted in this case due to a litany of deficiencies they ascribe to the process that led to the Plains transaction. Specifically, the plaintiff alleges that Matthews and the board were ill informed, and that no independent financial adviser was hired by the board of directors or the Special Committee to opine on the fairness of the Plains transaction to Unit holders;[39] that the Special Committee was tainted by Matthews's and Chambers's presence and participation at most meetings of the Committee;[40] that Chambers himself was conflicted because his employer, Lehman Brothers, owns both Units and Notes; that Matthews failed to use the negotiating leverage provided by the threat of bankruptcy to persuade Note holders to accept an arrangement that would provide greater value to Unit holders;[41] and that Matthews and the Link board of directors ignored a potentially superior "alternative recapitalization proposal" forwarded by Jeffrey Priest,[42] the managing member, president, and sole originator and founder of Amajac (the general partner of the plaintiff Blackmore Partners).

According to Priest's deposition, the content of this alternative transaction proposal was essentially as follows: Priest attempted to contact Link first in January, leaving a voice mail with an unidentified person at Link indicating that Amajac would be interested in organizing financing for Link.[43] Receiving no immediate response to his voicemail, Priest claims to have called Link again three to five days later, and again received no

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[38] *Id.* at 68.
[39] Hutchinson Dep., 55: 7-11, May 12, 2005.
[40] Rodd Aff., Ex. 2 at 5-6; Ex. 5; Ex. 6; Ex. 8; Ex. 27.
[41] Kaelber Dep., 180-81, April 18, 2005.
[42] Priest Dep. 5-16, March 11, 2005.
[43] *Id.* at 41-42.

response.[44] Finally, Priest spoke to an analyst who worked with Link in an attempt to make contact with the company's management, but succeeded only in learning that Link would do nothing without consulting Priest.[45] No other evidence was presented concerning any alternative transaction emanating from Priest.

Finally, the plaintiff contends that the defendants violated their duty to disclose material facts to the Unit holders by waiting until March 16, 2004 to give any indication that the Plains transaction might leave the Unit holders without recovery. Because this fact was only confirmed in a press release on March 31, 2004, one day before the transaction closed,[46] the plaintiff argues that he was not given sufficient time to take action on the provided information.

The defendants deny that they violated any of their fiduciary duties, and argue the lack of any factual basis for the plaintiff's contentions about the handling of negotiations with Note holders,[47] and as to the supposed alternative proposal made by Priest.[48] The defendants also argue that although Matthews and Chambers were present during many Special Committee meetings, the record shows that they were there only as sources of information, and were asked to leave at crucial moments.[49]

## II.

Under Court of Chancery Rule 56, summary judgment will be granted when the moving party demonstrates that there are no genuine issues of material fact in dispute, and the moving party is entitled to judgment as a matter of law. When determining whether to grant summary judgment, a court must view the facts in the light most favorable to the nonmoving party.[50]

Delaware's business judgment rule operates primarily as a presumption that directors making business decisions act in good faith, on an informed basis, and in the honest belief that their actions are in the corporation's best interest.[51] The burden is on the party challenging the

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[44]*Id.* at 62.

[45]*Id.* at 66: 20-25.

[46]Rodd Aff., Ex. 18.

[47]Matthews Dep., 177:15-24, April 1, 2005.

[48]The defendants claim never to have even heard of the plaintiff, Amajac, or Priest until the filing of the law suit. Matthews Dep. 51: 1-2, April 1, 2005; Chambers Dep. 163: 13-18, April 6, 2005. Vanloh Dep., 123: 20-21, May 9, 2005.

[49]Chambers Dep., 105:4-15, April 6, 2005; Vanloh Dep., 54:4-12, May 9, 2005.

[50]*Haas v. Indian River Volunteer Fire Co.*, 2000 Del. Ch. LEXIS 116, *11, *aff'd*, 768 A.2d 469 (Del. 2001).

[51]*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

decision[52] to allege particularized facts creating a reasonable doubt that (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[53] The plaintiff here also alleges that the board's action in depriving the Unit holders of value is subject to a form of enhanced scrutiny. The court will examine this last claim, and then test the board's action against the business judgment rule.

## III.

The plaintiff claims that Chancellor Allen's decision in *Orban v. Field*[54] requires "that when a board approves a transaction that favors one corporate constituency over another, they lose, at least as an initial matter, the cloak of business judgment protection."[55] But the plaintiff's reliance on *Orban* for the proposition that the company owed the Unit holders a higher duty of care in this case is misplaced.

It is doubtless true, as Chancellor Allen noted in *Orban*, that a board deploying corporate power against a class of shareholders must specially demonstrate that it acted reasonably and in good faith.[56] But that duty, though important, is limited to circumstances where the board uses the very levers of corporate power against its own shareholders in order to achieve some purportedly higher end. In *Orban* itself, for example, the board did not simply make a business decision that hurt shareholders while repaying creditors, but engaged in an elaborate maneuver in which the defendant company intentionally diluted a major shareholder to a position where he was powerless to stop a merger favored by the directors.[57] In the face of such overwhelming force, it was clearly appropriate for the court to require the board to demonstrate the reasonableness and good faith of its action on a full evidentiary record. And even in that case, the court eventually upheld the board's action as necessary in otherwise pressing circumstances.[58]

This case stands in sharp contrast to *Orban*. The corporate action complained of here, though it did result in Unit holders being left with no residual value, did not involve the use of corporate power against a shareholder class in the sense of *Orban*. The defendants did not act "solely or primarily for the express purpose of depriving a shareholder of effective

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[52] *Id.* at 812, *citing Puma v. Marriot*, 283 A2d. 693, 695 (Del. Ch. 1971).
[53] *Id.* at 815.
[54] 1997 Del. Ch. LEXIS 48.
[55] Pl.'s Answering Br. In Opp'n to Defs.' Mot. for Summ. J. 28.
[56] *Orban*, 1997 Del. Ch. LEXIS at *28-29.
[57] *Id.* at *32-3.
[58] *Id.*

enjoyment of a right conferred by law."[59] Crucially, the Unit holders, by charter, did not even retain the right to vote on the sale of substantially all of Link's assets. Thus, no extraordinary efforts were needed to secure approval, or to stop a vote, for no such approval or vote was necessary. In such a case, it seems plain that *Orban*'s enhanced scrutiny does not apply.[60] It is a test designed for different circumstances, ones raising the omnipresent specter of management entrenchment.

Even if one were to apply *Orban* to this case, however, the defendants meet the enhanced standard required by that case. Link was insolvent, teetering on the brink of bankruptcy. At any moment, the provider of its chief credit facility could have forced it into default. Business prospects were declining, reducing daily the amount of consideration the company could hope for in any non-bankruptcy alternative. Finally, no better transaction was available. These corporate interests are every bit as compelling as those that were served in *Orban*.

## IV.

### A. The Company's Fiduciary Duty To Creditors

The plaintiff claims that the defendants violated their fiduciary duties to Unit holders by concentrating on the interests of creditors to the exclusion of their fiduciary duties to Unit holders. This claim fails on summary judgment. Under Delaware law, directors generally owe no fiduciary duties to creditors. In limited cases, however, such duties do arise. As this court held in *Geyer v. Ingersoll Publications Company*, "directors do not owe creditors duties beyond the relevant contractual terms absent 'special circumstances.'"[61] Under long established precedent, one of those circumstances is insolvency, defined not as statutory insolvency but as insolvency in fact, which occurs at the moment when the entity "has liabilities in excess of a reasonable market value of assets held."[62] When the insolvency exception arises "it creates fiduciary duties for directors for the benefit of creditors."[63] The court, therefore, must first decide whether the company was insolvent at the time of the disputed transaction, and second whether the defendants discharged their duties to Link's Unit holders.

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[59] *Phillips v. Insituform*, 1987 Del. Ch. LEXIS 474, *18.
[60] *See Orban*, 1997 Del. Ch. 48. *See also Insituform*, 1987 Del. Ch. LEXIS at *12.
[61] 624 A.2d 784, 787 (Del. Ch. 1992).
[62] *Geyer*, 621 A.2d at 789.
[63] *Id.* at 787.

As to the first question, the plaintiff apparently concedes in its brief that the company was indeed insolvent as a matter of fact at the time of the Plains transaction. Even if the court reads the plaintiff's brief as trying to reserve the question of the company's insolvency,[64] the plaintiff does not contradict expert testimony introduced by the defendants as to the insolvency of the company in the relevant period.[65] The plaintiff is correct, of course, to say that having fiduciary duties to creditors does not excuse violations of fiduciary duty to Unit holders. During insolvency, the directors owe fiduciary duties to both the creditors and the Unit holders. But ultimately, the board of directors of an insolvent company may take into account the interests of creditors at the apparent expense of stockholders if, in doing so, the board meets its fiduciary duties to all relevant constituencies.

B. The Business Judgment Presumption

The plaintiff alleges that the business judgment rule's presumption of due care and good faith should be rebutted for two reasons. First, the plaintiff claims that the company's transaction with the Note holders was "wholly flawed" in part because Chambers was conflicted, therefore tainting board determinations. The claim that Chambers was conflicted rests primarily on the fact that Chambers was a managing director of Lehman Brothers, a holder of an equal percentage of both the Notes and the Units.[66] To the extent the plaintiff has made a cognizable argument as to conflict, this court's decision in *Cooke v. Oolie*[67] is instructive. In that case,

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[64]The plaintiff makes some ambiguous statements as to this point, but does not appear to contest the expert report presented by the defendants. ("[R]egardless of whether Link was insolvent, or in the zone of insolvency." Pl.'s Answering Br. in Opp'n to Defs.' Mot. for Summ. J. 35-36.)

[65]Ex. to Defs.' Opening Br. in Supp. of their Mot. for Summ. J. 42.

[66]It is unclear why Lehman's ownership of equal percentages of Notes and Units created a substantial conflict, at least as to the negotiation over whether to pay the Note holders more than was due to them by contract. Unlike the situation in *Cooke*, Lehman would seem to gain no financial advantage from allocating the residue of the Plains transaction to Notes rather than Units. Because it owns the same percentage of both instruments, Lehman would receive the same amount of consideration no matter how any remaining value after satisfying Link's creditors was divided. At most, therefore, Lehmans dual ownership served to make it indifferent as to whether funds were distributed to the Unit holders or to the Note holders. Hutchinson Dep. 46-49, May 12, 2005. The plaintiff also claims that Chambers was conflicted because Lehman Brothers issued a fairness opinion to the board in connection with the Plains transaction. But as the defendants note, Lehmans fairness opinion had nothing to do with the Note holder transaction. Rather, Lehman issued a fairness opinion relating to the entire Plains transaction. Rodd. Aff., Ex. 10.

[67]2000 Del. Ch. LEXIS 89.

the defendants were both shareholders and creditors of a corporation considering an acquisition proposal, although their interests were not in proportion as Lehmans are here. As Chancellor Chandler noted, this left the defendants torn between their fiduciary duty of loyalty to shareholders, which required them to seek the best possible acquisition for that constituency, and their own status as creditors, knowing that "any acquisition of TNN might affect their financial interests."[68] The court frankly acknowledged "that the potential for a conflict of interest" was present.[69] But even amid that potential, the court granted summary judgment for the defendants, concluding that the plaintiffs bore the burden of showing that an actual conflict existed, and that the deal chosen by the defendants offered superior terms for creditors and inferior terms for the plaintiff shareholders compared to other proposals available to the defendant corporation.[70] Since the plaintiffs in *Cooke* did not present such evidence, their claims failed.

This case differs from *Cooke* on the fundamental basis that the defendants here did, in fact, owe fiduciary duties to creditors because the company was insolvent. The choice between creditors and Unit holders in this case, therefore, does not present the same clear conflict of interest this court perceived in *Cooke*. To the extent that a potential conflict of interest would arise by virtue of Chambers's membership on the board, there is no evidence of any other potential transaction that might have been better for Unit holders than the Plains transaction. The only possibility, Priest's shadowy proposal, remained at all times entirely hypothetical. Indeed, Priest conceded that the entirety of the so-called alternative proposal consisted of an ambiguous voicemail left with an undetermined person at Link to which an answer was never received.[71] This was, of course, far short of an alternative proposal.

Nor would the court's determination change if the court were to conclude that Chambers was indeed conflicted. The protections of the business judgment rule may still insulate a board decision from challenge so long as a majority of the directors approving the transaction remain disinterested.[72] Aside from the unsubstantiated allegations discussed above as to Chambers, the plaintiff makes no claims that any other directors were interested, and therefore a clearly independent majority of the board made the relevant decisions.[73]

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[68]*Id.* at *39.
[69]*Id.* at *40.
[70]*Id.* at *41.
[71]Priest Dep. 43:1-24, March 11, 2005.
[72]*Aronson*, 473 A.2d at 812.
[73]Though the plaintiff does not make this argument expressly in its response to the

Second, the defendants do not rely solely on the independent board majority to justify their approval of the Plains transaction. Rather, even though the Link board was not required to delegate its responsibilities to a special committee in this case,[74] a special committee made up entirely of independent directors was indeed formed.[75]

The plaintiff claims that the Special Committee was rendered inutile by the presence of Matthews and Chambers during meetings of the Committee. But Delaware law does not require that special committees be segregated from sources of vital information. Moreover, there is no evidence at all that Chambers or Matthews influenced the Special Committee, or acted as anything more than necessary sources of information. Nor does the record reveal the kind of secret or subversive communications between Chambers and Matthews and others that troubled the court in *In Re Freeport-McMoRan Sulphur Inc.*[76] Even taking all the evidence in the light most favorable to the plaintiff, the court concludes that the Special Committee, created to reinforce the independence of a majority independent board, operated with sufficient independence to merit the cloak of business judgment protection.

C. Due Care

The plaintiff's claims as to the defendants' alleged breach of the duty of care can be summarized in the following way. First, the plaintiff claims that the directors approved the Plains transaction without sufficient expert information, blindly following the lead of a CEO acting on erroneous information. Second, the plaintiff claims that the defendants violated the business judgment rule by neglecting to use the leverage afforded by a potential bankruptcy filing against the Note holders in order to secure a better settlement for the Unit holders.

To the extent that the plaintiff's claims are based on allegations of insufficient care, their claim is precluded through the operation of Section 6.8 of Link's charter agreement, exculpating directors for all awards of damages for violations of the duty of due care. The plaintiff claims that Link's exculpatory clause is inoperable because of the defendants' bad

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motion for summary judgment, the defendants are correct to note that debt holders may appoint the board majority without necessarily tainting the board's determinations. Absent a showing of personal financial interest, a board of directors is presumed to act in accordance with their fiduciary duties to the corporation. *Aronson*, 473 A.2d at 812.

[74] *Rand v. Western Air Lines*, 1994 Del. Ch. LEXIS 26, *9.

[75] *Id.*

[76] 2005 Del. Ch. LEXIS 96, *51.

faith.[77] But as the court concludes below, the plaintiff has presented no evidence of bad faith or other circumstance that would render the exculpatory provision inoperable. That being so, the plaintiff's challenge to Link's exculpatory clause falls short. The court nonetheless will briefly address the plaintiff's duty of care claims. The duty of due care requires directors to inform themselves of all material information reasonably available to them before making a corporate decision.[78] This duty, however, does not require any particular actions or roadmap. Exactly what procedures the law requires varies according to the nature and importance of the considered transaction.[79] The advice of an investment banker or other expert is never required, though it may be useful.[80]

The defendants' actions in this case cannot be said to have reached the level of gross negligence required to find a violation of the duty of due care. The record shows that the Special Committee met repeatedly over months to address the issue of the company's impending insolvency and to consider alternatives. Nor can the court find that the defendants' alleged negligence in not using the leverage generated by the company's potential bankruptcy rises to the level of gross negligence required by Delaware law.[81] At its most simple, the Note holders, through the restrictive covenant that effectively allowed them to veto any proposed transaction, had substantial negotiating leverage against the company. They would rationally have stopped any transaction that did not at least promise them something more than their interest and principle. But even more important, the choices made in formulating a negotiating strategy are within the core of what is protected by the business judgment rule. Therefore, while it is regrettable that a solution salvaging some value for Unit holders was not found as a result of the board's efforts, the evidence does not support the plaintiff's claimed violation of due care.

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[77]The plaintiff also claims that the exculpatory clause does not apply because the relief requested (purportedly the return of up to $11 million in cash) is equitable in nature, and thus falls outside the clause. But the transaction proceeds that the plaintiff claims can be equitably distributed are already contractually promised to Note holders. This court does not accept that paradigmatically legal damages such as those at issue here can be converted into equitable relief by the simple expedient of labeling them as such.

[78]*Aronson*, 473 A.2d at 812.

[79]*Citron v. Steego*, 1988 Del. Ch. LEXIS 119, *26 (holding that "there is no ritual in these matters with which thoughtless compliance will assure later judicial approval or from which thoughtful deviation will risk automatic judicial censure").

[80]*Kleinhandler v. Borgia*, 1989 Del. Ch. LEXIS 81, *14.

[81]It is not even clear that the plaintiff has alleged any facts at all as to this supposed breach of duty. The evidence on which the plaintiff relies, a statement by Kaelber, confesses only that Kaelber cannot recall whether such threats were made or not. Kaelber Dep., 180-81, April 18, 2005. This is in sharp contrast to Matthews's contention that the bankruptcy possibility was used in his negotiations. Matthews Dep., 182:18-183:4, April 1, 2005.

The plaintiff alternatively claims that the defendants acted in bad faith in approving the Plains transaction. As this court has previously explained, in cases where the business judgment presumption applies, the subjective bad faith of directors may be inferred from corporate actions which are "so egregious as to be afforded no presumption of business judgment protection."[82] After examining the record, however, the court concludes that there is no basis to draw an inference of bad faith or waste in this case. The directors were faced with a pressing situation that was only worsening over time. They acted as they plausibly thought necessary in order to extract value for the corporation. The fact that Unit holders were left with nothing at the end, given a context in which the chief alternative substantiated by evidence was an equally barren bankruptcy proceeding, does not suffice to rebut the presumption that the directors were acting in the good faith exercise of their fiduciary duties, or to establish a claim of waste.[83]

## V.

For the foregoing reasons, the defendants' motion for summary judgment pursuant to Rule 56 is GRANTED. IT IS SO ORDERED.

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[82]*Aronson*, 473 A.2d at 815; *Grobow v. Perot*, 539 A.2d 180, 189 (Del. 1998).

[83]The plaintiff additionally appears to claim in its brief that the defendants violated their duty to disclose material information to shareholders "by delay[ing]] any disclosure of the details of the Plains Transaction to the public or to Unitholders who were not also 9% Noteholders until it was too late for minority Unitholders to take any steps to save their investment." Pl.'s Answering Br. in Opp'n to Defs.' Mot. for Summ. J. 9. In cases where the corporation does not require shareholder action, however, a "stockholder must allege he received 'false communications' from directors who were 'deliberately misinforming shareholders about the business of the corporation.'" *Steinman v. Levine*, 2002 Del. Ch. LEXIS 132, * 47-48, *aff'd*, 822 A.2d 397, *quoting Malone v. Brincat*, 722 A.2d 5, 14 (Del. 1998). The plaintiff here makes no such accusations of deliberate false communications.

# *IN RE* COMPUCOM SYSTEMS, INC. STOCKHOLDERS LITIGATION

No. 499-N

*Court of Chancery of the State of Delaware, New Castle*

September 29, 2005

R. Bruce McNew, Esquire, of Taylor & McNew LLP, Greenville, Delaware; Carmella P. Keener, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware, co-liaison counsel for plaintiff.

Darren J. Robbins, Esquire, Randall J. Baron, Esquire, A. Rick Atwood, Jr., Esquire, and Shaun L. Grove, Esquire, of Lerach Coughlin Stoia Geller Rudman & Robbins LLP, San Diego, California, of counsel; Samuel H. Rudman, Esquire, and David A. Rosenfeld, Esquire, of Lerach Coughlin Stoia Geller Rudman & Robbins LLP, Melville, New York, lead counsel for plaintiff Wolf Popper LLP.

Marc A. Topaz, Esquire, of Schiffrin & Barroway, LLP, Radnor, Pennsylvania, of counsel, for plaintiff's executive committee members.

Bruce L. Silverstein, Esquire, and Martin S. Lessner, Esquire, of Young Conaway Stargatt & Taylor LLP, Wilmington, Delaware, for defendants Coleman, Smith, Musser, Johnson, and CompuCom Systems, Inc.

Richard M. Donaldson, Esquire, of Montgomery, McCracken, Walker & Rhoads, LLP, Wilmington, Delaware; William F. Drake, Jr., Esquire, and Charles B. Casper, Esquire, Montgomery, McCracken, Walker & Rhoads, LLP, Philadelphia, Pennsylvania, of counsel, for defendants Emmi, Ford, Harper, Loewenberg, Paoni, and Patrone.

Alan J. Stone, Esquire, Morris, of Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Safeguard Scientifics, Inc.

LAMB, *Vice Chancellor*

## I.

Former minority shareholders of a Delaware corporation bring this purported class action suit against the company, its directors, and the

controlling shareholder alleging a breach of fiduciary duty in connection with the sale of the company to a third party on terms that treated all stockholders equally. The complaint alleges that, when the defendant directors sold the company, they were dominated and controlled by the majority shareholder and improperly agreed to sell the company for an inadequate price in order to satisfy the majority shareholder's pressing need for cash.

The defendants have moved to dismiss the complaint for failure to state a claim upon which relief can be granted, in accordance with Rule 12(b)(6) of the Court of Chancery Rules. The issue presented is whether the complaint adequately alleges facts which, if true, would overcome the business judgment rule presumption that the directors acted in good faith and after a careful investigation when they voted to authorize the transaction.[1] The court finds that the well-pleaded allegations of fact found in the complaint, if true, could not support a reasonable inference that the board breached its fiduciary duties. Therefore, the defendants' motion to dismiss will be granted.

## II.

The plaintiff brings this purported class action against CompuCom, its former board of directors, and CompuCom's former controlling shareholder, Safeguard Scientifics, Inc., alleging breach of fiduciary duty in connection with the sale of CompuCom to Platinum Equity Capital Partners, L.P. Specifically, the plaintiff alleges that the CompuCom board of directors failed to comply with its fiduciary duties when it structured a sale of the company to Platinum[2] under terms that are alleged to have improperly favored Safeguard, the majority shareholder, to the detriment of the minority shareholders. The plaintiff also alleges that the defendants sought to discourage CompuCom shareholders from pursuing their statutory right to an appraisal by disseminating a materially false and misleading proxy statement.

### A. The Parties

CompuCom is a Delaware corporation with its principal executive offices located in Dallas, Texas. CompuCom is regarded as a leading IT service provider and has been profitable since its formation in 1987.

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[1]The facts recited in this opinion are taken from the well-pleaded allegations of the complaint, unless otherwise noted, and are presumed to be true for the purpose of this motion.

[2]Prior to the acquisition, CompuCom and Platinum were unaffiliated third parties.

CompuCom's controlling shareholder, Safeguard, is a corporation duly existing and organized under the laws of the Commonwealth of Pennsylvania, having its principal executive offices in Wayne, Pennsylvania. At the time of the disputed transaction, Safeguard owned approximately 48% of CompuCom's common stock and 100% of CompuCom's preferred stock. Due to a super voting provision in the preferred stock agreement, Safeguard held 51% of the voting rights of CompuCom's stock entitled to vote on the acquisition and 58% of the voting rights with respect to the election of CompuCom's directors.

The plaintiff in Civil Action No. 499-N, Central Laborer's Pension Fund, is a trust fund created to provide retirement and other benefits for approximately 14,000 active and inactive union laborers and their beneficiaries. The Pension Fund was a beneficial owner of over 72,000 shares of CompuCom stock.

B. The Sale Of CompuCom

The complaint alleges that the CompuCom board, acting at the behest of Safeguard, timed and structured the sale of CompuCom to benefit Safeguard, a company that was in serious need of cash. According to the complaint, Warren V. Musser, Safeguard's founder and former CEO, personally invested and caused Safeguard to invest millions of dollars in risky Internet and technology companies. When the Internet bubble burst, the value of Safeguard's and Musser's investments in those companies plummeted, leaving Musser in dire straits. Making matters worse, in September 2000, Safeguard guaranteed Musser's margin loans on the failing investments. In May 2001, when Musser was unable to pay back the margin loans, Safeguard bailed him out, loaning him $26.5 million. On January 1, 2003, this loan became payable, but Musser did not have sufficient assets to satisfy the outstanding balance due.[3] Thus, allegedly to end the embarrassment of being unable to collect on a loan against its founder and former CEO, coupled with the need for cash to fund its operating costs and ongoing corporate transactions,[4] Safeguard began

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[3]Pl.'s Second Am. Class Action Compl. ("Compl.") ¶ 48. "Safeguard's loans to Musser bear interest at a default annual rate of 9% and became payable on January 1, 2003 . . . . According to Safeguard's March 2004 Annual Report to Shareholders, based on the information then available to Safeguard, Safeguard has concluded that Musser may not have sufficient personal assets to satisfy the outstanding balance due under the loan when the loan became full recourse against Mr. Musser on April 30, 2006."

[4]Due to Musser's failed investment strategies at Safeguard, the value of Safeguard's assets fell from approximately $1.65 billion on December 31, 2000 to $836 million on December 31, 2003. Its shareholders' equity fell from $904.4 million on December 31, 2000 to

liquidating investment assets in companies in which Musser also invested, which included CompuCom, at "fire sale" prices.[5] This provided the impetus for the sale of CompuCom.

On August 1, 2002, the CompuCom board organized a Special Committee comprised of four purportedly independent directors, Richard F. Ford, Edwin L. Harper, Anthony J. Paoni, and Edward N. Patrone, to sell Safeguard's shares of CompuCom, or, in the alternative, put CompuCom up for sale. The Special Committee was charged with evaluating indications of interest received from potential acquirers, reviewing CompuCom's strategic alternatives, and making recommendations to the full board of directors. In connection with this sale process, the Special Committee retained Houlihan Lokey Howard & Zukin Financial Advisors, Inc. as its financial advisor to render a fairness opinion to the Special Committee on any proposed transaction. In addition, the Special Committee independently selected and retained legal and financial advisors to assist the committee in considering strategic alternatives available to CompuCom. The company retained Broadview International LLC to act as the financial adviser to the full board. After over 18 months of exploring various strategic alternatives, the Special Committee had not located a suitable deal.

The complaint does not discuss the committee's efforts over those 18 months and does not allege any specific defect in the sale process pursued by the Special Committee. In fact, the complaint makes no allegations at all about any deficiencies in the actions of the Special Committee in the sale of CompuCom. Instead, the complaint focuses on attacking the independence of the committee members.

In February of 2004, the CompuCom board added two members, Michael J. Emmi and John D. Loewenberg, to the Special Committee. At this time, negotiations with Platinum were underway. On March 24, 2004, Platinum proposed to pay $5 per share in cash to the non-Safeguard common stockholders, $4.50 in cash for the shares of CompuCom common stock held by Safeguard, and $8 million for the shares of CompuCom preferred stock, all of which was held by Safeguard. This offer was rejected by Safeguard and the Special Committee. Then, on May 27, 2004, CompuCom and Platinum entered into an Agreement and Plan of Merger (the "Merger Agreement") which provided that each outstanding share of CompuCom's common stock, in a non-discriminatory manner, would be

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$236.2 million on December 31, 2003.

[5]Compl. ¶ 49. In May 2003, Safeguard sold its interest in Pac-West Telecom and collected approximately $1 million from Musser, who also owned an interest in Pac-West, which was applied towards the unpaid balance of Musser's loan. Additionally, in April 2004, Safeguard received a total of $4.5 million in net cash proceeds from Musser as a result of the sale of Safeguard's and Musser's interest in Sanchez Computer Associates.

converted into the right to receive $4.60 in cash, and each outstanding share of CompuCom's preferred stock would be converted into the right to receive the par value of the preferred ($15 million in the aggregate), plus accrued and unpaid dividends. The total consideration for the transaction was valued at $254 million, of which Safeguard received approximately $128 million.

Houlihan Lokey and Broadview made formal presentations to the Special Committee and the CompuCom board stating their opinion that the proposed merger consideration of $4.60 in cash for the common stock was fair to CompuCom's public stockholders.[6] Houlihan Lokey's and Broadview's fairness opinions were supported by a number of financial analyses that were disclosed in the proxy statement distributed to CompuCom's stockholders in connection with the merger. After reviewing the terms of the Merger Agreement and Houlihan Lokey's fairness opinion, the Special Committee unanimously resolved to recommend the Merger Agreement to the full board. Thereafter, in reliance on the Special Committee's recommendation and Broadview's fairness opinion, the board unanimously approved the Merger Agreement.

The complaint attacks the adequacy of the acquisition price. First, the plaintiff alleges that the deal provided no premium to the public shareholders for their shares of common stock. Indeed, the price of $4.60 in cash per common share paid by Platinum represented a discount to CompuCom's closing price of $4.84 on May 27, 2004, the day before the proposed acquisition was announced.[7] As negotiations were in progress, however, the public trading price for CompuCom's shares ranged from as low as $4.16 to as high as $5.99.[8] Second, the plaintiff points to CompuCom's profitability at the time of the acquisition, alleging that CompuCom had more than $264 million in current assets, including cash, cash equivalents, and inventory, and approximately $400 million in total assets on its balance sheet. According to the complaint, "the Company has been profitable each of its seventeen years of operation."[9] Lastly, the plaintiff alleges that the unfair terms of the acquisition raised the "ire of the investment community."[10] To support this contention, the plaintiff cites to news articles in which portfolio managers called the acquisition an "unappealing proposition . . . at a price for a stock that's extremely

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[6]Compl. ¶ 77.
[7]Compl. ¶ 75.
[8]*Id.*
[9]Compl. ¶ 2.
[10]Compl. ¶ 80.

undervalued" and a deal "so out of whack that it fails to pass the smell test."[11]

Although the complaint attacks the adequacy of the deal price, it does not claim that the Merger Agreement contained strong lock-ups or other deal protection provisions that prevented the emergence of a competing bid.[12] Indeed, the complaint refers to the fact that, although Safeguard agreed to vote in favor of the merger, its obligation to do so was conditioned on the approval of its own stockholders. From this allegation, it is obvious that any superior competing proposal could have succeeded. Nonetheless, the complaint fails to allege that any higher or better alternative to the Platinum proposal ever emerged.

On July 15, 2004, the company issued a definitive proxy statement that solicited its shareholders' approval of the merger. Then, on August 19, 2004, several weeks after the filing of the amended complaint in this action, the defendants issued a supplement to the proxy statement and postponed the shareholder meeting and vote. The proxy supplement was issued to "avoid any argument that the proxy statement should have included factual information on the issues identified by the plaintiffs."[13] The proxy supplement provided additional disclosures about, among other things, the relationship between Safeguard and CompuCom's Special Committee members and information regarding the board's efforts to find alternative value-maximizing transactions. Thereafter, on September 9, 2004, the company issued a press release announcing the merger had been approved by the company's stockholders.

### C. The Individual Defendants

Before the transaction at issue, CompuCom had an 11-member board of directors consisting of defendants J. Edward Coleman, Anthony L.

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[11]Compl. ¶¶ 80-84.

[12]The Platinum/CompuCom Merger Agreement contained a break-up fee in which CompuCom agreed to pay a termination fee of $8.88 million to Platinum if the CompuCom board of directors canceled the sale of CompuCom, or, in the alternative, CompuCom was to pay Platinum's fees and expenses incurred in the transaction up to $4 million if the merger was terminated because either CompuCom's or Safeguard's shareholders did not approve the merger. The Merger Agreement also contained a "No Solicitation" provision prohibiting any CompuCom employee, director, officer, accountant, lawyer or other representative from engaging in discussions with any third party concerning the sale of CompuCom to an alternative purchaser—including potential alternative purchasers who express an interest in making a superior offer to Platinum's— until and unless a third party's interest is reduced to a written proposal, communicated to Platinum, and Platinum is given two days to meet or exceed the proposal.

[13]Compl. ¶ 8.

Craig, Michael J. Emmi, Richard F. Ford, Edwin L. Harper, Delbert W. Johnson, John D. Loewenberg, Warren V. Musser, Anthony J. Paoni, Edward N. Patrone, and M. Lazane Smith. The complaint alleges that,

> Safeguard has used its voting power to pack CompuCom's 11 member Board of Directors, and the so called "Special Committee," that ostensibly was created to evaluate the Proposed Acquisition on behalf of the minority shareholders of CompuCom, with individuals dominated and controlled by Safeguard.[14]

The plaintiff contends that the CompuCom board and the Special Committee were beholden to Safeguard, and thus dominated and controlled by it, based on numerous connections between the individual defendant directors and Safeguard.[15] The complaint makes specific factual allegations that at least a majority of its 11 directors served as directors and/or officers of Safeguard, had other substantial associations with Safeguard's affiliates and/or subsidiaries, and/or previously served on multiple Safeguard portfolio company boards in which Safeguard held large equity interests.

First, as to the five non-Special Committee director defendants, Coleman, Smith, Musser, Craig, and Johnson, the plaintiff alleges that they were dominated and controlled by Safeguard because they were placed on the CompuCom board through Safeguard's voting power. In addition, Coleman and Smith obtained a new employment agreement and other monetary benefits as a result of the acquisition.[16] Musser was the founder and former chairman of Safeguard, and Craig was the current president, chief executive officer, and director of Safeguard. Johnson served as an executive of Safeguard for 30 years and as a director emeritus of Safeguard and was chairman of the board and chief executive officer of Pioneer Metal Finishing, a former division of Safeguard.

Second, as to the six Special Committee members, the plaintiff contends that, while the members were not at the time employed by Safeguard, they were sufficiently connected to Safeguard to make them beholden to Safeguard. Specifically, the plaintiff alleges that between May 1993 and April 2000, Special Committee directors Paoni, Patrone, Ford, Emmi, and Loewenberg purchased, or were given the opportunity to purchase, shares in the initial public offerings of several Safeguard

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[14]Compl. ¶ 2.

[15]Compl. ¶ 45.

[16]Coleman received over $5 million and Smith received over $2 million as a result of the acquisition.

portfolio companies.[17] These IPO allocation benefits allegedly enabled the directors to receive profitable financial opportunities through their association with Safeguard. Additionally, Harper was an employee of Fortis, Inc., which had a business relationship with DocuCorp, a company in which Safeguard formerly held a significant equity interest. Paoni held outside directorships with two portfolio companies of Safeguard, Arista Knowledge Systems, Inc., and e-Certify, and was vice chairman of DiamondCluster International, Inc., a company previously taken public by Safeguard. Emmi served on the Safeguard board of directors from 1998 to 2002 and was a director of Metallurg, Inc., a majority-owned subsidiary of Safeguard. Loewenberg is alleged to have served as an advisor to Safeguard through an independent consulting firm, JDL Enterprises, where he is the managing partner. Moreover, Loewenberg previously served on boards of directors of several companies in which Safeguard at one time owned substantial equity interests.[18]

## III.

The standard for dismissal pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted is well established. A motion to dismiss will be granted if it appears with reasonable certainty that the plaintiff could not prevail on any set of facts that can be inferred from the pleading.[19] That determination is generally limited to the factual allegations contained in the complaint. In considering this motion, the court is required to assume the truthfulness of all well-pleaded allegations of fact in the complaint.[20] All facts of the pleadings and inferences that can reasonably be drawn therefrom are accepted as true.[21] However, a trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in the plaintiff's favor unless they are reasonable inferences.[22]

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[17]Compl. ¶ 8. These companies included: Artemis International Solutions Corporation, Cambridge Technology Partners, Inc., Coherent Communications Systems Corporation, Chroma Vision Medical Systems Inc., DocuCorp, DTP, eMerge Interactive, Inc., Internet Capital Group, Inc., OAO Technology Solutions, Inc., Pac-West Telecom, Inc., Sanchez, and USDATA Corporation.

[18]Loewenberg was a director of DocuCorp International, Inc., Diamond Technology Partners, Inc., and Sanchez Computer Associates, companies in which Safeguard formerly maintained significant equity positions.

[19]*Kohls v. Kenetech Corp.*, 791 A.2d 763, 767 (Del. Ch. 2000).

[20]*Grobow v. Perot*, 539 A.2d 180, 188 n.6 (Del. 1988).

[21]*Id.*

[22]*In re Lukens Inc. Shareholders Litig.*, 757 A.2d 720,727 (Del. Ch. 1999).

## IV.

The court begins its analysis with the presumption of the business judgment rule. At the core of Delaware corporate law is the presumption that, in making a business decision, the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken is in the best interest of the company.[23] "Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption."[24] In this way, the business judgment rule serves to promote the role of the board, and not the court, as the ultimate manager of the business and affairs of the corporation.[25]

When a board of directors determines to put the corporation up for sale, its responsibility is to endeavor to secure the highest value reasonably attainable for the stockholders.[26] Thus, when the CompuCom board, at the suggestion of Safeguard, undertook to find a buyer for the whole enterprise, the CompuCom board and the Special Committee were charged with getting the maximum value reasonably attainable for the stockholders. "This obligation is a contextually-specific application of the director's duty to act in accordance with their fiduciary obligations, and there is no single blueprint that a board must follow to fulfill its [Revlon] duties."[27] Rather, the court must take into account the relevant circumstances to determine whether the CompuCom board and the Special Committee acted faithfully and with due diligence. If the court concludes that the facts do not support an inference of disloyalty or lack of due care, the board's actions are entitled to the protections of the business judgment rule.

The plaintiff asserts that it has pleaded facts sufficient to rebut the presumption of the business judgment rule, and that this court should refuse dismissal at this stage of the proceedings. The court disagrees. Taking the plaintiff's allegations as true, the plaintiff has not alleged sufficient facts to support a reasonable inference that the CompuCom board and the Special Committee were dominated and controlled by Safeguard. Similarly, the plaintiff's factual allegations contained in the complaint do not overcome the presumption that the CompuCom board acted on an informed basis, in good faith, and in an honest belief that the Platinum transaction was in the best interest of CompuCom and all its shareholders.

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[23] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

[24] *Id.*

[25] 8 *Del. C.* § 141(a).

[26] *McMillan v. Intercargo Corp.*, 768 A.2d 492, 502 (Del. Ch. 2000) (citing *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*, 506 A.2d 173, 182 (Del. 1986)).

[27] *Id.*

A. Sale Of CompuCom

The plaintiff's factual allegations that the defendant directors breached their fiduciary duties in the sale of CompuCom are threefold: (1) that the board orchestrated a "fire sale" in order to address Safeguard's desperate need for cash; (2) that the board, at the behest of Safeguard, refused to accept less consideration for Safeguard's controlling shares than was to be paid for the shares owned by the public stockholders; and (3) that the $4.60 sale price was inadequate.

Generally speaking, a controlling shareholder has the right to sell his control share without regard to the interests of any minority shareholder, so long as the transaction is undertaken in good faith.[28] The same has long been true as a general proposition when a parent chooses to negotiate for the sale of a subsidiary corporation to an independent third party. The reasons for the law's tolerance of such sales is clear—as the owner of a majority share, the controlling shareholder's interest in maximizing value is directly aligned with that of the minority.

In *McMullin v. Beran*, the Delaware Supreme Court held that in the context of such a transaction, the board of the subsidiary corporation cannot entirely abdicate its responsibilities to its minority shareholders.[29] It cannot, as the board did in that case, simply leave everything to the management of a different corporation.[30] As discussed in *McMullin*, the Chemical board delegated full control of the sales process to the controlling shareholder, ARCO. ARCO hired an investment bank, solicited bids, and reviewed and rejected bids. The Chemical board permitted ARCO to unilaterally initiate, structure, and negotiate the merger agreement without establishing any procedural safeguards to protect the interests of the

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[28]*See Harris v. Carter*, 582 A.2d 222, 234 (Del. Ch. 1990) (stating that "it is [a] principle [of Delaware law] that a shareholder has a right to sell his or her stock and in the ordinary case owes no duty in that connection to other shareholders when acting in good faith").

[29]765 A.2d 910, 919 (Del. 2000).

[30]*See In re Siliconix Inc.*, 2001 Del. Ch. LEXIS 83, at *29-30 (Del. Ch. June 19, 2001). *McMullin* teaches, *inter alia*, that in the context of a merger of a subsidiary with a third party (thereby effecting a complete sale of the subsidiary) where the controlling shareholder wants the merger to occur and the minority shareholders are powerless to prevent it: (i) the directors of the subsidiary have an 'affirmative duty to protect those minority shareholders' interests;' (ii) the board cannot 'abdicate [its] duty by leaving it to the shareholders alone' to determine how to respond; and (iii) the board has a duty to assist the minority shareholders by ascertaining the subsidiary's value as a going concern so that the shareholders may be better able to assess the acquiring party's offer and, thus, to assist in determining whether to pursue appraisal rights.

Chemical minority shareholders.[31] The Chemical board also did not conduct a critical assessment of the third party transaction, nor did it make an independent determination as to whether the transaction maximized value for all shareholders.[32]

Such neglect is inconsistent, the Supreme Court explained, with the important bonds of fiduciary duty that tie directors to those who rely on them for protection from potentially overbearing controllers. When faced with such a transaction, therefore, this court has a duty to test the actions of the board against the business judgment rule. The business judgment rule's presumption may be rebutted by an allegation of a breach of the duty of due care, as when a board is rushed or uninformed. More important for the instant case, however, the presumption that the board acted in good faith can be rebutted if the court finds that the plaintiff has alleged sufficient facts that, if true, permit a reasonable inference that (1) the board was dominated by the controlling shareholder, and (2) this domination led the board to accommodate the controller rather than act in the best interest of all the subsidiary's shareholders. The latter test may be met, for example, by precisely the kind of allegation made in *McMullin*—that the subsidiary board allowed the parent to independently negotiate a deal uniquely advantageous to itself, without regard to conflicting the interests of the subsidiary's minority shareholders.[33]

Unlike *McMullin*, the complaint itself reveals that the board of CompuCom undertook its fiduciary duty of care with all the seriousness and diligence that was required. The CompuCom board formed a Special Committee of outside directors to negotiate the sale with Platinum.[34] This Special Committee evaluated indications of interest received from potential acquirers, reviewed CompuCom's strategic alternatives, negotiated the deal with Platinum, and made recommendations to the full CompuCom board. All this was done with the aid of independently selected and retained legal and financial advisors. The CompuCom board reasonably relied on Houlihan Lokey's and Broadview's fairness opinions, which concluded that the $4.60 in cash consideration for CompuCom common stock was fair to

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[31] *McMullin*, 768 A.2d at 921 (emphasis added).

[32] *Id.* at 920.

[33] *Id.*

[34] *Id.* at n.48 The Supreme Court in McMullin criticizes the board for not involving the company's Special Committee in the sale process when it states, "[t]he Board failed, however, to authorize the Special Committee to protect and enhance the interests of the Company and its public shareholders in connection with the subsequent sale of the Company to Lyondell . . . . The Board's failure to empower the Special Committee to actively participate in the sale of the Company is inexplicable."

the CompuCom public stockholders. These fairness opinions were supported by a number of financial analyses.

Moreover, the CompuCom board did not hastily approve a transaction about which it was not fully informed. In *McMullin*, the board met once to consider the transaction.[35] Here, by contrast, the plaintiff itself concedes that the sale of CompuCom was the culmination of a multi-year process, beginning in 2002 and coming to agreement in 2004, in which the Special Committee explored various strategic alternatives to maximize stockholder value.[36] Thus, the plaintiff's claim that the CompuCom board orchestrated a "fire sale" and rashly sold CompuCom for a discounted price rings particularly hollow.[37]

Nor can the court infer that the price of the challenged merger was so inadequate as to overcome the business judgment rule. It is not enough to argue that the financial press published objections to the adequacy of the $4.60 price.[38] Nor is the fact that the final price per share was below the market price on the day of sale enough to rebut the business judgment presumption. As the plaintiff concedes in its complaint, the public trading price for CompuCom's shares ranged from as low as $4.16 (9.6% below the offer price) to as high as $5.99 (30.2% above the offer price) during the period that negotiations were underway with Platinum. Simply put, the mere fact that the deal price was 24 cents below a market price buffeted by the force of entirely predictable volatility does not state a claim for breach

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[35] *Id.* at 922.

[36] Compl. ¶ 58.

[37] Compl. ¶ 49. The plaintiff also claims that the board breached its fiduciary duties by agreeing to equal consideration amongst the common stockholders. Specifically, the complaint alleges that

> Safeguard originally agreed to structure the transaction in such a way that it received less per-share consideration than CompuCom's non-Safeguard shareholders (with those non-Safeguard shareholders to receive at least $5 per share for their CompuCom stock), but through its control of the special committee, Safeguard was able to obtain a larger share of the total merger consideration, ultimately getting the same $4.60 per share as the Company's non-Safeguard shareholders. Compl. ¶ 60.

This claim, that the minority shareholders were entitled to more per share consideration than Safeguard, the controlling shareholder, is not supported by Delaware law. *Mendel v. Caroll*, 651 A.2d 297, 305 (Del. Ch. 1994) ("The law has acknowledged . . . the legitimacy of the acceptance by controlling shareholders of a control premium.); c.f. *Paramount Communications v. QVC Network*, 637 A.2d 34, 45 (Del. 1994) (*Revlon* requires an auction because "an asset belonging to public stockholders [a control premium] is being sold and may never be available again.").

[38] To support this allegation, the plaintiff points to the market price of CompuCom prior to the announcement of the transaction and news articles in the *Wall Street Journal* in which portfolio managers called the acquisition an "unappealing proposition . . . at a price for a stock that's extremely undervalued." Compl. ¶ 80.

of fiduciary duty. Moreover, if the plaintiff was dissatisfied with the price, it could have exercised its appraisal remedy.

Lastly, the plaintiff does not contend that the Merger Agreement contained any strong lock-ups or other deal protection measures that would unduly impede a bidder willing to pay a higher price from coming forward.[39] The plaintiff also does not allege that a better offer was available. Not surprisingly, after several years of actively seeking to sell the company, no higher bid emerged. Stated briefly, the well-pleaded allegations do not support a reasonable inference that the CompuCom directors were inadequately informed, acted irrationally, or did not fulfill their obligation to seek the best value reasonably available to the stockholders.[40]

Because the plaintiff has not alleged sufficient facts to show that the CompuCom board neglected its duty of care in the sale transaction, the plaintiff must alternatively show that the Compucom board was dominated and controlled by Safeguard to such an extent as to overcome the business judgment presumption. A party alleging domination and control of a company's board of directors bears the burden of proving such control by showing a lack of independence on the part of the directors.[41] In assessing director independence, the court is called upon to apply a subjective "actual person" standard, instead of an objective "reasonable director" standard in making its determination.[42] An independent director is one whose decision "is based on the corporate merits of the subject before the board rather than extraneous considerations or influence,"[43] while a director who is not independent is "dominated or otherwise controlled by an individual or entity interested in the transaction."[44] Control over individual directors is established by facts demonstrating that "through personal or other relationships the directors are beholden to the controlling person"[45] or so under their influence that "their discretion would be sterilized."[46]

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[39]Compl. ¶¶ 64-65; *See Paramount*, 637 A.2d at 49.

[40]The court notes that the CompuCom Restated Certificate of Incorporation contains an exculpatory provision pursuant to Section 102(b)(7). The complaint does not contest the existence or authenticity of CompuCom's 102(b)(7) provision. As to the plaintiff's duty of care claim, the plaintiff does not allege conduct on the part of the Special Committee members that could be viewed as rising to the level of gross negligence or bad faith. *See In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 289 (Del. Ch. 2003).

[41]*Odyssey Partners, L.P. v. Fleming Co.*, 735 A.2d 386, 407 (Del. Ch. 1999).

[42]*Orman v. Cullman*, 794 A.2d 5, 24 (Del. Ch. 2002); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995).

[43]*Aronson*, 473 A.2d at 816.

[44]*In re Maxxam, Inc.*, 659 A.2d 760, 773 (Del. Ch. 1995).

[45]*Aronson*, 473 A.2d at 815.

[46]*Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

Based on the aforementioned standard and the main factual allegations in the plaintiff's complaint, the court cannot reasonably infer that the Special Committee directors were improperly influenced or controlled by Safeguard. First, as to the alleged IPO allocation benefits, the complaint does not explain why having received these benefits in years past would constitute a disabling conflict for the members of the Special Committee. The complaint does not address how much the IPO opportunities were worth, why the members of the Special Committee received them, and which (if any) of the members of the Special Committee actually invested in the IPOs. The complaint simply does not allege that these IPO allocation benefits were material to the directors. Moreover, the complaint does not allege that Safeguard *gave* the members of the Special Committee the IPO opportunities. Instead, the complaint simply repeats the words of the proxy supplement and then alleges that the Special Committee members were able to purchase shares in these IPOs "through their relationship with Safeguard."[47] This bare allegation, without more, is insufficient to reasonably infer that the Special Committee lacked independence from Safeguard.[48]

Second, as to the directors' connections to Safeguard, it is significant that, at the time the sale to Platinum was negotiated, none of the members of the Special Committee had employment relationships with CompuCom, Safeguard, or Platinum.[49] The plaintiff does not allege that any of the Special Committee board members received special benefits as a result of the transaction or were given improper incentives to favor Safeguard. Instead, the plaintiff claims that the Special Committee lacked independence because a majority of the Special Committee members served as directors and executives in companies in which Safeguard *formerly* held an equity interest.

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[47]Compl. ¶¶ 8, 88.

[48]One can certainly imagine a situation where receiving the current opportunity to invest in an IPO would be sufficient to prove, or at least raise a reasonable inference of, a lack of independence. For example, a complaint alleging that the opportunity was extremely valuable, or that the director was in desperate need of cash, or some combination of the two.

[49]The plaintiff quotes *McMullin* as controlling precedent; however, *McMullin* found that 8 of the 12 Chemical directors were not independent because 6 of the Chemical directors were currently employed by ARCO, to wit, ARCO's chief financial officer and executive vice-president, another ARCO executive vice-president, and 4 senior vice-presidents of ARCO. The remaining 2 directors were alleged to have prior affiliations with ARCO as officers of other ARCO subsidiaries. Unlike *McMullin*, the complaint here does not allege that any of the Special Committee members were employed by Safeguard when the Platinum transaction was consummated.

The court recognizes that under certain circumstances, professional, financial, and personal relationships of directors may preclude a finding of independence.[50] However, the plaintiff's factual allegations do not meet the relevant standard.[51] According to *Tremont*, "the independence or not of the member of a special committee is a question of fact that turns not simply upon formality but upon the reality of the interests and incentives affecting the independent directors."[52] Here, the plaintiff does not allege that these former business relationships were material to the directors or that Safeguard has or ever had an ability to influence or exert any control over these directors.[53] "Our cases have determined that personal friendships, without more; *outside business relationships*, without more . . . are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment."[54] Thus, the court cannot infer that Safeguard had the ability to influence and impair the business judgment of these directors because they formerly served as outside directors for companies in which Safeguard held an equity interest.

The plaintiff makes additional allegations about Emmi and Loewenberg, the directors added to the Special Committee in 2004. In particular, Emmi was a non-management director of Mettullurg, Inc., which was a majority-owned subsidiary of Safeguard, and he was also a former director of Safeguard from 1999 to 2002. Loewenberg served as an advisor to Safeguard through an independent consulting firm, JDL Enterprises, of which he was the managing partner.

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[50]*See Krasner v. Moffet*, 826 A.2d 277, 283 (Del. 2003) (finding that at the pleading stage, the plaintiff's allegations that two directors were interested when they "received substantial income from other entities within the interlocking directorates of Freeport-McMoRan companies and arguably had an interest in appeasing the MOXY and FSC insiders who also served" with them "on the boards of other Freeport companies" was sufficient to sustain an inference of interestedness).

[51]*Beam v. Stewart*, 845 A.2d 1040, 1052 (Del. 2004). (stating that "to create a reasonable doubt about an outside director's independence, a plaintiff must plead facts that would support the inference that . . . the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director"). Although *Beam* involved a review of the sufficiency of the plaintiff's allegations under Rule 23.1, the Supreme Court's interpretation of the type of relationship required to rebut the presumptive independence of an outside director provides insight in the context of this dismissal motion brought pursuant to Rule 12(b)(6).

[52]*Kahn v. Tremont*, 1992 Del. Ch. LEXIS 165, 1992 WL 205637 *3 (Del. Ch. Aug. 21, 1992), *rev'd on other grounds*, 694 A.2d 422 (Del. 1997).

[53]*Official Comm. Of Unsecured Creditors of Integrated Health Servs. v. Elkins*, Del. Ch. C.A. No. 20228, Noble, V.C. (Aug. 24, 2004) ("General allegations of domination over a Board are simply not sufficient under Delaware law to state a tradition duty of loyalty claim.").

[54]*Cal. Pub. Employee's Ret. Sys. v. Coulter*, 2002 WL 31888343, at *9 (Del. Ch. Dec. 18, 2002) (emphasis added).

The allegation that Emmi was a director of another majority-owned subsidiary of Safeguard does not support an inference that he was dominated and controlled by Safeguard in the transaction to sell CompuCom. The complaint does not allege that Emmi received material compensation for serving as a director, that Emmi felt beholden to Safeguard, or that Emmi was conflicted in his loyalties with respect to the challenged board action.[55] In addition, the fact that Emmi was a former non-management Safeguard director does not mean he could not assert independent judgment in this transaction. Therefore, the court concludes that the plaintiff's allegations are insufficient to rebut Emmi's presumptive independence from Safeguard.

The complaint does not allege sufficient facts as to Lowenberg to support an inference that he was dominated and controlled by Safeguard. The plaintiff does not allege what compensation Loewenberg and/or JDL Enterprises obtained for Loewenberg's advisory services, nor does the complaint allege that such fees constituted such a large part of his or the firm's income so as to be material to Loewenberg or JDL Enterprises. The plaintiff merely states conclusory allegations which do not support a reasonable inference that Loewenberg lacked independence.

In summary, the court finds that the factual allegations do not suffice to rebut the business judgment rule's presumption of director independence. The plaintiff has not alleged facts sufficient to establish that the Special Committee lacked the independence to consider objectively whether the transaction was in the best interest of CompuCom and all of its shareholders.

Furthermore, the complaint does not contain enough well-pleaded factual allegations to support a reasonable inference that Safeguard's, the Special Committee's, or the CompuCom board's interests were not aligned with the plaintiff. The plaintiff's theory that Safeguard improperly forced an immediate sale of CompuCom at a "fire sale price" because of its desperate need for cash simply does not hold water, especially since the process of finding a suitable transaction dragged on for more than two years. Nor does the complaint allege that Safeguard or any other holder of CompuCom's common stock received different consideration for its shares in the merger. The plaintiff does not allege that Safeguard received any special benefits in the transaction at the expense of the minority shareholders. In other words, the plaintiff does not adequately allege that the merger was anything other than an arms-length transaction with an

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[55] *Litt v. Wycoff*, 2003 WL 1794724, at *4 (Del. Ch. Mar. 28, 2003).

unaffiliated third party pursuant to the goal of maximizing shareholder value by attaining the best possible price.[56]

It appears that the plaintiff is merely expressing its disagreement with the business judgment of the members of the CompuCom board regarding the merits of the Merger Agreement. This does not provide a basis for liability. Thus, for all of the foregoing reasons, the court concludes that the complaint does not allege sufficient facts of a violation of the defendants' fiduciary duties to overcome the presumption of the business judgment rule.

B. Misleading Proxy

Finally, the plaintiff claims that the defendants sought to discourage the CompuCom shareholders from pursuing its statutory right to an appraisal by failing to adequately disclose all material information to CompuCom's shareholders.[57] The operative complaint (which is the second amended complaint) contains allegations regarding the defendants' alleged failure to make adequate disclosures in the original proxy statement distributed to CompuCom's stockholders. That complaint also acknowledges that, after the filing of the first amended complaint, CompuCom issued a proxy supplement that addressed several, if not all, of the plaintiff's non-disclosure allegations, disclosing information about the Special Committee directors' ties to Safeguard and the CompuCom board's efforts to find alternative value-maximizing transactions.[58] What the operative complaint does not do is explain why the disclosures made in the proxy supplement are insufficient to cure the alleged disclosure violations the plaintiff previously advanced with respect to the original proxy statement. The plaintiff's brief in response to the motion to dismiss also makes little effort to argue for the continued existence of any material issue relating to the proxy materials.[59] Indeed, a review of the complaint and all the relevant proxy materials leads the court to conclude that the proxy supplement cured whatever well pleaded disclosure claims the plaintiff originally alleged.

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[56]The plaintiff just makes a blanket statement in the complaint that "the Acquisition is the product of a hopelessly flawed process that was designed to ensure the sale of CompuCom to one buyer and one buyer only, on terms preferential to Platinum and to subvert interests of the plaintiff and the other public stockholders of CompuCom." Compl. ¶ 73.

[57]Compl. ¶ 98.

[58]Compl. ¶¶ 85-88.

[59]The plaintiff argues in its brief in opposition to the defendants' motion to dismiss that the Broadview and Houlihan Lokey fairness opinions were materially inadequate, without any specification, because they failed to adequately disclose the work performed and analysis underlying their opinions. After reviewing the proxy, the court cannot infer that the defendants did not adequately disclose the underlying analysis of their opinions.

V.

For the foregoing reasons, the defendants' motion to dismiss pursuant to Rule 12(b)(6) is GRANTED. IT IS SO ORDERED.

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ISHIMARU v. FUNG

No. 929

*Court of Chancery of the State of Delaware, New Castle*

October 26, 2005

Kenneth J. Nachbar, Esquire, and Megan Ward Cascio, Esquire, of Morris, Nichols Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

John C. Phillips, Esquire, of Phillips, Goldman & Spence, P.A., Wilmington, Delaware; and Sam Israel, Esquire, of Sam P. Israel, P.C., New York, New York, of counsel, for defendant William Fung and nominal defendant Paradigm Financial Products International LLC.

P. Clarkson Collins, Jr., Esquire, and Amy A. Quinlan, Esquire, of Morris, James, Hitchens & Williams, LLP, Wilmington, Delaware; and Rodney F. Page, Esquire, and Alison L. Perine, Esquire, of Bryan Cave LLP, Washington, DC, of counsel, for defendant Ivy Asset Management Corp.

STRINE, *Vice Chancellor*

In essence, this is a derivative suit brought by Asami Ishimaru, a member of nominal defendant Paradigm Financial Products International LLC ("Paradigm"), against defendant Ivy Asset Management Corp. ("Ivy Asset"). Ishimaru alleges that defendant William Fung, who controls a majority of the membership interests in Paradigm and is its managing member, has not and will not consider fairly whether to press Paradigm's claims against Ivy Asset.

Ishimaru seeks an order allowing her to prosecute a claim in Paradigm's name that Ivy Asset breached contractual promises it made to Paradigm regarding the basis on which Ivy Asset would market certain investment funds in Japan. Ishimaru wants this court to hear that claim. But Ivy Asset argues that the breach of contract claim Ishimaru seeks to assert on Paradigm's behalf must be arbitrated, consistent with an arbitration clause (the "Arbitration Clause") in an operating agreement (the "Joint Venture Agreement") between Paradigm and Ivy International, LLC ("Ivy International"), a subsidiary that Ivy Asset formed specifically for the purpose of pursuing a joint venture with Paradigm in Japan (the "Joint Venture"). Ivy Asset therefore seeks to dismiss this action in favor of arbitration.

In this opinion, I conclude that Ishimaru may press a derivative claim on Paradigm's behalf against Ivy Asset. Her complaint articulates particularized facts that, if true, demonstrate that Fung is incapable of disinterestedly determining whether to cause Paradigm to sue Ivy Asset. Those facts indicate that Fung attempted to use financial products developed for Paradigm for his own benefit and to sacrifice the interests of Paradigm in order to secure concessions from Ivy Asset that would benefit him personally, rather than as a member of Paradigm. Therefore, an order permitting Ishimaru to proceed on Paradigm's behalf shall issue.

I rule against Ishimaru, however, on the issue of where she can press that claim. Ishimaru's attempt to escape the reach of the arbitration clause of the Joint Venture Agreement is unavailing. By her own description of Paradigm's supposed claim, both in the current amended complaint and in the original complaint which also named Ivy International as a defendant, Ishimaru plainly alleges that Ivy Asset breached later promises (the "New Bargain") that had the effect of amending the Joint Venture Agreement. Indeed, Ishimaru alleges that Ivy Asset's motive for the New Bargain was its desire to avoid a dispute with Paradigm about whether Ivy Asset, by undertaking certain marketing activity in Japan outside the Joint Venture, had breached contractual duties it owed to Paradigm under the Joint Venture Agreement.

Although Ivy Asset is not, by literal terms, bound by the Arbitration Clause, that mere fact does not excuse Ishimaru's refusal to arbitrate Paradigm is bound. Moreover, Ishimaru alleges that Ivy Asset owed important contractual duties to Paradigm by virtue of the Joint Venture Agreement. Not only that, Ishimaru alleges that Ivy Asset breached a promise made in a business plan that became, per the provisions of the Joint Venture Agreement, part of that Agreement. The New Bargain Ishimaru claims that Ivy Asset made and then breached had an important negative effect on Ivy International's rights under the Joint Venture

Agreement. As a signatory to the Arbitration Clause, Paradigm fairly is bound to arbitrate claims premised on the notion that a non-signatory, Ivy Asset, signed a contract, the New Bargain, fundamentally amending the terms of the Joint Venture Agreement and then breached that amendment. In essence, Paradigm's claims are contingent upon the proposition that Ivy Asset was, by Paradigm's consent, admitted as a party to the Joint Venture Agreement, could and did, by agreement with Paradigm, alter the formal terms of that Agreement, and thereafter breached the altered Joint Venture Agreement. Under the teaching of a series of well-reasoned federal cases,[1] Paradigm is equitably estopped from denying Ivy Asset's demand to arbitrate.

## I. Factual Background

The description of the facts is drawn primarily from Ishimaru's amended complaint. Ordinarily, I would not draw much attention to the occurrence of an amendment. Regrettably, one cannot avoid dealing with both pleadings here. For reasons that she denies are tactical, Ishimaru amended her complaint in several important ways, including dropping Ivy International as a defendant. Although she denies that the reason for the amendment was to escape the Arbitration Clause, the happy coincidence seems to be that the amendment makes it easier for her to argue that she is free from the Arbitration Clause's reach. Whatever her motives, Ishimaru is not entitled to blind this court to her prior pleading, and the court will highlight the ways in which she has altered the claim she seeks to assert on Paradigm's behalf.

### A. The Formation Of Paradigm

Ishimaru, Fung, and two associates of Fung formed Paradigm in 1997 to exploit what they hoped would become a growing demand among Japanese investors for hedge fund investments. Through Paradigm, Ishimaru and Fung hoped to bring hedge fund products of their own to the Japanese markets, and to place the capital of Japanese investors with other providers of hedge funds.

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[1] *E.g.*, *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524 (5th Cir. 2000); *Thomson-CSF, SA v. Am. Arbitration Assn*, 64 F.3d 773 (2d Cir. 1995); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753 (11th Cir. 1993); *McBro Planning and Dev. Co. v. Triangle Elec. Constr. Co.*, 741 F.2d 342 (11th Cir. 1984).

The basic skill divide among the Paradigm founders was clear. For his part, Fung, a research professor, possessed expertise in risk management. He was therefore to be the founder most involved on the investment side of the business, structuring funds and managing investments. In exchange for this role, Fung got 50% of Paradigm's equity and was named the managing member; his associates received another 18% of the equity.

For her part, Ishimaru was experienced in marketing and had business relationships in Japan that she could exploit. Therefore, she was to secure Paradigm's entrée into the Japanese market. According to her, this was a critical function. As of the time of Paradigm's formation, Japanese investors had little experience with hedge funds and such funds had little market penetration. Ishimaru's task was to familiarize Japanese investors with the concept of hedge fund investing and encourage them to entrust their capital to this emerging form of investment fund. As part of the founders' agreement, Ishimaru received 32% of Paradigm's equity.

### B. Paradigm Looks To Ivy Asset As A Partner

After forming Paradigm, Fung and Ishimaru realized that Paradigm had a problem. Although Fung had written about risk management as an academic, he had no track record as the manager of an actual investment portfolio. Given Japanese investors' relative unfamiliarity with hedge fund investments, the absence of successful past performance by Paradigm made inducing Japanese capitalists to invest in hedge funds more than tenably challenging.

To address this, Paradigm, through Fung, approached Ivy Asset, a registered Investment Company known for its management of investment funds that invest in hedge funds. The concept was that Ivy Asset and Paradigm would form a joint venture to sell hedge fund products to Japanese investors. Ivy Asset would bring to the table its track record and components of its products. Paradigm would provide Fung's risk management skills and Ishimaru's marketing skills and Japanese contacts, attributes that Ivy Asset lacked because it was not licensed to sell funds in Japan and had no Japanese contacts of its own.

For the purposes of entering into the Joint Venture with Paradigm, Ivy Asset formed Ivy International, a Delaware limited liability company. At the time of the formation of the Joint Venture, Ivy Asset was the sole member of Ivy International.[2] The formal Joint Venture vehicle was PI

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[2]This apparently changed in October 2000. When Bank of New York acquired Ivy Asset and Ivy International, it became the sole member of both Ivy Asset and Ivy International.

Asset Management, L.L.C., which was created by an operating agreement on December 18, 1997, i.e., by the Joint Venture Agreement.

By its terms, the Joint Venture Agreement identified Paradigm and Ivy International as the Joint Venture's only members ("Members")[3] and provided that they would jointly serve as managing members. But the Joint Venture Agreement reflected the essential business reality that the two primary Joint Venture partners were actually Ivy Asset and Paradigm, with Ivy International simply functioning as the formal corporate vehicle through which Ivy Asset would participate. I do not advance that proposition lightly, recognizing the importance of the corporate form and contractual language. I advance it because the Joint Venture Agreement and the subsequent course of dealing by the parties under that Agreement alleged by Ishimaru make that reality plain.

### C. The Relevant Provisions Of The Joint Venture Agreement

A few features of the Joint Venture Agreement highlight that reality. For starters, the purposes of the Joint Venture emphasized the parties' intention to create an offshore investment fund that would invest in another fund involving multiple managers through a master-feeder structure. The so-called Offshore Master Fund was to employ strategies "substantially similar to those currently employed by the managers of Ivy Asset Management Corp.'s multi-manager funds . . . ."[4]

In § 1.08, the parties restricted transfers of membership interests, but they made exceptions that permitted Ivy International and Paradigm to transfer all or portions of their interests to affiliates, including specifically to Ivy Asset. In § 1.08(c), Paradigm and Ivy International agreed to disclose and keep current a list of each of their members.

The Joint Venture Agreement also spelled out certain rights and responsibilities, not only of Paradigm and Ivy International themselves, but of their affiliates, including Ivy Asset. For example, § 2.05 addressed activities by the members and their affiliates as follows:

> Each of the Members (and their equity owners) and any members, officers, employees or other agents or advisers of the Members or the Company (collectively, "Affiliates") shall devote so much of their time to the affairs of the Company as the conduct of the business of the Company shall reasonably

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That fact is not of material significance.

[3]Joint Venture Agreement ("JVA") § 5.01.

[4]JVA § 1.03.

> require. Nothing herein contained shall be deemed to preclude the Members or their Affiliates from engaging, directly or indirectly, in any other business, irrespective of whether any such business is similar to, or a competitor with, the business of the Company. No Member shall have the right to participate in any manner in any profits or income earned or derived by or accruing to the other Member or its Affiliates from the conduct of any such other business.

Relatedly, § 2.06 provided exculpation for Members and their affiliates, while § 2.07 enhanced that exculpatory protection by granting Members and their affiliates certain advancement and indemnification rights against the Joint Venture in the event of proceedings related to their actions on behalf of the Joint Venture.

Importantly, § 9.03 protected the Joint Venture by binding Members and a group that would ordinarily be termed, but was not in that section, "affiliates." Rather, § 9.03 purports to bind Members and their officers, employees, agents, and the Members' own members. In pertinent part, it provides as follows:

> All knowledge and information . . . relating to the Company, each Member, any Fund or the Offshore Master Fund not already within the public domain which each Member may acquire by virtue of the performance of services hereunder shall at all times and for all purposes, be regarded by each Member as strictly confidential and held by each Member in strict confidence, and shall not be directly or indirectly disclosed by a Member or its respective officers, employees, members or agents to any person whatsoever.

By the plain terms of § 9.01, the Joint Venture was only to be amended "by a written instrument executed by each Member." Presumably, this amendment feature also applied to the business plan incorporated in § 1.03(a) of the Joint Venture Agreement (the "Business Plan"). By virtue of § 1.03(a), the Joint Venture was to be operated in accordance with a Business Plan, the initial version of which was annexed to the Joint Venture Agreement. The Business Plan was to "be in place at all times."[5] The initial Business Plan uses the term Ivy to refer to Ivy Asset. All of the duties to be undertaken under the Business Plan on behalf of the Joint

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[5] *Id.*

Venture by an entity with the name "Ivy " are, by plain reading of the text, to be accomplished by Ivy Asset. The only reference to Ivy International is as the "Delaware LLC[]" formed by Ivy Asset to "participate in the JV." There is a similar reference to an LLC being formed by Paradigm for that purpose. Both references are in a section entitled "Taxes," indicating the use of this form was for tax purposes.

The last operative provision of the Joint Venture Agreement, § 9.13(b), is the Arbitration Clause, which provides that "[u]nless otherwise agreed in writing, each Member agrees to submit all controversies arising between Members, or one or more Members and the Company, concerning this Agreement to arbitration in accordance with the provisions set forth below." The Arbitration Clause does not, by its own terms, refer to affiliates of Members.

### D. The Course Of Dealing Of The Parties Under The Joint Venture Agreement

Consistent with the Business Plan, the Joint Venture's operations in all practical respects were carried out by Paradigm and Ivy Asset. Ivy Asset worked with Fung to put together the product offerings of the Joint Venture, while Ishimaru concentrated on obtaining Japanese investors for those products. The Business Plan spelled out the roles with some precision.

In September 1998, the Joint Venture launched its first fund product in Japan—the PI Market Neutral Fund (the "Neutral Fund"). The Neutral Fund was to be a combination of two existing Ivy Asset financial products. The Neutral Fund concept was met with apprehension by Japanese investors due to their unfamiliarity with hedge funds and the novelty of this particular fund. Furthermore, the Joint Venture was not licensed to sell funds directly in Japan.

The Joint Venture took steps to address these concerns. To address the Japanese investors' reluctance to invest in a hedge fund, the Joint Venture offered the Neutral Fund along with a bond providing principal protection at maturity that sharply limited downside risk (the "Neutral Fund Bonds"). To provide a path to market, Ishimaru convinced licensed intermediary NatWest Tokyo to sell the Neutral Fund and the Neutral Fund Bonds.[6] The Neutral Fund was launched with approximately $50 million

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[6]Consistent with its general nature, the amended complaint's description of the relationship between the Neutral Fund and the Neutral Fund Bonds is unclear. It is not clear whether investors in the Neutral Fund could buy the Neutral Fund Bonds as optional protection or whether the only thing sold in Japan was Neutral Fund Bonds, which had returns linked to the

in seed money from Japanese investors. Later, in September 2000, the Joint Venture secured an additional dealer, Sakura Securities, to market the Neutral Fund and the Neutral Fund Bonds. Sakura Securities subsequently was merged into Daiwa Securities SMBC Co. Ltd. ("Daiwa"), which Ishimaru convinced to continue to distribute Joint Venture products.

The Joint Venture's second financial product was launched in November 2001. The PI Long Short Hedge Equity Fund Ltd. ("PILS") was allegedly unique by the standards of investment funds comprised of underlying hedge funds. What supposedly made it special was that the Joint Venture, as the portfolio manager, maintained direct control over all portfolio investments, which allowed it to continually monitor and hedge away risk. As of the time of the amended complaint, the Neutral Fund Bonds and PILS were the only two products marketed by the Joint Venture.

### E. Ivy Asset's And Paradigm's Interests Diverge

In October 2000, a transaction took place that created a divergence in interest between Ivy Asset and Paradigm. That month the Bank of New York ("BoNY") acquired Ivy Asset. Unlike Ivy Asset, BoNY had a presence in Japan that pre-dated the Joint Venture, but that presence was limited to banking.

After the BoNY transaction, Ivy Asset allegedly began approaching unlicensed intermediaries in Japan to sell its own products, such as its Rosewood Offshore Fund, to Japanese investors. Paradigm got wind of this in May 2001 when Daiwa cried foul after learning that Ivy Asset was selling Rosewood in Japan through BoNY and other unlicensed vendors, activity that undercut Daiwa's effort to sell the products of the Joint Venture. In the Joint Venture's Business Plan for 2000-2001, which amended the original Business Plan, the following statement was made: "Both joint venture parties remain committed to the business plan and will not engage in substantially similar businesses targeted at the Japanese market which may damage the success of the JV."[7]

Ishimaru and Fung contacted an Ivy Asset managing director, Jeffrey Lindenbaum, about their beef.[8] At that point, Ivy Asset admitted contacting

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similar Ivy Asset products but with principal protection.

[7]Am. Compl. ¶ 14. Ishimaru cited this Business Plan for 2000-2001 in her amended complaint as the most recent Business Plan based on "belief and information" but did not provide the entire document. Additionally, it appears that a more recent Business Plan that does not contain this permissive language was in effect at the time of this dispute. Fung appended the Business Plan for 2001-2002 to his motion to dismiss the original complaint.

[8]Jeffrey Lindenbaum is clearly a Managing Director of Ivy Asset. Am. Compl. ¶ 22. As is typical, the amended complaint and complaint make deciphering whether and how

ten Japanese institutions about buying Rosewood, and Lindenbaum agreed to limit Ivy Asset's activities in Japan to these ten institutions (the "Carve Out List"). Ishimaru and Fung agreed to this compromise. But, according to Ishimaru, Lindenbaum was not good to his promise and Ivy Asset continued to spread in Japan to investors not on the Carve Out List.

In late 2001 or early 2002, Daiwa again notified Paradigm that an unlicensed subsidiary of a Japanese trading company, Mitsui and Co., Ltd., was selling a fund managed by Ivy Asset. When called on this, Lindenbaum denied that Ivy Asset had authorized the sale of that fund through Mitsui. In April 2002, a Mitsui subsidiary secured a license to sell hedge funds in Japan. In September 2002, NatWest alerted Paradigm that Mitsui had approached a Neutral Fund Bonds investor and attempted to sell them Ivy Asset investment products. Concurrently, Daiwa complained that Mitsui was undercutting their ability to sell the Neutral Fund Bonds because Ivy Asset was offering vendors of the Rosewood Fund preferential pricing to that received by vendors of the Joint Venture's products. Once again, Lindenbaum denied that Ivy Asset had authorized Mitsui to contact any institutions other than the Carve Out List.

In October 2002, Lindenbaum ended his campaign of denial. He informed Paradigm that Norinchukin, a large Japanese investor not on the Carve Out List, wanted to meet with Ivy Asset; he also confessed that Mitsui was indeed the matchmaker. Later in 2002, Ivy Asset directly contacted Daiwa — distributor of the Neutral Fund Bonds about the possibility of marketing Rosewood in Japan. Daiwa again informed Paradigm of this occurrence. In addition, Lindenbaum entered into discussions with Mizuho Trust to distribute Rosewood to Japanese pension funds.

After learning of these Ivy Asset dealings with investors not on the Carve Out List, Ishimaru contacted Lindenbaum and Lawrence Simon, who served as CEO of Ivy Asset, President of Ivy International, and co-CEO of the Joint Venture. Lindenbaum and Simon took the position that the Neutral Fund Bonds and the PILS Fund—the Joint Venture's only two products—should simply become part of an array of Ivy Asset products to be offered in Japan. Paradigm did not receive this proposal warmly. With Fung's permission, Ishimaru informed Ivy Asset that its compromise proposal was rejected and that Paradigm would seek legal advice about its options.

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Lindenbaum is involved with Ivy International difficult. The original complaint refers to Lindenbaum as a Managing Director of Ivy when Ivy was defined as both Ivy Asset and Ivy International, and the amended complaint states he is a Managing Director of Ivy defined as Ivy Asset. Compl. ¶ 23.

F. The Alleged "New Bargain" Between Ivy Asset And Paradigm

By the spring of 2003, the Joint Venture partners had not worked out their differences. In March and April of that year, Fung, Ishimaru, Lindenbaum, and Simon met twice to consider options for resolving their disagreements without filing claims. Fung assigned Ishimaru lead responsibility to work things out because he considered it to be a marketing dispute in her bailiwick. Ishimaru alleges that Fung authorized all of her activities on behalf of Paradigm.

Ishimaru claims that Ivy Asset and Paradigm reached an accord at the second meeting, what I have termed the New Bargain. She further argues that the accord was formalized in an e-mail exchange between herself and Lindenbaum. Ishimaru's e-mail states:

> Based on our meetings on March 27th and April 16th, my understanding of what you offered regarding Japan is the following . . . all Ivy business in Japan will be conducted by the joint venture. The joint venture will be the unified front offering all Ivy related products and services in Japan. The fee split will be 50/50 with the following exception. 1) When an existing product managed solely by Ivy (e.g. Rosewood) is sold to a Japanese Investor, Paradigm will receive 25% of the fees paid by the investor. 2) If the Japanese investor is introduced by the Bank of New York, the fee split will be negotiated on a case by case basis.[9]

Lindenbaum's reply states in pertinent part that:

> We concur with all that you have stated, and most importantly, the spirit of uniform cooperation and joint activities will make this very worthwhile. As to BONY and possible future business, the fee structure will potentially vary depending on size of AUM placement, BONY fee share, and what Ivy gets as its portion. I can assure you that it will be worthwhile should these opportunities come to completion, and await the first to see what can be codified as a percentage of fees. Please be patient to see what may and can be allocated, I need a little time as I am negotiating with BONY as to how Ivy/BONY split fees for future business.[10]

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[9]Ishimaru Ans. Br. Ex. A.
[10]*Id.*

Ishimaru contends that the e-mail exchange represents a formal contract between Ivy Asset and Paradigm that has the following primary terms:

- Ivy Asset, with limited exceptions, would conduct all of its business in Japan through the Joint Venture;
- any fees generated by the sale of Ivy Asset's products managed by the Joint Venture to Japanese investors would be split 50%/50% between Ivy Asset and Paradigm;
- any fees generated by the sale of existing Ivy Asset products managed by Ivy Asset to Japanese investors would be split 25% to Paradigm and 75% to Ivy Asset; and
- any fees generated by the sale of Ivy Asset products to Japanese investors that were introduced to Ivy Asset by BoNY would be split on a case-by-case negotiated basis.

### G. Ivy Asset Breaches The New Bargain

Ishimaru insists that she acted with alacrity in response to the New Bargain. Having assented to the marketing of Ivy Asset products in Japan in exchange for a cut of the proceeds, Ishimaru focused on maximizing the size of the overall pie. Therefore, she helped introduce Ivy Asset's products and key managers to many of her contacts in the Japanese investment community. Ishimaru encouraged Daiwa and other Japanese contacts to market not only Joint Venture products but also existing Ivy Asset products. Consistent with those efforts, Daiwa soon placed over $200 million in investments in Rosewood, and Ivy Asset received other infusions in Rosewood from sources not on the Carve Out List.

Ishimaru claims Paradigm and Ivy Asset even worked out a fee split on Ivy Asset products to be sold through the Mizuho Trust, which Lindenbaum claimed had been introduced to Ivy Asset by BoNY. Lindenbaum, on behalf of Ivy Asset, offered Paradigm 10% of the fees generated from Ivy Asset business placed through Mizuho Trust. Paradigm accepted this offer.

According to Ishimaru, Ivy Asset led her to believe that it thought things were going swimmingly under the New Bargain. She allegedly received e-mails from Lindenbaum and Simon expressing satisfaction with

the new arrangements and encouraging her to continue her marketing efforts. But when Ishimaru contacted Ivy Asset in October 2003 and requested payment of Paradigm's share of the fees generated on Ivy Asset products sold in Japan, Ivy refused and disclaimed the New Bargain.

While the Joint Venture partners' relationship was deteriorating, so too was the relationship between Fung and Ishimaru. According to Ishimaru, Fung began planning in 2002 to strike out on his own in Europe by marketing an investment fund product essentially identical to PILS. His problem was that PILS was a Joint Venture product, and his desire to use it for himself and to tout PILS's track record of success was arguably at odds with the provisions of the Joint Venture Agreement. Among other things, the Joint Venture Agreement § 9.03 expressly states:

> All knowledge and information (referred to herein as "Information") . . . not already within the public domain . . . shall at all times and for all purposes, be regarded by each Member as strictly confidential. The Information referred to above shall include names of investment managers and their performance records, or other information relating to such managers obtained in connection with a Fund, and any details relating to the financial engineering, Fund structure and identity of the financial intermediaries associated with any Company product.

Moreover, while the Joint Venture Agreement gave Members and their affiliates the right to compete, Fung was not trying to compete using assets and skills unrelated to the Joint Venture; he was trying to parlay Joint Venture property — PILS and its strategies — into gains for himself not for the Joint Venture or even Paradigm. Although Fung allegedly proceeded without worrying much about the rights of his fellow Paradigm investors, he was worried that Ivy Asset, which had worked with Paradigm to develop the PILS product, would not be pleased if he proceeded to market a new PILS-like product without involving Ivy Asset.

Fung allegedly dealt with this concern by suggesting that Paradigm soften its position towards Ivy Asset's violation of the New Bargain. Fung was willing to trade away claims relating to Ivy Asset's conduct in Japan in exchange for concessions from Ivy Asset that would permit him to establish a personally-controlled entity to market a PILS-like product in Europe under the Ivy Asset banner. He engaged in these discussions with Ivy Asset behind Ishimaru's back. Fung believed that the Market Neutral Bonds product had little upside and that he could make out better by ignoring the Joint Venture's rights in Japan and focusing on securing a relationship for

himself with Ivy Asset centered on PILS. Thus, Fung refused to back up Ishimaru in her desire to have Paradigm assert its rights against Ivy Asset. He then went even further and terminated Ishimaru's operational role on behalf of Paradigm and ceased paying her profit distributions.

In the meantime, Ivy Asset has reaped the benefits of Paradigm's paralysis. It has raised over $1 billion in capital in Japan since 2003 through its Rosewood product. During the same period, the Joint Venture's Market Neutral product has not attracted a single new investor despite having outperformed Rosewood during the same period.

### H. Ishimaru's Initial Complaint

In December 2004, Ishimaru filed the original complaint in this action. The first count sought relief against Fung for not filing suit on Paradigm's behalf against Ivy Asset and Ivy International. The second count named both Ivy Asset and Ivy International as defendants and sought relief against them for breaching the New Bargain (the "New Bargain Claim"). Not only that, the original complaint, consistent with the obvious business reality, defined Ivy Asset and Ivy International collectively as "Ivy."

The original complaint is consistent with the facts rendered previously in the opinion. But it did not seek to distinguish between Ivy Asset and Ivy International in any material way, except to note that Ivy International was formed as the subsidiary of Ivy Asset that was a direct party to the Joint Venture Agreement. By its clear terms, the original complaint makes plain the reality that Paradigm dealt with Ivy Asset and Ivy International indistinguishably and treated Ivy Asset as capable of making decisions as if it was the Member under the Joint Venture Agreement.

In that respect, the original complaint alleged that Ivy, as a collective comprising both Ivy Asset and Ivy International, was a party to the New Bargain. The original complaint specifically alleged:

> *Ivy and Paradigm entered into a contract by which the parties reaffirmed their agreement that the parties' business dealings in Japan, including the marketing and funding of investment products, would be conducted by PI, the joint venture the parties had previously formed for that purpose.* The parties additionally reaffirmed that all fees generated from Japanese business would be shared 50% by Paradigm and 50% by Ivy Int'l. For all existing products sold in Japan which Ivy Asset Management managed independently of [the