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.

To expedite the attorney's research, all cases are headnoted according to the National Reporter key number classification system.* Indices are provided for case names, statutes construed, rules of court, and key numbers and classifications for this issue.

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COOPER COS., INC. v. COOPER DEVELOPMENT CO., INC.

No. 10,729

Court of Chancery of the State of Delaware, New Castle

June 15, 1989

Plaintiff, The Cooper Companies, Inc. (TCC), entered into a definitive agreement with Miles Inc. to sell TCC's wholly owned subsidiary, Cooper Technicon, Inc. The transaction required TCC's preferred stockholders to consent to the sale. Although TCC's preferred stockholders, defendant Cooper Development Company, and Cooper Life Services, Inc. consented to the sale of Cooper Technicon to Miles, the sale was not consummated by the contemplated sale date of March 31, 1989. TCC filed a complaint seeking a declaratory judgment that the preferred stockholders' consents are still legally valid and binding. The defendants, in their motion to dismiss, contended that the issues were not ripe for adjudication, and the consents are invalid, or in the alternative, have expired.

The court of chancery, per Vice-Chancellor Jacob, granted plaintiff's motion for declaratory judgment and denied defendants' motion to dismiss. The court specifically held that TCC's action is ripe for adjudication and that the preferred stockholders' consents were legally valid and effective.

1. Constitutional Law ⟹ 69

Declaratory Judgment ⟹ 23, 61

The enactment of the revised declaratory judgment statute does not obviate the requirement that there be an "actual case or controversy."

2. Declaratory Judgment ⟹ 61

One of the requisites for an actual controversy is that the case must be ripe for judicial determination.

3. Declaratory Judgment ⟹ 5, 62

Whether or not a given issue is ripe for adjudication is a determination calling for a balance of all relevant practical consid-

erations and the sound exercise of discretion, not an analytic approach that is legalistic or formalistic.

4. Declaratory Judgment ⟹ 5, 10, 65

The reasons for not rendering a hypothetical opinion must be weighed against the benefits to be derived from the rendering of a declaratory judgment, which requires the exercise of judicial discretion which should turn importantly upon a practical evaluation of the circumstances of the case.

5. Declaratory Judgment ⟹ 5, 67, 68

The grant of declaratory judgment is always discretionary; and before a court should declare the rights of parties in a dispute, it must not only be convinced that litigation sooner or later appears to be avoidable, but also that the material facts are static and that the rights of the parties are presently defined rather than future or contingent.

6. Declaratory Judgment ⟹ 4, 5, 62

In determining whether or not a given issue is ripe for adjudication, a court may consider a practical evaluation of the legitimate interest of the plaintiff in a prompt resolution of the question presented and the hardship that further delay is a major concern. Other necessary considerations include the prospect of future factual development that might affect the determination to be made, the need to conserve scarce resources, and a due respect for identifiable policies of the law touching upon the subject matter of the dispute.

7. Constitutional Law ⟹ 69

The concepts of ripeness and mootness raise two conceptually distinct kinds of issues: (1) those that are truly hypothetical and, therefore, not ripe, at the time the complaint is filed; and (2) questions that initially are ripe because they involve an actual case or controversy between the litigants, but which may later become moot for reasons external to the legal dispute.

8. Declaratory Judgment ⟹ 5, 62, 65

A third party's ability to moot an action does give the court reason to conceivably determine that an issue is not ripe for adjudication; however, in the unique situation where (1) the case has been fully tried on the merits and briefed; (2) it appears just as likely that the issue will not become moot; (3) resolving the merits at this point would involve risking a relatively small, incremental portion of the court's resources; and (4) a decision not to proceed would risk that the moving party would face serious financial jeopardy, to so conclude the issue is not ripe for adjudication would be an unsound exercise of discretion.

9. Contracts ⟹ 147.2

Contracts must be founded upon expressions of intent that are manifested and communicated, not those that are uncommunicated or disguised.

10. Contracts ⟹ 212(1), 215(1)

The common law contract's principle that would impose a reasonable time limitation for stockholder consents' duration is not applicable where the delay has been less than three months.

11. Corporations ⟹ 12, 192

Under the Delaware General Corporation Law, section 228(c), the term "action" refers to the corporate action referred to in the stockholder consent itself. DEL. CODE ANN. tit. 8, § 228(c) (1987).

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JACOBS, *Vice-Chancellor*

On October 12, 1988, the plaintiff, The Cooper Companies, Inc. ("TCC"), entered into a definitive agreement to sell to Miles Inc. ("Miles") TCC's wholly owned subsidiary, Cooper Technicon, Inc. ("CTI"). A critical condition of that transaction was that TCC's preferred shareholders would give their consent to the sale. On October 21, 1988, TCC's preferred stockholders, the defendants Cooper Development Company ("CDC") and Cooper Life Services, Inc. ("CLS"), executed a written consent to the sale of CTI to Miles.[1] Although it was contemplated that the sale of CTI would close no later than March 31, 1989, in fact it did not, and to date that sale has not closed.[2]

On March 21, 1989, the Chairman and Chief Executive Officer of both CDC and CLS wrote a letter to TCC, taking the position that their October 21, 1988 consents were no longer valid. In response, TCC filed a complaint on March 30, 1989, seeking a declaration by this Court that the CDC/CLS consents are, and continue to remain, legally valid and binding. TCC also sought an expedited trial on the merits. Because of the perceived need for a prompt adjudication of the issue while the TCC/Miles agreement remained in force, the Court ordered that the action proceed and be tried on an expedited basis.

Trial on the merits took place on May 8, 9, and 10, 1989. Post-trial briefing was completed on May 26, 1989. Supplemental briefing on the defendants' post-trial motion to dismiss on the ground that the action is not ripe for adjudication, was completed on June 2, 1989.

This is the decision of the Court on the defendants' motion to dismiss and on the merits of the plaintiff's claim for declaratory relief.

I.

TCC is a Delaware corporation whose principal business is located in Palo Alto, California. Historically, TCC had been engaged

1. CDC and CLS also furnished consents to an amendment of TCC's certificate of incorporation to eliminate its preferred stock "mandatory redemption" feature.

2. Since its original execution, the TCC/Miles agreement has been amended three times, with the result that the outside date for closing was extended to May 15, 1989, then later to May 30, 1989, and, most recently, to June 30, 1989.

in various health care related businesses, but in May, 1988, it began a major restructuring that resulted in the divestiture of most of those businesses. The proposed sale of CTI to Miles is part of that ongoing restructuring effort.

CDC and CLS, both Delaware corporations whose principal businesses are located in Mountain View, California, together own all outstanding shares of TCC's preferred stock. Originally, TCC, CDC and CLS were wholly owned subsidiaries of Cooper Laboratories, Inc., a holding company founded in 1958 by the present Chairman and President of CDC and CLS, Parker G. Montgomery. Cooper Laboratories was liquidated in the early 1980s, and the common stock of TCC, CDC and CLS was spun off to Cooper Laboratories' stockholders. At that time Mr. Montgomery became Chairman of all three companies, as well as TCC's Chief Executive Officer.

In May, 1988, two family investor groups (the Singers and the Sturmans) threatened to wage a proxy contest for control of TCC. The threatened proxy battle came at a time when TCC was beginning its restructuring, which involved selling the entire company or, alternatively, all or substantially all of its assets. Because TCC's directors were concerned that a proxy battle could seriously jeopardize that program, an accord was reached with the Singers and Sturmans involving the appointment of three of their members to TCC's nine-member board of directors. Later, on July 12, 1988, the Singers and Sturmans acquired effective control when two other members of the Singer family joined TCC's board.

Throughout 1988 TCC had experienced a severe financial crisis, which TCC attempted to alleviate not only by its restructuring, but also by seeking to resolve certain ongoing financial disputes with CDC and CLS. After the Singers and Sturmans secured control of TCC in July, 1988, they began negotiating with CDC and CLS to reach a "global" settlement of all outstanding disputes.[3] Those negotiations culminated in a series of agreements executed by TCC,

3. Those disputes included: (1) a $14.5 million debt owed by CDC to TCC under a $22 million line of credit, (2) the registration of TCC's preferred stock which was 100% owned by CDC and CLS, (3) certain golden parachute and severance benefits purportedly owed to individuals TCC had terminated and who had worked directly for Parker Montgomery, (4) intercompany accounting items, including office relocation, (5) costs and expenses associated with new insurance, and (6) certain outstanding litigation and indemnification issues.

CDC, and CLS on October 21, 1988 (the "October 21, 1988 settlement agreements").

While it was negotiating with CDC and CLS, TCC was also contracting to sell certain of its businesses to third parties. In September and November, 1988, respectively, TCC sold its contact lens solution businesses (for approximately $40 million in cash) and certain of its United States and Japanese soft contact lens businesses (for approximately $35 million in cash) to Wesley-Jessen Corporation. During September, 1988 TCC contracted to sell its Cooper Surgical Ophthalmic business to Alcon Laboratories, Inc. ("Alcon") for approximately $325 million in cash, a sale that ultimately closed in February, 1988.

Finally, on October 12, 1988, TCC entered into a definitive agreement (the "Miles Purchase Agreement") to sell Cooper Technicon, Inc. (CTI) to Miles for $212 million in cash, plus the assumption by Miles of up to $288 million of CTI's debt. The Miles Purchase Agreement was made subject to certain conditions. Those conditions included the approval of a majority of TCC's common stockholders and of a certain class of TCC's outstanding debentures, and—most critically—the approval of the holders of a majority of TCC's outstanding preferred stock, *i.e.*, CDC and CLS.

The Miles Purchase Agreement also provided that:

> . . . in no event shall the Closing occur later than 11 a.m., New York City Time, on March 31, 1989 (said time and date being referred to herein as the "Last Day to Close").

Finally, the Miles Purchase Agreement obligated TCC to close if all conditions precedent were satisfied by March 31, 1989, but imposed no reciprocal obligation upon Miles to close after January 31, 1989. That is, if the closing did not occur by January 31, 1989, TCC would remain contractually bound to close until March 31. However, after January 31, Miles was free to elect, in its sole option, whether or not to close.

TCC's parallel negotiations with CDC and CLS initially focused upon resolving the various claims flowing from TCC's termination (in July, 1988) of an intercorporate agreement under which TCC had provided administrative, accounting, and legal services to CDC and CLS. As the discussions progressed, the negotiating agenda was broadened to include, among other things, (i) TCC's obligation under an October, 1987 agreement to register the TCC preferred stock owned by CDC and CLS, and (ii) whether TCC would repurchase or redeem its preferred stock.

These negotiations clearly were influenced by TCC's simultaneous efforts to sell its businesses to Alcon and Miles. Early in the settlement discussions, TCC indicated its desire to receive the "blanket" consents of CDC and CLS to future sales of TCC's assets. Those consents were viewed as one of several elements of a possible global settlement of the three companies' outstanding disputes. CDC and CLS had no problem with furnishing consents; they were concerned only with whether it was advisable to give open-ended, "blanket" consents to unspecified future asset sales. As the negotiations progressed, those concerns were satisfactorily addressed. Ultimately the parties agreed to restrict the CDC/CLS consents to the specific asset sales to Alcon and Miles.

The consents ultimately agreed upon were embodied in two essentially identical consent documents executed by CDC and CLS on October 21, 1988. The first of these concerned the sale of Cooper Surgical to Alcon;[4] the second concerned the sale of CTI to Miles. Because the consent to the sale of CTI to Miles is at the heart of this controversy, its full text is set forth below:

> As holders of 100% of the outstanding shares of TCC's Senior Exchangeable Redeemable Preferred Stock (the "TCC Preferred Stock"), the undersigned [*i.e.*, CLS and CDC] hereby irrevocably consent to the sale by TCC of all of the outstanding capital stock of Cooper Technicon, Inc., a Delaware corporation ("CTI") to Miles Inc., an Indiana corporation, substantially in accordance with the terms and conditions of the Purchase Agreement dated as of October 12, 1988 (the "Purchase Agreement") between TCC and Miles Inc., a copy of which has been previously delivered to us. The undersigned acknowledge and agree that the Purchase Agreement may be amended or modified by TCC and Miles Inc. and conditions of the parties thereunder to close may be modified, amended or waived by TCC or Miles Inc. without any further approval or consent from the undersigned, provided that if any modification or amendment results in a material reduction in the consideration to be paid to TCC pursuant to the Purchase Agreement, such modification or amendment may be made without

4. Because the sale to Alcon was successfully concluded, the formal consent to that sale is not an issue in this proceeding.

> any further consent or approval from the undersigned only if, in connection with the completion of the transaction, TCC obtains an opinion from a nationally recognized investment banking firm to the effect that (a) the transaction is fair from a financial point of view to the shareholders of TCC, which opinion shall be deemed conclusive evidence of the fairness of the transaction to such holders or (b) the consideration to be received by TCC under the Purchase Agreement, as so amended, is comparable from a financial point of view to that originally provided for in the Purchase Agreement.
>
> The consent set forth herein shall survive any transfer or assignment of the TCC Preferred Stock and TCC is hereby authorized to affix an appropriate legend to the stock certificates for the TCC Preferred Stock. The undersigned acknowledge and agree that this consent will be furnished to Miles Inc. in connection with the closing under the Purchase Agreement.
>
> The undersigned agree to keep the terms of the Purchase Agreement confidential and to execute any additional documents and take any additional action necessary to evidence this consent.

By its terms the consent is irrevocable, and it has no specified duration or expiration date. Nonetheless, certain trial witnesses who negotiated the consent on CDC's and CLS's behalf testified to their belief that the consent would expire on March 31, 1989. That date was the "last day to close" under the original Miles Purchase Agreement. However, it is undisputed that no one on the CDC/CLS side ever communicated their belief to TCC or its representatives. It is also undisputed that no discussions of any kind concerning the duration or termination of the consent took place during the negotiations.

Another highly important issue covered in the parties' July-October, 1988 negotiations was what would be done with the TCC preferred stock then owned by CDC.[5] That stock represented a major CDC asset, yet was unregistered and, therefore, was essentially unmarketable and illiquid. CDC's desire to make that investment liquid was a significant factor that motivated both its negotiations

5. CDC later transferred some of the preferred stock to CLS.

with TCC and its (and CLS's) later effort to repudiate the consents they had furnished on October 21, 1988.

As of July, 1988, the status of the TCC preferred stock was twofold. It was the subject of a mandatory redemption provision contained in TCC's certificate of incorporation; however, that redemption right was of little immediate benefit, because it would not take effect until the year 2007. The preferred stock was also the subject of a registration rights agreement between TCC and CDC, entered into in October, 1987 when the preferred was first issued to CDC. That agreement required TCC to register the preferred stock within 270 days of its issuance, that is, by the end of July, 1988. In May or June of 1988, TCC's board of directors authorized the preparation and filing of a registration statement for the preferred stock. However, when the Singers and Sturmans obtained control in July, all registration efforts ceased.

In August, 1988, CDC and CLS formally demanded that TCC register the preferred stock, which, they claimed, should have been done by the end of July. TCC responded that it was not categorically required to register the preferred, because the registration rights agreement provided for the payment of liquidated damages if TCC failed to perform its registration obligation. These conflicting positions led to a reopening of the entire "preferred stock question" during the parties' subsequent "global settlement" negotiations.

The negotiated resolution of the preferred stock question took two forms. First, CDC and CLS gave their written consent to an amendment of the TCC certificate of incorporation to eliminate its mandatory redemption feature.[6] Second, TCC covenanted, in the October 21, 1988 settlement agreements, that it would file two registration statements with respect to the TCC preferred stock. One would be on Form S-3 to permit a "shelf registration" of the shares. The other would be on a form appropriate to permit a dividend or other distribution of the preferred stock to the companies' shareholders or, alternatively, a sale or pledge of those shares to a third party.

Those undertakings came about in the following way: throughout the settlement negotiations, CDC and CLS consistently pressed for

6. That consent is also challenged in this litigation. However, as to it, CDC and CLS advance no separate argument that is independent of, or different from, their challenge to the consent to the sale of CTI to Miles. Accordingly, the consent to the certificate amendment will not be separately treated, and the Court's analysis will focus primarily upon the consent to the sale of CTI to Miles.

a contractual commitment by TCC to repurchase or redeem the preferred stock. TCC's representatives recognized that from TCC's standpoint, something would eventually have to be done with the preferred stock, if only because the dividends payable on the preferred were of the "payment-in-kind" variety. If allowed to continue accumulating, those dividends would eventually "wipe out the equity of TCC." (Pl. Op. Br., p. 25).

However, TCC's representatives took the position that TCC could not commit, at that time, to purchase or redeem the preferred stock because certain restrictive covenants in the indenture to TCC's debentures and other loan covenants precluded TCC from doing so. But TCC's representatives did advise CDC and CLS that when TCC received the proceeds from the proposed sale of CTI, it likely would be in a better position to repurchase or redeem the preferred stock. TCC also told the CDC and CLS representatives that if they consented to the elimination of the mandatory redemption provision in TCC's certificate of incorporation, that would enlarge the "baskets" within TCC's debt covenants that would facilitate TCC's repurchase or redemption of its preferred shares.

As a result of these discussions, CDC and CLS accepted and understood that: (1) TCC's debt covenants precluded any present contractual commitment by TCC to redeem or repurchase the preferred stock, and (2) TCC would attempt to negotiate such a transaction with CDC and CLS at some future time when it became free of the restraints imposed by those covenants. But (3) TCC did agree to register the preferred stock on the terms provided in the October 21, 1988 settlement agreements. On the basis of these understandings and agreements, CDC and CLS furnished their written consents to the sale of CTI to Miles, and to the proposed certificate amendment eliminating the mandatory redemption provision.

Unfortunately, that did not produce the hoped-for global resolution of the parties' differences. After the October 21, 1988 settlement agreements were signed, TCC subsequently encountered a host of regulatory, legal, and other obstacles that forced a delay of the closing on the CTI-Miles transaction. Those obstacles also slowed down TCC's efforts to register the preferred stock pursuant to the October 21, 1988 settlement agreements. These developments resulted in a meeting on January 31, 1989, where representatives of TCC and Miles formally acknowledged that the sale of CTI could not close by March 31, 1989. Accordingly, on February 8, 1989, Miles and TCC amended the Miles Purchase Agreement to establish May 15, 1989 as the last day to close. When it became obvious that the

proposed sale could not close by May 15, 1989, a second amendment was executed on April 24, 1989, establishing May 31, 1989 as the last day to close.

Three months earlier, on February 13, 1989, TCC had filed its Form 10-K for the fiscal year ending October 31, 1988, wherein it disclosed its intent to use the CTI sale proceeds to reduce TCC's debt and acquire new businesses. Mr. Montgomery inferred from that disclosure that TCC had reneged upon what he regarded as TCC's promise to use those proceeds for a negotiated repurchase or redemption of the TCC preferred stock. After discussions with, and prompting by, a major shareholder of CDC and CLS, Mr. Montgomery wrote a letter to TCC on March 21, 1989. In that letter he asserted that TCC's demonstrated lack of candor and good faith in dealing with CDC and CLS had rendered their previously executed consents null and void. Mr. Montgomery also took the position that, in all events, the written consent to the sale of CTI to Miles would expire by March 31, 1989.

In response, TCC commenced this action for declaratory relief on March 30, 1989. While this case was *sub judice*, TCC once again was required to seek an extension of the closing date under the Miles Purchase Agreement. That latest amendment, executed on May 31, 1989, extended the last day to close to June 30, 1989. As a *quid pro quo* for granting the extension, Miles extracted a $21 million reduction in the purchase price.[7] Under this arrangement, Miles would continue to have an option (as opposed to a contractual obligation) to purchase CTI.

II.

CDC and CLS attack the validity of their October 21, 1988 consents on four grounds, all of which TCC vigorously opposes. First, the defendants argue that the consents expired on March 31, 1989, because that was the parties' intent, and alternatively, because in the absence of a specified termination date, a reasonable duration of the consents would end on March 31, 1989. Second, CDC and CLS contend that under 8 *Del. C.* § 228, the consents expired within 60 days of their delivery to TCC because the concurrent approval by TCC's common stockholders to the transactions being consented

7. Pursuant to the terms of the CDC/CLS consent (*See* Fn. 14, p.25, *infra*), TCC will be obtaining an investment banker's opinion as to the fairness of the reduced price.

to was not obtained within that 60 day period. Third, CDC and CLS argue that the consents are invalid under principles of contract law and because TCC violated its fiduciary duty of candor. Fourth, the defendants urge that equitable relief should be denied to TCC[8] because TCC failed to discharge its renewed obligation to register the TCC preferred stock under the October 21, 1988 settlement agreements.

[1-2] Finally, in their motion to dismiss, the defendants raise the threshold question of whether the merits issues are presently ripe for adjudication. Being essentially jurisdictional,[9] the ripeness question is first addressed in Part III, *infra*, of this Opinion. Because the consent validity issues are found to be ripe for adjudication, they are dealt with in Part IV, *infra*.

III.

The defendants ground their argument that the "merits" issues are not ripe for adjudication solely upon the fact that Miles has an option, but no contractual obligation, to purchase CTI. Defendants urge that even if this Court were to decide the consent validity issues in TCC's favor, Miles is still free at any time to walk away from the Miles deal, which would render any merits adjudication academic. In response, TCC argues that that possibility alone is legally insufficient to render the merits issues "hypothetical," as that term is understood in declaratory judgment jurisprudence. Moreover, TCC contends, Miles has given every indication that it will purchase CTI if the contractual conditions are fulfilled.

[3-5] Whether or not a given issue is ripe for adjudication is a determination calling for a balancing of all relevant practical considerations and the sound exercise of discretion, not an analytic approach that is legalistic or formalistic. Our Supreme Court so recognized in *Stroud v. Milliken Enterprises, Inc.*, 552 A.2d at 480, 481, where it stated:

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8. In addition to declaratory relief, TCC seeks specific performance of the provision of the consents requiring CDC and CLS to "execute any additional documents and take any additional action necessary to evidence this consent."

9. The enactment of the revised declaratory judgment statute does not obviate the requirement that there be an "actual case or controversy." *Stroud v. Milliken Enterprises, Inc.*, Del. Supr., 552 A.2d 476, 479 (1989). One of the requisites for an actual controversy is that the case must be ripe for judicial determination. *Id.* at 480; *Rollins Int'l, Inc. v. Int'l Hydronics Corp.*, Del. Supr., 303 A.2d 660, 662-63 (1973).

> The reasons for not rendering a hypothetical opinion must be weighed against the benefits to be derived from the rendering of a declaratory judgment. This weighing process requires "the exercise of judicial discretion which should turn importantly upon a practical evaluation of the circumstances" of the case . . . [citation omitted].
>
> * * *
>
> The grant of declaratory judgment is always discretionary; and before a court should declare the rights of parties in a dispute, it must not only "be convinced that litigation sooner or later appears to be unavoidable," but also that the material facts are static and that the rights of the parties are presently defined rather than future or contingent . . . [citation omitted].

Id. at 481.

[6] In *Schick, Inc. v. Amalgamated Clothing and Textile Workers Union*, Del. Ch., 533 A.2d 1235 (1987), cited and quoted with approval in *Stroud*, Chancellor Allen enumerated some of the considerations pertinent to a "ripeness" analysis, including:

> [a] practical evaluation of the legitimate interest of the plaintiff in a prompt resolution of the question presented and the hardship that further delay may threaten is a major concern. Other necessary considerations include the prospect of future factual development that might affect the determination to be made; the need to conserve scarce resources; and a due respect for identifiable policies of the law touching upon the subject matter of the dispute.

Id. at 1239 (footnote omitted); *See also Siegman v. Tri-Star Pictures, Inc.*, Del. Ch., C.A. No. 9477, Jacobs, V.C. (May 5, 1989).

A practical evaluation of the business reality confronting this declaratory judgment plaintiff impels me first to observe that if TCC is to unburden itself of its substantial debt and restore itself to fiscal soundness, it needs the immediate cash and debt assumption that the CTI sale will afford. For that transaction to close, the consent of the preferred shareholders is needed, yet the defendants' challenge to those consents has clouded TCC's ability to satisfy that vital contract condition. Without an adjudication of the merits by this Court, TCC will have no remedy. Moreover, if an adjudication is to be had, it must occur before June 30, *i.e.*, two weeks hence. That is because June 30 is at present the last day to close, and there is

no assurance that Miles will grant any further extensions. Thus, as a practical matter, a refusal to adjudicate the merits now will likely be tantamount to denying TCC a remedy altogether, and would visit upon TCC financial injury that might be irreparable. Lastly, to paraphrase the language of *Stroud*, "the material facts [relating to the merits] are static and . . . the rights of the parties are presently defined . . ." 552 A.2d at 481.

CDC and CLS do not seriously dispute these considerations, but argue simply that they are outweighed by the fact that irrespective of any decision by this Court, Miles could walk away from the CTI deal at any time, and thereby render moot any judicial opinion on that subject. Defendants argue that unless and until Miles contractually commits itself (subject to fulfillment of the contractual conditions) to purchase CTI, the consent validity issues must be viewed as hypothetical.

Miles' unilateral ability to moot a merits adjudication raises admitted concerns. That those concerns are not trivial is evidenced by the defendants' cited authorities holding or suggesting (on their particular facts) that a declaratory judgment rendered in connection with the exercise of an option would be advisory, unless the optionee exercises the option or takes action unequivocally evidencing its intent to do so.[10] The question presented here is whether that single circumstance compels the conclusion that the merits are not ripe for adjudication. I find, on these particular facts, that it does not.

The thrust of defendants' argument is that the "option" factor merits conclusive weight as a matter of law. But under *Stroud* that factor, while undoubtedly relevant (and in a different case perhaps determinative) cannot categorically be deemed controlling in all circumstances, irrespective of the equities or practicalities involved. *Stroud*, as I read it, mandates that all relevant practical and policy considerations be weighed and balanced in each particular case. Therefore, any conclusion that the "merits" issues are not ripe by reason of the Miles option, must flow from a discretionary judgment arrived at by weighing all practical concerns, not from an *a priori* approach such as that proposed by the defendants here.

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10. *See Reese v. Klair*, Del. Ch., C.A. No. 7485, Hartnett, V.C. (December 16, 1986) (dictum); *rev'd on other grounds*, Del. Supr., 531 A.2d 219 (1987); *Middle South Energy, Inc. v. City of New Orleans*, 800 F.2d 488 (5th Cir. 1986); *City of Philadelphia v. Philadelphia Transp. Co.*, Pa. Supr., 171 A.2d 768 (1961). The defendants' cited cases (all of which involved different factual circumstances) were decided before *Stroud* and do not employ the *Stroud* analytical approach.

[7] The defendants' argument also appears to confuse the concepts of ripeness and mootness, which raise two conceptually distinct kinds of issues: *i.e.*, (i) those that are truly hypothetical, and therefore not ripe, at the time the complaint is filed, and (ii) questions that initially are ripe because they involve an actual case or controversy between the litigants, but which may later become moot for reasons external to the legal dispute.[11] The question that concerned the *Stroud* Court is of the former type, *i.e.*, disagreements that have no "*significant current impact* and may never ripen into legal action," and matters where "*the facts are not fully developed* . . . ." 552 A.2d at 480 (emphasis added). In the instant case, the pertinent (*i.e.*, merits-related) facts are fully developed, and a merits adjudication would have a significant current impact upon the parties. Therefore, while it is true that a determination of the merits issues could be rendered moot by Miles' subsequent unilateral action, those issues cannot properly be characterized, for that reason alone, as "hypothetical."

[8] Finally, Miles' ability to moot this action does give this Court reason to pause, and on different facts that fact might conceivably tip the scales on the side of "nonripeness." However, to so conclude in this particular case would be an unsound exercise of discretion because of the unique circumstances confronting the Court, namely: (a) the case has now been fully tried on the merits and briefed;[12] (b) it appears just as likely that Miles will exercise its

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11. An example of a truly hypothetical or "nonripe" issue is *Stroud* itself, which involved a challenge to the validity of a proposed statutory notice of a corporate stockholders' meeting that the corporation had not officially put into effect. An example of the latter type of question would be an action brought by a tender offeror seeking an adjudication of the validity of a target corporation's defensive measures taken in response to the offer. Such actions have, in most cases, been viewed as presenting "ripe" issues, even though any adjudication could subsequently be rendered moot if the offeror were to withdraw its offer by reason of the nonfulfillment of one or more standard conditions or "outs." If the defendants' ripeness argument were valid, then all takeover litigation instituted by an offeror where there are any conditions to closing, would be potentially "hypothetical" in that sense. *See, e.g.*, *Revlon, Inc. v. MacAndrews Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173 (1986); *Mills Acquisition Co. v. MacMillan, Inc.*, Del. Supr., ___ A.2d ___, Nos. 415 & 416 (May 3, 1989).

12. In this connection the Court notes that this case was permitted to go to trial without the Miles option arrangement having been brought to its attention beforehand. Both TCC's original and amended complaints failed to disclose the Miles option, and left the distinct impression that Miles was subject to a bilateral contractual obligation to acquire CTI. At the office conference where TCC's motion for expedited trial was considered, there was no mention of that option. Only in the defendants' pretrial memorandum (filed the day before the trial), and then

option as that Miles will not; (c) resolving the merits at this point would involve risking a relatively small, incremental portion of the Court's resources (*i.e.*, the effort required to decide the case), yet a merits decision could result in TCC's financial salvation; and (d) on the other hand, a decision not to proceed would risk (if not assure) that TCC will face serious financial jeopardy. Given those practical realities and the lack of "middle ground" alternatives, the more prudent course would be to hazard the risks involved in a decision to proceed.

Accordingly, I find that this action is ripe for adjudication.

IV.

I turn now to the merits, and will address the defendants' consent invalidity arguments *seriatim*.

A.

CDC and CLS first argue that the consents expired on March 31, 1989, because the parties so intended. They further argue, in the alternative, that because the consents do not specify a termination date, they are valid for only a reasonable time, which should be no later than March 31, 1989. Both arguments, in my view, lack merit.

First, I find no persuasive evidence, in either the language of the consents or the trial testimony and exhibits,[13] that March 31, 1989 was the intended expiration date. The consents specify no termination date, and the language of the "CTI sale" consent indicates that the parties intended for the consents to be coextensive with the Miles Purchase Agreement. The CTI sale consent expressly describes its subject as being the sale of CTI to Miles, "substantially in accordance with the terms and conditions of the Purchase Agreement dated October 12, 1988 (the "Purchase Agreement") between TCC and Miles, Inc." The consent then goes on to provide that:

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during the first day of trial, was the existence of the option arrangement disclosed and thereafter confirmed. Although the option has been found not to warrant dismissal in this particular case, it is a circumstance that clearly is relevant to a ripeness determination. It should, therefore, have been promptly disclosed by the plaintiff.

13. TCC argues that the parol evidence rule precludes any consideration of evidence extrinsic to the consents and the Miles Purchase Agreement. Because the Court has considered the extrinsic evidence and finds it insufficient to support the defendants' legal contentions, the parol evidence issue need not be decided.

> [t]he undersigned [CDC and CLS] acknowledge and agree that the Purchase Agreement may be amended or modified by TCC and Miles, Inc., and conditions of the parties thereunder to close may be modified, amended or waived by TCC or Miles, Inc. without any further approval or consent from the undersigned [*i.e.*, CDC and CLS] . . . .

The consent language makes it clear that (a) the terms of the CTI sale consent are governed by the Miles Purchase Agreement, and (b) if TCC and Miles chose to amend or modify that Agreement, the amendments or modifications would be binding upon CDC (and CLS) without any further need to obtain those parties' approval.[14] It is evident from the breadth and generality of the consent language that the parties intended for the consent to endure so long as the Miles Purchase Agreement remains in force. Thus, if the Miles Purchase Agreement were modified to extend the "last day to close" beyond March 31, 1989 (as has now thrice occurred), that modification would bind CDC and CLS.

[9] Nor is there persuasive extrinsic evidence that requires a different result. The extrinsic evidence, if credited, shows (at most) that CDC and CLS believed that (a) the consent would not endure beyond March 31, 1989, and (b) the consent language permitting amendments and modifications to the Miles Purchase Agreement applied only to trivial, technical, or minor provisions thereof. But that evidence does not go far enough. If such were the defendants' beliefs, they were totally subjective and were never communicated or otherwise manifested to TCC, either orally or in writing, during the negotiations leading up to the October 21, 1988 settlement agreements. Finally, there is no persuasive evidence that TCC shared (let alone assented to) the defendants' professed belief that the consents would legally expire on March 31, 1989 and could not be extended by amending the Miles Purchase Agreement.[15] Contracts must be

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14. The only exception, not relevant here, would involve a material reduction in the purchase price. Even in that case, no further consent by CDC or CLS would be required if TCC obtains an opinion from a nationally recognized investment banking firm as to the fairness of the transaction.

15. The defendants point to various expressions and statements made by TCC or its representatives (including TCC's October 12, 1988 Form 10K, *see* Miles Exhibit 4) as evidence that TCC also believed that the Miles Purchase Agreement would expire on March 31, 1989. There is little doubt that between October, 1988 and January, 1989, TCC sincerely did entertain the belief and expectation that the CTI transaction would close, at the latest, by March 31, 1989. However, that

founded upon expressions of intent that are manifested and communicated, not those that are uncommunicated or disguised. *See Warner Communications, Inc. v. Chris Craft Indus.*, Del. Ch., C.A. No. 10817, Allen, C. (May 15, 1989); *Mesa Partners v. Phillips Petroleum Co.*, Del. Ch., C.A. No. 7871, Walsh, V.C. (December 20, 1984).

[10] *Second*, the evidence is insufficient to establish the defendants' proposition that March 31, 1989 marks the outer limit of a "reasonable time" for the consents' duration. The common law contract principle that would impose a "reasonable time" limitation might conceivably come into play if the Miles Purchase Agreement were to remain executory for an excessive period, and thereby threaten some legitimate preferred shareholder or other cognizable interest. But this is not such a case, nor is that scenario likely to occur. Here the delay has been less than three months. To induce Miles to grant its latest 30 day extension, TCC had to consent to a $21 million reduction in the purchase price. The likelihood that any further extensions would be similarly costly gives TCC every economic inducement to close as soon as possible.

No reason has been shown why the consents should not remain binding for the time needed to consummate this critical transaction. That is what the written consents contemplate, and there is no demonstrated equity or similar circumstance (such as detrimental reliance by the defendants or a third party) that would justify according talismanic significance to the March 31 date. That date was simply the originally agreed upon "last date to close" under the Miles Purchase Agreement. The contracting parties who chose that date (TCC and Miles) have the undoubted contractual power to modify it, and indeed they did so on three separate occasions. A finding that the consents expired on March 31, 1989 would effectively nullify those parties' contract modifications, as well as the CDC/CLS consents whose terms are governed by those contract modifications.

B.

The defendants next argue that the consents expired on December 20, 1988, 60 days after they were delivered to TCC, by reason of 8 *Del. C.* § 228(c), which pertinently provides:

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evidence does not prove that TCC believed or understood that the Miles Purchase Agreement could not be amended to extend that closing date, or that any such extension would not bind CDC and CLS.

> [N]o written consent shall be effective to take the corporate action referred to therein unless, within sixty days of the earliest dated consent delivered in the manner required by this Section to the corporation, written consents signed by a sufficient number of holders or members to take action are delivered to the corporation. . . .

The defendants' argument runs as follows: Section 228(c) provides that written stockholder consents in lieu of action taken at a meeting will automatically expire, unless written consents "signed by a sufficient number of holders or members to take action" are delivered to the corporation within the 60 day period specified by the statute. The "corporate action" referred to in the October 21, 1988 consents, was (respectively) the approval of the sale of CTI, and the authorization for the proposed certificate amendment. Because neither of those corporate actions could be achieved without the concurrent approval of TCC's common shareholders, and because common shareholder approval was not obtained within the 60 day period, the defendants conclude that the consents failed to become "effective to take the corporate action referred to therein." Therefore, they argue, the consents expired on December 20, 1988, *i.e.*, 60 days after their delivery to TCC.

[11] That argument fails, because even if § 228 is assumed to be applicable in this context,[16] the defendants misinterpret its requirements. Section 228(c) requires the delivery of "consents signed by a sufficient number of holders or members to take action." The term "action" in that particular sentence refers to "the corporate action referred to therein," that is, the action referred to in the consent itself. 8 *Del. C.* § 228(c). The "corporate action[s]" referred to in the consents at issue here are *the approval of the holders of TCC's preferred stock* of the sale of CTI to Miles and the approval of the proposed certificate amendment. CDC and CLS are the owners of 100% of the TCC preferred stock. Therefore, their written consent

16. The plaintiff argues that § 228 does not apply to consents given in the context of a negotiated commercial transaction to which the corporation is a party, but, rather applies only to consents furnished in lieu of a stockholders' meeting involving the corporation's internal affairs. The Court's ruling assumes without deciding that § 228 is applicable, and leaves for another day the question of that statute's transactional reach.

was all that was required "to take action" within the meaning of 8 *Del. C.* § 228(c).[17]

C.

The defendants next argue that the consents should be denied effect in equity because they (CDC and CLS) were induced to give the consents on the basis of misrepresentations made by TCC's Co-Chairman. The misrepresentations are said to consist of various statements to CDC and CLS, the clear and intended import of which was that the CTI sale proceeds would be used (among other purposes) to repurchase or redeem the TCC preferred stock. Defendants argue that although those representations fell short of a contractual commitment, they amounted to a violation of TCC's fiduciary duty of candor owed to the defendants as preferred shareholders, and constitute a sufficient basis for this Court to avoid the consents on fiduciary and contractual[18] grounds.

In response TCC argues that it owed no fiduciary duty because it did not deal with CDC and CLS as a fiduciary but, rather, as an adversary in a commercial, arm's-length bargaining relationship where both sides were independently represented by legal counsel. TCC further argues that even if it owed a duty to the defendants, no duty was violated because TCC representatives made no misrepresentations of any kind during the negotiations.

I find it unnecessary to address the legal issues raised by these arguments because the defendants' effort to avoid their consents on equitable grounds founders on the facts and the evidence. The defendants have failed to prove that TCC misrepresented that the CTI sale proceeds would be used to redeem or repurchase the TCC preferred stock. All the evidence shows, as the Court has found, is that TCC represented that at a future time, when it was free of its debt covenant restrictions, TCC would sit down with CDC and CLS

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17. The Court also notes in passing that the defendants' § 228 argument is inconsistent with their contractual intent argument (and with Mr. Montgomery's March 21 letter to TCC) that the consents expired on March 31, 1989. That position also appears fatally inconsistent with Mr. Montgomery's testimony that as of October 21, 1988, all parties looked forward to a closing on January 31, 1989—an event that would have made no sense if (as defendants now argue) the consents had expired on December 20, 1988, five weeks earlier.

18. CDC and CLS argue (citing *Norton v. Poplos*, Del. Supr., 443 A.2d 1 (1982)) that a contract may be rescinded not only for fraud or mutual mistake, but also for misrepresentations that, while facially accurate, create a misimpression that constitutes a material inducement to the contract.

and attempt to negotiate a redemption or repurchase transaction of some kind. Apparently because TCC was unable to make a more definitive or concrete commitment, CDC and CLS were able to secure TCC's agreement to register its preferred stock. Thus, even though there could be no assurance that the preferred stock would be repurchased or redeemed, at least that stock would be made marketable.

Finally, it appears that TCC has, in fact, attempted to negotiate a repurchase or redemption transaction with the defendants, but thus far the parties have been unable to reach an accord. That the negotiations did not succeed cannot transform TCC's statements into material misrepresentations that would serve as a basis for the defendants to now avoid their written consents.

D.

Finally, the defendants argue that TCC's application for specific performance should be denied because TCC failed to satisfy its obligation to register the preferred stock pursuant to the October 21, 1988 settlement agreements. CDC and CLS seek to rely upon the principle that specific performance will not be granted to a party that fails to show substantial performance on its part. *See Safe Harbor Fishing Club v. Safe Harbor Realty Co.*, Del. Ch., 107 A.2d 635, 638 (1953).

I find it unnecessary to address this contention because the defendants advance it only as a defense to TCC's claim for specific performance, *i.e.*, for an order directing CDC and CLS to execute new consents. Because the Court has found that the October 21, 1988 consents are valid and effective, there is no need to require the defendants to execute new ones. In this instance declaratory relief is a sufficient remedy. Therefore, no useful purpose would be served by adjudicating a defense to a remedy (specific performance) that will not be granted.

Furthermore, to address the "failure to register" argument at this stage would be unwise because that dispute is the subject of a counterclaim that the defendants intend to pursue in a separate trial. By agreement of the parties, that counterclaim was severed from the issues recently tried. If that counterclaim is to be prosecuted, considerations of judicial economy counsel that its merits be addressed once, not twice. At this stage any expression of a judicial viewpoint on the "failure to register" defense would amount essentially to a dry run of the Court's later consideration of the same "failure to

register'' issue, reincarnated as an affirmative claim. In addition to being unnecessary, that approach would generate a new set of potential procedural complications (*e.g.*, law of the case and collateral estoppel issues) that, if possible, should be avoided.

V.

For the reasons set forth, the defendants' motion to dismiss is denied, and judgment will be entered in the plaintiff's favor declaring the October 21, 1988 consents at issue legally valid and effective. Counsel shall submit an appropriate form of order.

GIANCARLO v. OG CORP.

No. 10,669

Court of Chancery of the State of Delaware, New Castle

June 23, 1989

Plaintiff shareholder sought appointment of a liquidating custodian for a solvent corporation under the Delaware General Corporation Law which justifies such relief where the corporation has abandoned its business and fails to take steps to liquidate its assets within a reasonable time. Defendant corporation, formed for the purpose of holding and exploiting a certain patent, denied abandoning its business but admitted it was not currently taking action to exploit the patent.

The court of chancery, per Chancellor Allen, held that the board's inactivity related to a rational, lawful use of the corporate form and did not constitute a breach of duty to liquidate the firm in the face of the circumstances presented. Therefore, the court could not conclude that the corporation had ''abandoned its business'' so as to allow appointment of a receiver under Delaware law.

1. Contracts ⟹ 116(1), 137(4)

Where a non-competition agreement serves no valid purpose of one party and detrimentally impacts the ability of the other party

to earn a living, the law generally is that such a conclusion justifies a refusal to enforce the agreement.

2. Corporations ⟹ 14(1)

Delaware law, expressly since 1967 and implicitly from a much earlier date, has recognized that a corporation may validly be formed in order to engage in any lawful activity. DEL. CODE ANN. tit. 8, § 102(a)(3) (1967).

3. Corporations ⟹ 372, 540

Under section 226(a)(3) of the Delaware General Corporation Law, the words "its business" refer to any business within the purposes clause of the corporation's charter in which the corporation purports to be engaged. DEL. CODE ANN. tit. 8, § 226(a)(3) (1953).

4. Corporations ⟹ 552

Delaware courts have traditionally demonstrated caution to the point of reluctance in appointing receivers for solvent corporations.

5. Corporations ⟹ 552, 564

The reticence of Delaware courts to appoint a receiver for a solvent corporation has in recent years been tempered by a concern for rights of fifty percent shareholders who are effectively excluded from an equal voice in the selection of the directors who manage the enterprise.

6. Corporations ⟹ 553(1), 554

Appointing of a receiver for a solvent corporation constitutes a radical step that ought not to be granted unless the plaintiff has rather plainly shown his entitlement to it.

7. Corporations ⟹ 552, 553(1), 553(6)

Section 226(a)(3) of the Delaware General Corporation Law recognizes that where directors cease to manage the assets committed

to them and abandon the business, they may be said to forfeit their claim to control those assets so that if no steps have been taken to dissolve the enterprise, the court is authorized to appoint a custodian. DEL. CODE ANN. tit. 8, § 226(a)(3) (1953).

8. Corporations ⟹ 14(1)

A corporation may be formed and maintained as a passive instrumentality.

9. Corporations ⟹ 310(1)

Under certain circumstances, a board's waiting to see if an opportunity presents itself to realize a return on its investment cannot be seen as breaching a duty to the corporation or its shareholders.

10. Corporations ⟹ 553(1), 554

A court must be able to conclude it is a breach of duty not to liquidate a firm in the face of the circumstances presented before it can conclude that the corporation has abandoned its business. DEL. CODE ANN. tit. 8, § 226(a)(3) (1953).

11. Corporations ⟹ 310(1), 553(2), 553(8)

The question of abandonment under section 226(a)(3) is not entirely a question left to the business judgment of the board, but requires the court to decide objectively whether the business has been "abandoned." The court must keep in mind that it is the board not the court that is charged with managing the enterprise. DEL. CODE ANN. tit. 8, § 226(a)(3) (1953).

12. Corporations ⟹ 310(1), 553(1), 553(8)

Whenever a board asserts in good faith a plausible explanation for corporate inactivity that relates to a rational, lawful use of the corporation form, an order under section 226(a)(3) for the appointment of a receiver is not warranted. DEL. CODE ANN. tit. 8, § 226(a)(3) (1953).

Kenneth J. Nachbar, Esquire, and Leone L. Ciporin, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Willkie Farr & Gallagher, New York, New York, for plaintiff.

James C. Strum, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Henry B. Gutman, Esquire, and Kerry L. Konrad, Esquire of O'Sullivan Graev & Karabell, New York, New York, for defendants.

ALLEN, *Chancellor*

The complaint seeks the appointment of a liquidating custodian for OG Corporation, a Delaware corporation, formed in 1986. The ground asserted as justifying that relief is, in the language of the pertinent statute, that "the corporation has abandoned its business and has failed within a reasonable period to take steps to dissolve, liquidate or distribute its assets." 8 *Del. C.* § 226(a)(3). Plaintiff is an individual owning 25% of the voting power of OG. He claims that the Company was formed for the purpose of holding and exploiting a certain patent but that it has taken no steps nor does it presently plan to take any steps designed to exploit the commercial value of that patent. Thus, he concludes that "the corporation has abandoned its business" and, absent voluntary liquidation, should be forced to liquidate on his application.

Defendants are the corporation itself and an individual who owns, indirectly, 75% of its voting power and who, along with plaintiff, is a director of OG. Defendants deny that the corporation has abandoned its business although it is admitted that OG is not currently doing anything to exploit its patent. It has, it says, taken action to protect its patent and leaves open the possibility of various techniques of exploiting the asset in the future—including sale, licensing or otherwise. The Company has been maintained in good standing and its books and records are maintained.

The case has been tried. Based upon the evidence adduced and my understanding of the relevant law, I conclude that plaintiff has not shown himself entitled to the extraordinary remedy of the appointment of a liquidating custodian of a solvent corporation.

* * * *

This is the first suit brought in this court under Section 226(a)(3)

since that section was first adopted in the 1967 revision of the Delaware General Corporation Law and this case is anomalous. The corporation that is sought to be involuntarily dissolved has a single valuable asset: a patent on certain electronic switching technology. Yet the shareholder who seeks to force liquidation of the corporation has disclaimed any interest in that asset. Rather, something other than his interest as a stockholder in OG admittedly motivates his suit.

[1] At the heart of the matter lies plaintiff's desire to be free of constraints imposed upon him by a certain non-competition agreement that he entered into with OG in connection with the planned exploitation of OG's patent which was planned to include his employment with the firm. That agreement is governed by New York law. Plaintiff asserts that his ability to earn a living is detrimentally impacted by this agreement and, in effect, that the agreement serves no valid purpose of OG. The law generally is that such a conclusion, if reached by a court, would justify a refusal to enforce the agreement. *See, e.g.*, 6A *Corbin on Contracts* § 1394 (1962); Restatement, Contracts § 515 Comment B; *McCann Surveyors, Inc. v. Evans*, Del. Ch., C.A. No. 1268-S (July 24, 1987); *LewMor, Inc. v. Fleming*, Del. Ch., C.A. No. 8355 (January 29, 1986); *E.L. Conwell & Co. v. Gutherlet*, 298 F. Supp. 623 (D. Md. 1969), *aff'd*, 429 F.2d 527 (4th Cir. 1970). But plaintiff has chosen not to cast his complaint as an attack upon the present enforceability of the non-competition agreement; he has instead chosen to attempt to eradicate the holder of the right by which he feels oppressed. Thus, the case is brought as a corporation law matter seeking the first judicial application of Section 226(a)(3). In this effort to construe the legal meaning of our statutory corporation law, the court must take a very different approach than is appropriate when the question is whether equity will refuse to enforce a particular agreement.

* * * *

The applicable statutory words are few:

> (a) the Court of Chancery, upon the application of any shareholder, may appoint . . . a custodian . . . when:
>
> * * *
>
> (3) the corporation has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute assets.

8 *Del. C.* § 226(a)(3).

Analysis of the central legal issue of this case involves an interpretation of the statutory words "abandoned its business." That analysis may be broken up into two parts. The first part asks, to what do the words "its business" refer. The second part constitutes a factual inquiry into the question whether that business has been "abandoned."

As to the first issue, plaintiff lays stress upon the pronoun "its" that modifies the word "business." He has offered testimony and other evidence relating to the original plan or intention of those who incorporated OG (or on whose behalf it was incorporated). This original conception, plaintiff says, is for OG "its" business. The evidence shows, plaintiff says, that that business importantly involved, indeed was entirely made up of, plans to exploit the patent that OG would own. But, plaintiff says, the evidence shows that that business was never engaged in and has been abandoned.

[2] I am, however, unable to agree that in employing the phrase "its business," Section 226(a)(3) refers to any original understanding of the purposes to be served by the corporation. To accept plaintiff's premise would mean, for example, that corporate boards that decide (with the concurrence of a majority of shareholders) to sell substantially all of the firm's assets and to re-deploy them in a radically different type of enterprise might safely do so only with unanimous concurrence of shareholders—since such a step might involve an abandonment of the original idea of the reason for the corporation. But it is far too late in the evolution of the corporate form of organization to return to a regime in which corporations are only formed for particular or specified purposes. Our law, expressly since 1967 (*see* Section 102(a)(3)) and implicitly from a much earlier date,[1] has recognized that a corporation may validly be formed in order "to engage in any lawful activity." It would be a mistake and unwarranted to conclude that the legislature intended to insert the concept of a binding, limiting, original intention through the device of Section 226(a)(3) at the very time that it amended Section 102(a)(3).

[3] Accordingly, I conclude that "its business" does not refer to any original intention more narrow than the purposes clause of a corporation's charter. Rather, in my opinion, "its business" refers

1. That is, prior to the 1967 revision, it was the common practice to insert into a charter's purposes clause standard language running sometimes to several pages in length.

to any business within the purposes clause of the corporation's charter in which the corporation purports to be engaged.

Thus, it seems to me the dispositive question here is not whether the present situation with respect to OG was or was not within the plan of its originators, but whether the corporation is engaging in any business whatsoever presently or has it "abandoned" all business.

* * * *

[4-6] In addressing this question, I note two preliminary points. First, Delaware courts have traditionally demonstrated caution to the point of reluctance in appointing receivers for solvent corporations. *See, e.g., Drob v. National Memorial Park, Inc.*, Del. Ch., 41 A.2d 589 (1945); *Zuchowski v. Boxwood Coastal Corp.*, Del. Supr., 93 A.2d 119 (1952); *Hall v. John S. Isaacs & Sons Farms, Inc.*, 163 A.2d 288 (1960). That reticence has in recent years been tempered by a concern for rights of 50% shareholders who are effectively excluded from an equal voice in the selection of the directors who manage the enterprise. *See Giuricich v. Emtrol Corp.*, Del. Supr., 449 A.2d 232 (1982); *Marciano v. Nakash*, Del. Ch., C.A. No. 7910, Berger, V.C. (May 14, 1985), *aff'd*, 535 A.2d 400 (1987). While *Giuricich* teaches that a reluctance to take the radical step of appointing a receiver for a solvent corporation cannot be taken to the point of failing to give to a clear statute its apparently intended effect, it remains the case that such relief constitutes a radical step that ought not to be granted unless the plaintiff has rather plainly shown his entitlement to it.

The second preliminary point concerns the purpose of this statute. It has been said that every statute has a purpose, the imaginative discovery of which is the surest guide to its correct interpretation. In discerning the purpose of Section 226(a)(3), we are not assisted by legislative history, for there is none. Moreover, neither side has called to my attention contemporaneous statements of commentators relating to the purpose of Section 226(a)(3). Finally, the prior case law does not expose a problem to which the statute was especially addressed.

[7] Given my understanding that the first clause of Section 226(a)(3) meant to refer to the abandonment of all substantive business activities, the rationale behind the section, however, seems discernible from its own words alone. The corporation in a residual sense (and originally) represents the collective investment of the shareholders. The directors are elected by the shareholders to manage the enterprise. If the directors cease to manage the assets committed

to them, if they abandon the business, they may be said to forfeit their claim to control those assets. Thus, Section 226(a)(3) recognizes that where that has occurred and no steps have been taken to dissolve the enterprise, the court is authorized to appoint a custodian. So understood, the statute seems less innovative than it may first appear. Even before its enactment, I have no doubt that upon a showing of the elements required to be shown under that provision, the Court of Chancery would have been authorized to issue a mandatory injunction requiring the directors to either engage in business or liquidate. In such circumstances, to do neither would constitute a repudiation of the directors' obligation to manage the enterprise in an effort to promote the corporation's welfare and, derivatively, the interests of its shareholders.

* * * *

Does the evidence then show that OG has abandoned all business and its directors are breaching a duty in failing to liquidate the firm? I cannot so conclude.

The evidence shows no current activity, but it does show that OG prosecuted its U.S. patent application in 1987. The U.S. patent issued in 1988. In 1987, OG pursued related patent filings in foreign jurisdictions and took action in that connection in 1988. OG made payments to counsel with respect to that work in 1988 and 1989. Additional funds to finance this work were advanced to OG by its other shareholder (who is controlled by the individual defendant) in 1987 and 1988.

OG presently has no operating expenses other than to maintain its registered agent, pay its franchise tax, maintain a small checking account and preserve its foreign patent filings. It must as well bear the cost of this suit.

[8] It is, of course, plain that a corporation may be formed and maintained as a passive instrumentality—for example, an entity that does no more than take and hold title to intangible investments is a commonly encountered phenomenon. But even investment holding companies typically receive interest, dividends or other distributions with respect to their investments and do typically change investments from time to time. OG has but one intangible "investment" and it generates no income at present. At present, it is inert. Defendants offer explanations for this consistent with their position that inactivity does not mean abandonment. They say that the corporation will have to achieve additional capital in order to try to exploit its patent

and that the prospect of such new capital is dim so long as certain litigation (not involving OG but involving claims relating to its technology) pends. The corporation has expended such funds as are necessary to secure its patent and to protect it abroad.

[9-10] The course that OG is now pursing—simply waiting to see if an opportunity presents itself to realize a return on its investment—is not irrational given its circumstances. The board that elects to pursue that policy of inaction in these circumstances cannot be seen as breaching a duty to the corporation or its shareholders. In my opinion, a court must be able to conclude it is a breach of duty not to liquidate the firm in the face of the circumstances presented before it can conclude that the corporation has "abandoned its business."

[11-12] I do not regard the question of abandonment under Section 226(a)(3) as being entirely a question left to the business judgment of the board. The enactment of this statute requires the court to decide objectively, so to speak, whether the business has been "abandoned." But in making that judgment, the court must keep in mind, in my opinion, that it is the board not the court that is charged with managing the enterprise. As a consequence, I am of the view that whenever the board asserts in good faith a plausible explanation for corporate inactivity that relates to a rational, lawful use of the corporate form, an order under Section 226(a)(3) is not warranted.

This, in my view, is the situation in this instance. The corporate form is being used rationally to hold an asset to await future developments. I cannot conclude that such course of action constitutes any part of a breach of fiduciary duty to the minority (although obviously in some circumstances it might) or that the goal sought is illegitimate. That the present situation represents a different turn of events than the individuals involved contemplated at the outset is, as I noted above, irrelevant. That this is a result that disadvantages plaintiff in his posture of one who has contracted with the corporation is even more clearly irrelevant to a proceeding of this type.

For the foregoing reasons, judgment will be entered in favor of defendants and against plaintiff. Defendants may submit a form of judgment order on notice.

GLASER v. NORRIS

No. 9538

Court of Chancery of the State of Delaware, New Castle

July 13, 1989

Plaintiff, individually and on behalf of a class of purchasers of limited partnership interests, initiated this action against the defendants alleging violations of sections 11 and 12(2) of the Securities Act of 1933. Specifically, plaintiff claimed that the prospectus for the public offering contained untrue statements of material facts and omitted to state material facts necessary to make the statements not misleading. The defendants moved to dismiss the action contending, *inter alia*, that the alleged misrepresentations and omissions set forth in the complaint were unsupported by allegations of specific fact and were not material in light of the disclosures made in the prospectus.

The court of chancery, per Vice-Chancellor Chandler, dismissed plaintiff's action for failure to state a claim upon which relief could be granted. The court held that plaintiff's allegations generally did not state a claim of a false or misleading statement of fact. Those portions of plaintiff's claim that survived the motion to dismiss were dismissed with leave to amend to plead sufficient facts to satisfy the federal securities laws statute of limitations.

1. Motions ⟹ 33

Pretrial Procedure ⟹ 624

In deciding a motion to dismiss, all inferences must be construed in favor of the plaintiff and the complaint may not be dismissed unless it appears that the plaintiff would be entitled to relief under any set of facts which could be proved in support of his claim.

2. Motions ⟹ 33

Pretrial Procedure ⟹ 687, 689

For the purposes of a motion to dismiss, the well-pleaded allegations are accepted as true; however, such a motion does not concede inferences or conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest or conclusions of law.

3. Securities Regulation ⟹ 122, 141

Under section 11 of the Securities Act of 1933, if a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission in the registration statement to establish his prima facie case. U.S. CODE ANN. tit. 15, § 77k (1934).

4. Securities Regulation ⟹ 117, 139

Pleadings ⟹ 8(15), 16

A complaint based on section 10(b) of the Securities Exchange Act of 1934, the "catch-all" antifraud provision, requires proof of scienter and is subject to the pleading requirements of Federal Civil Procedure Rule 9(b). U.S. CODE ANN. tit. 15, § 78j (1934); FED. R. CIV. P. 9(b).

5. Securities Regulation ⟹ 117, 139

Pleadings ⟹ 8(15), 16

Claims grounded on sections 11 and 12 of the Securities Act of 1933 are not required to meet the specific pleading requirements of Rule 9(b). U.S. CODE ANN. tit. 15, § 77k (1934); U.S. CODE ANN. tit. 15, § 77l(2) (1954); FED. R. CIV. P. 9(b).

6. Securities Regulation ⟹ 84

Securities and Exchange Commission Rule 175 furnishes immunity from liability under the federal securities laws for good faith, voluntary disclosures as long as they were made with a reasonable basis. 17 C.F.R. § 230.175(c)(1) (1988).

7. Securities Regulation ⟹ 3, 122

Securities and Exchange Commission Rule 175, a safe harbor rule, protects predictions which in fact prove to be wrong, but imposes liability where the predictive statement was false when made. Falsity

is determined by examining several factors, including whether the prediction suggested reliability, bespoke caution, was made in good faith or had a sound factual or historic basis. 17 C.F.R. § 230.175(c)(1) (1988).

8. Securities Regulation ⟹ 63, 119

A statement is material if there is a substantial likelihood that, under all the circumstances, a reasonable investor would have considered it important in reaching an investment decision.

9. Securities Regulation ⟹ 28, 103, 119

Not every omission from a prospectus is actionable under sections 11 and 12(2) of the Securities Act of 1933. U.S. CODE ANN. tit. 15, § 77k (1934); U.S. CODE ANN. tit. 15, § 78l(2) (1954).

10. Securities Regulation ⟹ 28, 103, 119

An omission from a prospectus is not actionable under sections 11 and 12(2) of the Securities Act of 1933, unless there is a material fact omitted and unless the material fact that is omitted adversely affects the reliability of other statements. U.S. CODE ANN. tit. 15, § 77k (1934); U.S. CODE ANN. tit. 15, § 77l(2) (1954).

11. Securities Regulation ⟹ 134

Section 13 of the Securities Act of 1933 provides that actions under section 11 and 12(2) must be brought within one year after the discovery of the untrue statements or the omission, or after such discovery should have been made by the exercise of reasonable diligence. U.S. CODE ANN. tit. 15, § 77m (1934).

12. Pleadings ⟹ 42, 68

In order to satisfy the discovery clause under section 13 of the Securities Act of 1933, a proper complaint should include: (1) allegations as to the time and circumstances of discovery of the alleged untrue statement or omission, (2) the reasons why discovery was not

made earlier if more than one year has elapsed since the alleged untrue statement or omission was made, and (3) the diligent efforts which plaintiff undertook in making or seeking such discovery. U.S. CODE ANN. tit. 15, § 77m (1934).

13. Securities Regulation ⟹ 2, 23

Under sections 12(1) and 12(2) of the Securities Act of 1933, the phrase "any person who offers or sells a security" contemplates at the very least the traditional buyer-seller relationship, imposing liability on the owner who passed title, or other interest in the security, to the buyer for value, and also contemplates the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner, such as a broker or securities vendor's agent. U.S. CODE ANN. tit. 15, §§ 77l(1), (2) (1954).

14. Securities Regulation ⟹ 142

Defendants are not required to admit wrongdoing before it is properly determined in a court of law whether in fact the securities laws were violated.

R. Bruce McNew, Esquire, and Pamela S. Tikellis, Esquire, of Greenfield & Chimicles, Wilmington, Delaware; and Richard D. Greenfield, Esquire, and Brenda M. Nelson, Esquire, of Greenfield & Chimicles, Haverford, Pennsylvania, for plaintiff.

A. Gilchrist Sparks, III, Esquire, Thomas C. Grimm, Esquire, and Robert J. Valihura, Jr., Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, or non-underwriter defendants.

CHANDLER, *Vice-Chancellor*

Plaintiff Henrietta Glaser, individually and on behalf of a plaintiff class consisting of purchasers of Class A Depositary Units ("Units") of defendant Commonwealth Mortgage of America, Limited Partnership ("Commonwealth"), has filed suit alleging, *inter alia*, violations of federal securities laws. Before the Court is a motion to dismiss the complaint pursuant to Rule 12(b)(6) for failure to state a claim upon which relief can be granted. The moving parties are

defendants Commonwealth, Commonwealth Mortgage Corporation of America ("CMCA"), Commonwealth Savings Association ("CSA"), S. Don Norris, Jamie J. Jackson and John J. Eikenburg. Not included in the motion is defendant Salomon Brothers, Incorporated ("SBI"), as representative of a defendant class of underwriters involved in the offering of the Units.

I

[1-2] In deciding a motion to dismiss, all inferences must be construed in favor of the plaintiff and the complaint may not be dismissed unless it appears that the plaintiff would not be entitled to relief under any set of facts which could be proved in support of his claim. *Weinberger v. UOP, Inc.*, Del. Ch., 409 A.2d 1262 (1979), *rev'd on other grounds*, Del. Supr., 457 A.2d 701 (1983) (*citing Fish Engineering Corp. v. Hutchinson*, Del. Ch., 162 A.2d 722 (1960)). For the purposes of the motion the well-pleaded allegations of the complaint are accepted as true. *Delaware State Troopers Lodge v. O'Rourke*, Del. Ch., 403 A.2d 1109, 1110 (1979). However, such a motion does not concede inferences or conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest or conclusions of law. *See Weinberger*, 409 A.2d at 1264; *Cohen v. Mayor of Wilmington*, Del. Ch., 99 A.2d 393, 395 (1953). *See also Grobow v. Perot*, Del. Supr., 539 A.2d 180, 187 n.6 (1988). On this latter principle rests the basis of the defendants' motion.

II

The facts alleged in the complaint and taken as true for the purposes of this motion are as follows. Plaintiff purchased for $10,000 1,000 Units of Commonwealth pursuant to the initial offering of 14.3 million Units on November 12, 1986. Commonwealth is a limited partnership which was organized by defendants CSA and CMCA to succeed to and conduct the mortgage banking business and operations of CSA and its subsidiaries. CSA is a stock savings and loan association. CMCA is a wholly-owned subsidiary of CSA and the sole general partner of Commonwealth. CSA currently has a negative net worth and is pursuing a plan to merge with Commonwealth as an alternative to being declared insolvent.

Commonwealth's activities include mortgage loan origination through solicitation of home buyers and real estate developers. The loans are then held or warehoused until they can be sold either

through mortgage-backed securities offerings or to private investors. Upon the sale of the loans, Commonwealth customarily enters into a fee agreement with the purchaser to perform certain administrative duties (commonly referred to as servicing) relating to the loans. Commonwealth has become a major nationwide mortgage loan originator and servicer through acquisitions, internal growth and purchases of loan administration contracts. At June 30, 1987, Commonwealth had 66 loan production offices located in 20 states that, during the fiscal year ended June 30, 1987, originated approximately $3.4 billion of mortgage loans.

Commonwealth uses its nationwide network of offices to originate geographically diverse pools of mortgage loans in an attempt to reduce the risks resulting from regional economic downturns and to provide an expanding base of loan administration contracts for its servicing portfolio. Commonwealth has developed a support organization to centralize administrative functions and to provide monitoring and quality controls for loan origination and servicing activities. An integral part of this support organization is the Commonwealth Loan Control System ("CLCS"), an on-line, real-time computer network that links all of the loan production offices with Commonwealth's central facilities.

In connection with the offering, Commonwealth's business was converted to partnership form. Immediately prior to the closing of the offering, CSA and its subsidiaries contributed to Commonwealth substantially all the mortgage banking assets and liabilities of CSA in exchange for 35,000,000 Class A Units and 25,000,000 Class B Units. Of these, 14,300,000 Class A Units were sold by CSA to plaintiff and members of the plaintiff class in the offering. Afterwards, CSA, through CMCA, retained an approximately 59% interest in the Class A Units of Commonwealth and 100% of the Class B Units.

Defendant SBI was one of the four lead and managing underwriters of the offering. A total of 82 underwriters participated in the offering. As one of the lead underwriters, SBI purportedly conducted or participated in the "due diligence" investigation into the business operations and prospects of Commonwealth. The individual defendants are corporate officers and directors of CSA and CMCA. They each signed or were named as *de facto* directors of Commonwealth in a Registration Statement of which the Prospectus was a part.

III

The crux of plaintiff's complaint is that the Prospectus through

which Commonwealth made its public offering contained untrue statements of material fact and omitted to state material facts required to be stated or necessary to make the statements made not misleading, in violation of sections 11 and 12(2) of the Securities Act of 1933. 15 U.S.C. § 77k, 77l(2).[1] Additionally, Count III alleges that this constitutes a breach of the fiduciary duty which CSA, CMCA and the individual defendants owed the plaintiff class under Delaware law.

The moving defendants contend that the alleged misrepresentations or omissions as set forth in the complaint are either conclusory and unsupported by allegations of specific fact or are not material in light of the disclosures made in the Prospectus. As additional grounds for dismissal, defendants contend that plaintiff has failed to

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1. 15 U.S.C. § 77k states in pertinent part:

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statments [sic] therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issue at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

. . . . . .

(5) every underwriter with respect to such security.

15 U.S.C. § 77l provides in pertinent part:

Any person who—

. . . . . .

(2) offers or sells a security . . . by use of any means or instruments of transportation or communication in interstate commerce or the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

plead sufficient facts to come within the statute of limitations, *see* 15 U.S.C. § 77m, and has failed to allege the requisite privity to maintain a section 12(2) claim. Finally, defendants argue that Count III should be dismissed because at the time the Prospectus was issued, there was no fiduciary relationship between the defendants and plaintiff. For the following reasons, I find the allegations of the complaint, with one exception, to be legally or factually insufficient to state a claim upon which relief can be granted.

IV

[3-5] Under section 11 of the 1933 Act, if a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983). In contrast, a complaint based on section 10(b) of the Securities Exchange Act of 1934, the "catch-all" antifraud provision, *See Chiarella v. United States*, 445 U.S. 222 (1980), requires proof of *scienter*, *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, *reh'g denied*, 425 U.S. 986 (1976) (a private cause of action for damages will not lie under § 10(b) and Rule 10b-5 in the absence of any allegation of intent to deceive, manipulate, or defraud), and is subject to the pleading requirements of Rule 9(b), Fed. R. Civ. P. 9(b).[2] *See, e.g.*, *In Re Consumers Power Co. Securities Litigation*, 105 F.R.D. 583, 591-94 (E.D. Mich. 1985); *Seidel v. Public Service Co. of New Hampshire*, 616 F. Supp. 1342, 1355-57 (D.C.N.H. 1985). Claims grounded on sections 11 and 12 of the 1933 Act do not require such specificity of pleading. *Seidel*, 616 F. Supp. at 1357. The plaintiff in this case, however, has failed to make out a *prima facie* case, with one exception.

The complaint alleges that the Prospectus contained at least seven false or misleading statements. These allegations can be grouped loosely into two categories: false predictive statements and omissions. I will discuss each allegation in the order in which it appears in the complaint.

(a) there was no reasonable basis for the projected quarterly cash distribution of $1.00 per unit to the unit

2. Rule 9(b) provides:

In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other conditions of mind of a person may be averred generally.

holders based on the known or foreseeable cash flow from Commonwealth's operations.

[6-7] This first allegation concerns the projected minimum quarterly cash distributions to unitholders detailed in the Prospectus. SEC Rule 175 furnishes immunity from liability under the Securities Act and Exchange Act for good faith, voluntary disclosures "containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items" as long as they were made with a reasonable basis. 17 C.F.R. § 230.175(c)(1) (1988). This safe-harbor rule protects predictions which in fact prove to be wrong, but imposes liability where the predictive statement was "false" when made. *Isquith v. Middle South Utilities, Inc.*, 847 F.2d 186, 203-204 (5th Cir.), *cert. denied*, ___ U.S. ___, 109 S.Ct. 310 (1988). Falsity is determined by examining several factors—whether the prediction suggested reliability, bespoke caution, was made in good faith, or had a sound factual or historical basis. *Id.* at 204 (and cases cited *infra*).

Plaintiff here alleges that the projected income distributions were unreasonable based on Commonwealth's known or foreseeable cash flow. Neither the complaint in general nor this allegation presents sufficient "facts" to support plaintiff's conclusion. The Prospectus contained financial statements of the mortgage banking division of CSA and its subsidiaries for the previous three years, as well as statements of the financial condition of Commonwealth and CMCA at June 30, 1986. Plaintiff does not cite any misplaced reliance upon past performance or flaw in the methodology by which the projections were made. Moreover, the Prospectus itself indicated that the distributions would not necessarily be made from cash flow. It stated that:

> [i]n the future, in the event net cash flow from operations . . . is insufficient to fund the Expected Minimum Quarterly Distributions, Commonwealth Mortgage expects . . . to supplement its available cash for distributions through (i) the utilization of its working capital, (ii) borrowings, or (iii) the sale of additional Units or other securities to Commonwealth and third parties.

Prospectus at 5, 11-12.[3]

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3. Defendants have introduced the Prospectus, dated November 12, 1986,

Having made the income projections, the Prospectus nevertheless cautioned potential investors that:

> [a]lthough Commonwealth Mortgage expects to be able to distribute the Expected Minimum Quarterly Distributions through September 30, 1991, unanticipated events that affect current or future results of operations may make it necessary or advisable to suspend or reduce cash distributions below such levels.

Prospectus at 5, 12. And in a section entitled "Special Considerations," the Prospectus advised potential investors that:

> [a]lthough Commonwealth Mortgage currently intends to make quarterly cash distributions at certain levels, there can be no assurance that Commonwealth Mortgage will have sufficient cash to pay any such distributions. The amount and payment of any quarterly cash distribution will be made in the discretion of CMCA after considering various factors.

Prospectus at 9.

In considering all the information concerning income projections presented in the Prospectus, it appears to the Court that plaintiff has not alleged sufficient specific facts to support her conclusion that the income projections lacked a reasonable basis and were, therefore, "false" when made. This allegation does not state a claim of a false or misleading statement of material fact in violation of sections 11 and 12(2).

> (b) there was no reasonable basis to expect that Commonwealth's business strategy of ever more aggressive expansion through acquisitions, internal growth and purchases of loan administration contracts could continue without a major correction and without paying for the reckless and overly ambitious growth of Commonwealth prior to the offering.

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as an exhibit to their motion pursuant to Chancery Court Rule 10(c). The Court will consider the contents of the Prospectus in deciding the motion to dismiss as the plaintiff has relied upon this document and incorporated it by reference in her complaint. *See Lewis v. Straetz*, Del. Ch., C.A. No. 7859, Hartnett, V.C. (Feb. 12, 1986).

Plaintiff's second allegation regarding Commonwealth's business strategy is insufficient on its face. Plaintiff does not point to any actual projection or forward-looking statement made in the Prospectus that was false. Instead, she asserts in a conclusory fashion that the company's growth was overly ambitious and reckless and due for a reversal. The prospectus disclosed the history of Commonwealth's expansion. Plaintiff could have drawn these conclusions prior to investing. This allegation does not state a claim of a false or misleading statement of fact.

> (c) there was no reasonable basis to anticipate that Commonwealth's provision of $2.9 million for foreclosure losses in fiscal year 1986 was adequate since defendants knew or should have known the nature and geographic location of its loan portfolio and the manner in which the mortages [sic] therein were granted.

The Prospectus at page 35 stated that:

> [a]t June 30, 1986, $4,448,000 had been reserved for losses due to foreclosures, and Commonwealth Mortgage believes that such reserves are adequate to cover losses that result from its obligation to pay principal and interest under loan administration contracts.

The Prospectus disclosed elsewhere that in fiscal year 1986, provision for foreclosure losses increased $2.9 million as a result of an economic downturn in certain geographic areas and the significant increase of delinquent loans. Prospectus at 18. In fact, as the complaint alleges, during the fiscal year ending June 30, 1987, Commonwealth provided approximately $19.1 million to cover foreclosure losses.

Plaintiff claims that the defendants should have known that the increase of $2.9 million was materially inadequate in light of the continued economic downturn in certain of Commonwealth's real estate markets and the quality of its mortgage portfolio. In support of this, plaintiff elsewhere alleges that CSA's demand for growth prior to the offering and its commission structure pressured employees of Commonwealth to grant mortgages that carried with them excessive risk and that prudent underwriting standards were not followed.

[8] Drawing the reasonable inferences from these allegations in favor of the plaintiff, I find them sufficient to state a claim of a false or misleading statement of material fact. The Prospectus implied that the additional $2.9 million in reserves was adequate to cover increased losses under Commonwealth's loan administration con-

tracts. However, Commonwealth knew or should have known that the figure did not reflect the actual risk of loss which was greater due to the poor quality of its loan portfolio. There was, therefore, no reasonable basis for this financial projection and the statement was "false" when made. The statement was material in that there was a substantial likelihood that, under all the circumstances, a reasonable investor would have considered it important in reaching an investment decision. *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

> (d) there was no reasonable basis to imply that the existence of Commonwealth's CLCS System and its hedging activities could provide Commonwealth and the unitholders with assurance that any losses from exposure to interest rate fluctuations or other losses would be minimal since defendants knew or should have known that Commonwealth's management and operating controls were inadequate to cope with the increasingly large volume of mortgage loan originations being generated;

Again, the complaint is deficient in that plaintiff does not point to any particular factual statement or financial prediction which is false. Nor is it reasonably possible to infer from the overall language in the Prospectus that investors were given misleading assurances of minimal losses. A review of the Prospectus reveals that no assurances were given and that the potential hazard of interest rate fluctuations was clearly disclosed.

> Commonwealth Mortgage is subject to the risk of interest rate movements from the time an interest rate commitment is made to a borrower until the time the loan is sold. . . . In an attempt to minimize the adverse effects of interest rate movements, Commonwealth Mortgage engages in hedging activities. . . . Using the CLCS system, management is able on a daily basis to compare the principal dollar amount of Commonwealth Mortgage's uncommitted mortgage portfolio against the current market value of such portfolio and, on the basis of such comparison, take appropriate hedging action. Commonwealth Mortgage believes that it has been generally successful in its hedging activities in that it has not experienced material losses on its warehouse of mortgage loans due to interest rate movements. Although management is experienced in hedging transac-

> tions, *there can be no assurance* that it will successfully offset the adverse effects of interest rate movements. Accordingly, Commonwealth Mortgage may experience either gains or losses as a result of its hedging operations.

Prospectus at 39 (emphasis added). Plaintiff's fourth allegation does not state a claim upon which relief can be granted.

> (e) there was no disclosure of the fact that the members of the defendant class used selling scripts and other means to "pre-sell" the offering to members of the plaintiff class to artificially generate enthusiasm for the offering, all of which resulted in a known "overallotment" of 1.3 million units and artificially high market prices in the after-market.

[9-10] This allegation falls within the omission category of claims. However, not every omission from a prospectus is actionable under sections 11 and 12(2). *See Greenapple v. Detroit Edison Co.*, 468 F. Supp. 702, 708 (S.D.N.Y. 1979), *aff'd*, 618 F.2d 198 (2d Cir. 1980). An omission is not actionable unless there is a material fact omitted and unless the material fact that is omitted adversely affects the reliability of other statements. *Id.* I find the alleged omission here not material as a matter of law. How the offering is marketed is not likely to be relevant to the investment decision. Even if it were, plaintiff does not show how this omission affected the reliability of other statements in the Prospectus. Finally, the Prospectus disclosed that up to 1.95 million additional Class A Units might be issued to cover overallotments, that is, 650,000 more than were actually sold. This allegation does not state a claim upon which relief can be granted.

> (f) there was no disclosure of CSA's deteriorating financial and operating condition, all of which was leading CSA to insolvency, thus necessitating the offering as a means for CSA to raise operating capital and, further, that after having raised funds from plaintiff and plaintiff class, to propose a plan to merge CSA into Commonwealth.

The Prospectus did, in fact, include statements from the three previous fiscal years of the financial condition and operations of CSA's mortgage banking division, whose assets were contributed to Commonwealth during the offering. Prospectus at F-4 - F-17. This information was clearly material to the offering of Commonwealth

Units. The question remains whether the Prospectus should have disclosed additional financial data to have enabled prospective investors to analyze the overall financial condition of CSA. CSA and Commonwealth, however, are autonomous entities and any additional information would not have been relevant to prospective investors in Commonwealth. Plaintiff attempts to avoid this conclusion by alleging that CSA is pursuing a plan to merge with Commonwealth. I will assume, for the purposes of this motion, that the proposed merger would not be in the best interests of the plaintiff class. If the merger were, nevertheless, consummated, the plaintiff class would have a remedy for breach of fiduciary duty against CSA, through CMCA as general partner and majority unitholder. The availability of such relief, therefore, militates against finding disclosure of CSA's overall financial condition material as a matter of law to the investment decision. This allegation, therefore, fails to state a claim.

> (g) there was no adequate disclosure of the prices CSA paid General Electric Mortgage Corporation ("GEMC") and JMC as a result of purchases of approximately $2.5 billion and $1.5 billion in net servicing rights respectively. Although the Prospectus disclosed that the "pro forma net tangible book value per Class A Unit" at June 30, 1986 was $2.12 per unit, prospective investors could not determine the extent to which such value reflected the acquisitions from GEMC and JMC or the relative prices paid for their servicing portfolios. Such disclosure could have enabled investors to make meaningful comparisons between the prices paid by CSA to sophisticated sellers negotiating on an arm's-lenth [sic] basis and what it and its fellow defendants were charging to the public for a portion of such businesses in the offering.

A review of the Prospectus shows that purchase prices of GEMC and JMC were disclosed at pages F-6, F-12 and F-41, as well as the various financial statements of the residential mortgage banking divisions of GEMC and JMC. This allegation, therefore, fails to state a claim upon which relief can be granted.

To sum up, Counts I and II, alleging violations of sections 11 and 12(2), respectively, of the Securities Act, are dismissed for failure to state a claim upon which relief can be granted, except for those portions of the complaint based on the allegation contained in subparagraph 36(c).

V

[11] The defendants also assert as grounds for dismissing plaintiff's securities claims that they are barred by the statute of limitations found in section 13 of the Securities Act, 15 U.S.C. § 77m. This section provides in relevant part:

> No action shall be maintained to enforce any liability created under section [11 or 12(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . .

Plaintiff filed suit on January 5, 1988. In her complaint, plaintiff alleges that this action was commenced "within one year of the time any Plaintiff Class members could have learned of the wrongs alleged herein." Plaintiff argues that in paragraph 32 of the complaint, she plead the precise date when she was put on notice of the falsity of the Prospectus. That date was September 25, 1987, when a news release first disclosed that Commonwealth would report a $10 million loss for the fiscal year ended June 30, 1987. These allegations, however, are insufficient to conform to the requirements of section 13.

[12] A proper complaint should include: (1) allegations as to the time and circumstances of discovery of the alleged untrue statement or omission; (2) the reasons why discovery was not made earlier if more than one year has elapsed since the alleged untrue statement or omission was made; and (3) the diligent efforts which plaintiff undertook in making or seeking such discovery. *Hill v. Der*, 521 F. Supp. 1370, 1389 (D. Del. 1981); *Brick v. Dominion Mortgage & Realty Trust*, 442 F. Supp. 283, 292 (W.D.N.Y. 1977); *Kroungold v. Triester*, 407 F. Supp. 414, 419 (E.D. Pa. 1975). In the instant case, the one year time period began to run at the latest on Sept. 25, 1987. However, plaintiff has failed to plead any facts to show whether or not discovery might have been made earlier or what efforts she undertook in seeking such discovery. Accordingly, those portions of Counts I and II that have survived the motion to dismiss for failure to state a claim will be dismissed with leave to amend to plead sufficient facts to satisfy the statute of limitations.

VI

Defendants also argue as grounds for dismissing Count II that plaintiff has failed to allege the requisite privity to maintain her section 12(2) claim. Section 12(2) provides that "[a]ny person who

. . . (2) offers or sells a security . . . shall be liable to the person purchasing such security from him . . . ." 15 U.S.C. § 77l(2). Defendants cite *Collins v. Signetics Corp.*, 605 F.2d 110 (3d Cir. 1979), for the proposition that a purchaser not in privity with the issuer of a security has no claim under § 12(2) against that issuer. According to the defendants, since plaintiff failed to allege that she purchased her Units from any of the non-underwriter defendants and since the Prospectus discloses that a firm underwriting agreement was in place, plaintiff's only section 12(2) claim is against the underwriter defendant class.

Plaintiff has argued that a recent United States Supreme Court case, *Pinter v. Dahl*, ___ U.S. ___, 108 S.Ct. 2063 (1988), extending liability as a "seller" under section 12(1) to those who successfully solicit purchases of securities, applies to this case. According to plaintiff, the rationale underlying *Pinter*, that is, the recognition that the purpose of the Securities Act is to promote full and fair disclosure to prospective purchasers, mandates finding the defendants Commonwealth, CSA and CMCA liable as "sellers" since they were responsible for the contents of the Prospectus.

An examination of the complaint reveals, however, that in paragraph 9, plaintiff did allege that "14,300,000 Class A Units were sold by CSA to plaintiff and members of Plaintiff Class in the Offering." Thus, plaintiff has alleged sufficient privity between CSA and the plaintiff class to survive the motion to dismiss as to this defendant.

[13] As to the remaining non-underwriter defendants named in this count, CMCA and Commonwealth, there is no basis for liability to be found in the pleading. Even were I to rule *Pinter* applicable to a section 12(2) claim, as some courts have done, *see Capri v. Murphy*, 856 F.2d 473 (2d Cir. 1988); *but see In re Craftmatic Securities Litigation*, No. 88-4530 (E.D. Pa. Jan. 13, 1989) (1989 U.S. Dist. Lexis 385), plaintiff's argument as to the reach of *Pinter* is not persuasive. In *Pinter*, the United States Supreme Court reviewed the relevant language of section 12(1) which is identical to the language in 12(2). 108 S.Ct. 2063, 2075-78 (1988). The Court found that the phrase "any person who . . . offers or sells a security" contemplates at the very least the traditional buyer-seller relationship, imposing liability on the owner who passed title, or other interest in the security, to the buyer for value. *Id.* at 2076. However, the Court further extended liability "to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner," such as a broker or

securities vendor's agent. *Id.* at 2079. Plaintiff's complaint is devoid of a showing of any such solicitation or promotion by CMCA or Commonwealth. In contrast, the complaint describes in some detail the "dog-and-pony road shows" conducted by sales personnel on behalf of the defendant class of underwriters. Nor do CMCA or Commonwealth come within the definition of "controlling persons" jointly liable with CSA under sections 11 or 12(2) by virtue of section 15 of the Securities Act, 15 U.S.C. § 77o. Therefore, that portion of Count II that survived the motion to dismiss for failure to state a claim is dismissed as to defendants CMCA and Commonwealth.

VII

Finally, defendants contend that Count III of plaintiff's complaint must be dismissed. In Count III, plaintiff alleges that CSA, CMCA and the individual defendants are liable for breach of fiduciary duty as a result of the alleged misrepresentations and omissions in the Prospectus. At the time the Prospectus was issued, however, the. plaintiff class had not yet become minority holders of the Class A Units and, defendants argue, were therefore not owed any fiduciary duty. *See, e.g.*, *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, Del. Ch., 521 A.2d 624 (1987), *aff'd*, Del. Supr., 645 A.2d 1171 (1988).

[14] I agree with the defendants and find plaintiff's arguments and authorities purportedly to the contrary neither persuasive, *see, e.g.*, *Heston v. Miller*, Del. Ch., C.A. No. 5820, Hartnett, V.C. (Oct. 11, 1979); *Swain v. Moore*, Del. Ch., 71 A.2d 262 (1950), nor apposite. *See, e.g.*, *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985); *Lynch v. Vickers Energy Corp.*, Del. Supr., 383 A.2d 278 (1977). Plaintiff's additional argument that, once the plaintiff class had invested in Commonwealth, defendants violated their duty of complete candor by failing to correct the alleged misrepresentations and omissions in the Prospectus is also unavailing. The defendants are not required to admit wrongdoing before it is properly determined in a court of law whether in fact the securities laws were violated. *Cf. Weinberger v. United Financial Corp.*, Del. Ch., C.A. No. 5915 (1979), Hartnett, V.C. (Oct. 13, 1983).

Plaintiff has requested leave to amend her complaint to state a claim for common law fraud in the event this Court finds that no fiduciary duty was owed to the plaintiff class. Plaintiff argues that the allegations in her complaint are sufficient to satisfy the elements of such a claim. As the complaint now stands, plaintiff has failed to allege the elements of fraud with sufficient particularity to withstand

a motion to dismiss. *See Stephenson v. Capano Development, Inc.*, Del. Supr., 462 A.2d 1069 (1983); Chancery Court Rule 9(b). The Court, however, will not refuse to consider an appropriate motion for leave to amend the complaint.

VIII

Except for those claims based on subparagraph 36(c) of the complaint, Counts I and II are dismissed for failure to state a claim upon which relief can be granted. The surviving claims under Counts I and II are dismissed with leave to amend to allege compliance with the statute of limitations. Count II is dismissed as against defendants CMCA and Commonwealth. Count III is dismissed for failure to state a claim upon which relief can be granted.

IT IS SO ORDERED.

HAMMERSMITH v. ELMHURST-CHICAGO STONE CO.

No. 10,837

Court of Chancery of the State of Delaware, New Castle

August 17, 1989

At a special shareholder's meeting to amend the bylaws, the plaintiff and his brother could not agree, as co-trustees of a majority of the outstanding shares of stock, how to vote on the amendments. In cross motions for summary judgment, the plaintiff claimed that the trust stock shares, although not voted, should be counted for purposes of determining the number needed to obtain a majority vote. The defendant claimed that the trust stock shares should not be counted to determine the necessary vote.

The court of chancery, per Vice-Chancellor Berger, held that the unvoted shares were not entitled to be counted in determining the necessary vote, thus the court granted summary judgment for the defendant. The court found that stock held by the co-trustees should be counted in determining a quorum. However, the co-trustees would be treated as limited proxy holders because they failed to agree on how the trust shares should be voted.

1. Corporations ⟹ 195, 198(5)

Where shares of stock are represented at a meeting by a limited proxy, those shares will be counted in determining the presence of a quorum but they will not be included in the calculation of the voting power present for any vote that is beyond the authorization of the limited proxy. DEL. CODE ANN. tit. 8, § 216 (Supp. 1988).

2. Corporations ⟹ 195, 198(5)

Co-trustees, who are unable to agree as to how shares held by a stock trust should be voted, are far more similar to that of a limited proxy holder, than to that of an individual stockholder who chooses not to vote.

3. Corporations ⟹ 198(5), 198.1(5)

Where neither co-trustee, acting alone, is empowered to cast a vote with respect to the trust shares, and the two co-trustees are unable to act together, the trust shares are not entitled to vote.

Allen M. Terrell, Jr., Esquire, Anne C. Foster, Esquire, and Frederick L. Cottrell, III, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Chapman & Cutler, Chicago, Illinois, of counsel, for plaintiff.

Bruce M. Stargatt, Esquire, and William D. Johnston, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and D'Ancona & Pflaum, Chicago, Illinois, of counsel, for defendant.

BERGER, *Vice-Chancellor*

This is the decision on cross motions for summary judgment in an action brought pursuant to 8 *Del. C.* § 225 to determine the results of certain votes taken at a special stockholders' meeting of Elmhurst-Chicago Stone Company (the "Company"). Plaintiff, George F. Hammersmith, Sr. ("George, Sr.") is battling with his brother, Charles P. Hammersmith, Sr. ("Charles, Sr.") for control of this family run business. The issue presented is whether certain trust shares, which were present at the meeting but were not voted,

should be counted for purposes of determining the number needed to obtain a majority vote. If George, Sr. were to prevail on his claim that the unvoted shares should be counted, the result would be that no corporate action was taken at the special meeting and George, Sr. would be able to effectively veto any other stockholder action. For the reasons that follow, however, I find that the unvoted shares should not be counted in determining the necessary vote and summary judgment will be entered in favor of the Company.

The relevant facts, which are undisputed, may be summarized as follows. The Company, a Delaware corporation with its principal place of business in Illinois, is engaged in the washed sand and gravel, concrete sewer pipes and ready-mixed concrete businesses. There are 391 issued and outstanding shares of the Company's stock. George, Sr. and his children own 91.86 shares, whereas Charles, Sr. and his children own or control 114.28 shares.[1]. Pursuant to a 1975 trust instrument, 160 of the remaining outstanding shares are held in equal trusts for the benefit of Charles, Sr., George, Sr. and their sister, Mary Rybus ("Mary"). George, Sr. and Charles, Sr. are the co-trustees of these trusts.[2]

By notice dated May 3, 1989, Charles, Sr., as President of the Company, called a special meeting of stockholders, to be held on May 15, 1989, for the purpose of amending the bylaws in various respects (including changing the number of directors) and electing directors. George, Sr. responded to the notice by seeking a preliminary injunction in the Illinois action to prevent Charles, Sr. from taking any action at the special stockholders' meeting. Judge Teschner denied the motion and ordered both Charles, Sr. and George, Sr., in their capacities as trustees, to attend the May 15, 1989 meeting. By the same order, Judge Teschner ruled that neither Charles, Sr. nor George, Sr. could vote the trust shares unless they both agreed on how to vote. *See Hammersmith, et al. v. Hammersmith, et al., supra,* (May 12, 1989) (ORDER).

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1. Charles, Sr. and his children own 91.86 shares and ECS Acquisitions, Ltd., whose sole stockholder is Charles, Sr.'s son, owns 22.42 shares.

2. In related litigation, both in this Court and Illinois, George, Sr. claims that his son is also a trustee of the trusts. *See Hammersmith v. Elmhurst-Chicago Stone Co.*, Del. Ch., Civil Action No. 9705 and *Hammersmith, et al. v. Hammersmith, et al.*, Ill. Cir. Ct., No. 88 CH 0190. However, both parties agree that the present controversy may be decided without addressing those claims.

All shares were present, in person or by proxy, at the May 15, 1989 special stockholders' meeting. Thus, there is no question but that a quorum existed. As noted at the outset, the 160 trust shares were not voted. At the meeting, counsel for George, Sr. stated that George, Sr., in his capacity as co-trustee, would not be voting the trust shares. Charles, Sr. announced that, in his capacity as co-trustee, he would have voted the 160 trust shares in favor of the proposed amendments. The Inspector of Election, who was also counsel to the Company, determined that the 160 trust shares were not entitled to vote in light of the Illinois court order requiring agreement among the co-trustees and the fact that no such agreement had been reached. Accordingly, the Inspector of Election announced that the amendments to the bylaws had been approved with 139.14 shares voting in favor, 91.86 shares voting against and 160 shares not entitled to vote.

George, Sr. registered his objection to the vote at the meeting and commenced this action two days later. He claims that no corporate action was taken at the stockholders' meeting because the 139.14 shares voted in favor of the bylaws amendments, for example, do not constitute a majority of the 391 shares present at the meeting. If George, Sr.'s interpretation were adopted, the failure to vote the 160 trust shares effectively would count as 160 "no" votes. The Company argues that, since the co-trustees were unable to agree upon how to vote the 160 trust shares, those shares became "not entitled to vote." The Company contends that, by analogy to the limited proxies in *Berlin v. Emerald Partners*, Del. Supr., 552 A.2d 482 (1989), the 160 trust shares should not be counted in deciding whether a majority vote was obtained.

[1] In *Berlin*, a stockholder brought suit to enjoin the consummation of a merger between the defendant corporation and several companies owned by a large stockholder of defendant. Plaintiff claimed that the merger was invalid because a supermajority vote, allegedly required for this particular transaction, was not obtained. The Delaware Supreme Court held that the supermajority vote provision was not applicable. However, after assuming for the sake of argument that the supermajority vote provision did apply, the Court went on to analyze the potential differences in counting shares for a quorum as opposed to a vote. The specific holding was that, where shares of stock are represented at a meeting by a limited proxy, those shares will be counted in determining the presence of a quorum but they will not be included in the calculation of the voting power present

for any vote that is beyond the authorization of the limited proxy. In reaching this conclusion, the Supreme Court noted that 8 *Del. C.* § 216[3] recognizes this distinction in counting shares:

> Section 216 evidences both a legislative recognition of and an authorization for corporations to differentiate between the greater "universe" of voting shares which are necessary to satisfy a quorum requirement and the "universe" of shares present in person or by proxy "entitled to vote on the subject matter."
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> [A] stockholder who is present by proxy for quorum purposes may not be voting power present for all purposes. Voting power present is synonymous with the number of shares represented which are "entitled to vote on the subject matter." 8 *Del. C.* § 216(2) (Supp. 1988). A stockholder who is present in person *or* represented at a meeting by a *general* proxy, is present for quorum purposes *and* is also voting power present on all matters. However, if the stockholder is represented by a *limited* proxy and does not empower its holder to vote on a particular proposal, then the shares represented by that proxy cannot be considered as part of the voting power present with respect to that proposal.

Berlin v. Emerald Partners, 552 A.2d at 492-493.

In applying the *Berlin* legal analysis to the facts of this case, the question is whether or not the trust shares were "entitled to vote." As George, Sr. sees it, the answer must be that they were since the

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3. Section 216 provides, in relevant part:
Subject to this chapter in respect of the vote that shall be required for a specified action, the certificate of incorporation or bylaws . . . may specify the number of shares . . . having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business. . . . In the absence of such specification in the certificate of incorporation or bylaws of the corporation:

(1) A majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders;

(2) In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders; . . . .

co-trustees had full authority to vote on any matter as to which they were able to agree. According to George, Sr., the fact that the co-trustees were unable to agree and, therefore, cast no vote should have no bearing on the determination of whether the trust shares were entitled to vote. George, Sr. contends that the failure to vote the trust shares, like any other abstention, counts as a "no" vote with the result that the bylaws amendments were defeated.

[2-3] George, Sr. makes a valid point when he distinguishes between a limited proxy holder who has no authority to vote on certain issues and the co-trustees here, who had full authority to vote on all issues if they are able to agree. However, when the co-trustees are unable to agree, their situation is far more similar to that of a limited proxy holder than it is to that of an individual stockholder who chooses not to vote. The word "abstain" is defined as "to withhold oneself from participation, to forebear or refrain voluntarily . . . ." Webster's International Dictionary (2d ed). Here, there has been no voluntary decision not to vote. To the contrary, Charles, Sr. stated at the meeting that he would have voted the trust shares in favor of the proposed amendment. He was unable to do so because George, Sr. did not agree to vote the trust shares in that fashion. Under these circumstances, I find that the trust shares were not entitled to vote in the sense that there was no one empowered to cast a vote with respect to those shares. Neither co-trustee, acting alone, was empowered to do so, and the two co-trustees were unable to act together.

Based upon the foregoing, and following the rule in *Berlin*, I find that the 160 trust shares should not have been counted in determining whether a majority of the votes were cast in favor of the proposed bylaws amendments. Accordingly, judgment is entered in favor of defendant.

IT IS SO ORDERED.

HERD v. MAJOR REALTY CORP.

No. 10,797

Court of Chancery of the State of Delaware, New Castle

June 23, 1989

(Written Decision June 27, 1989)

This action was brought by the plaintiff as part of his attack on the proposed merger between Major Realty Corporation (Major) and an investment group. The plaintiff filed a motion for a temporary restraining order prohibiting Major from selling properties belonging to the corporate assets. The plaintiff claimed that the proposed transaction was for an inadequate price, deprived the corporation of valuable assets, and was a subterfuge to help the potential acquirer meet its financial obligations under the merger agreement.

The court of chancery, per Vice-Chancellor Chandler, held that the plaintiff failed to meet the three standards required for the issuance of a temporary restraining order. The court found that the price offered for the land was at least fair market value; the selling of land is a regular part of the defendant corporation's business activities; and there was no evidence in the record to support the claim that the transaction would enhance the investment group's financial ability with respect to the merger.

1. Injunction ⟹ 14, 136(1)

For a party to be entitled to the extraordinary relief of a temporary restraining order, it must demonstrate a reasonable probability of success on the merits, a likelihood of irreparable injury if injunctive relief is denied, and that the balance of hardships tips in the moving party's favor.

2. Corporations ⟹ 310(1)

The conduct of the regular business of a corporation should be left to its directors.

3. Corporations ⟹ 310(1), 312(5)

There is ordinarily a presumption that the directors of a corporation involved in the sale of real estate have acted in the cor-

poration's best interest in proposing a sale of part of the corporation's assets.

Joseph A. Rosenthal, Esquire, of Morris, Rosenthal, Monhait & Gross, P.A., Wilmington, Delaware; and Stephen D. Oestreich, Esquire, and Chet B. Waldman, Esquire, of Wolf, Popper, Ross, Wolf & Jones, New York, New York, for plaintiff.

Randolf K. Herndon, Esquire, Jean C. Kissane, Esquire, and David Augustine, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and Samuel Kadet, Esquire, and Jeremy A. Berman, Esquire, of Skadden, Arps, Slate, Meagher & Flom, New York, New York, for defendants Major Realty Corp., Warren M. Cason, Charles L. Knight, and Thomas E. Weaver.

Charles F. Richards, Jr., Esquire, William J. Wade, Esquire, Daniel A. Dreisbach, Esquire, and Frederick L. Cottrell, III, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Steven B. Feirson, Esquire, and Arthur S. Gabinet, Esquire, of Dechert, Price & Rhoads, Philadelphia, Pennsylvania, for defendants Jeffrey P. Jorissen, Garry K. Stolicker, Randon A. Samelson, Major Acquisition Corp., Samelson Real Estate Partners, Inc. and Stoneridge Resources, Inc.

CHANDLER, *Vice-Chancellor*

This is the Court's written decision on plaintiff's motion for a temporary restraining order prohibiting the defendant Major Realty Corporation ("Major") from selling three parcels of Major's real estate assets ("the properties").[1] Because an oral agreement to sell the properties has been reached with an investment group and a written contract is about to be executed, Major and the other defendants vigorously contest the motion and urge the Court to deny it promptly.

The application for temporary injunctive relief is actually an offshoot of the heart of this litigation, which involves an attack on a proposed merger between Major and defendant Major Acquisition Corporation ("MAC"). That merger, as yet unconsummated, would

1. The application was denied in a bench ruling following oral presentation of the motion.

provide each Major stockholder the option to either receive $13.40 per share ($13.50 if the merger takes place after July 31, 1989) or to retain an equity interest in the surviving corporation.

The plaintiff, a stockholder in Major, filed the complaint in this case on March 22, 1989, shortly after the merger agreement was executed. Recently the plaintiff filed a proposed amended complaint asserting that the $13.40 merger price is "grossly inadequate" and that Major and its directors unfairly favored the Major-MAC merger agreement and failed to encourage other potential purchasers. Plaintiff also alleges that another company, Central Realty Investors, Inc. ("Central Realty"), has expressed a possible interest in acquiring all of Major's stock at $13.50 per share. On June 14, 1989, however, Major and MAC announced that MAC had secured the necessary financing commitments and the merger would be consummated. Two days later, Major's board approved the sale of the properties which are the subject of the instant motion to an investment group for approximately $21 million. Plaintiff's motion seeks to prevent Major from completing the sale of the properties, contending that the sale is at less than fair market value, that the sale may have a substantial impact on Central Realty's and other potential purchasers' interest in Major, and that the sale's real purpose is to assist MAC in meeting its financial commitments in connection with the merger.

A review of the developments leading to the proposed sale of the properties, as revealed in undisputed affidavits submitted by two of Major's directors (Jorissen and Weaver) will be helpful to understanding the parties' contentions.

Major, a Delaware corporation with its principal executive offices in Orlando, Florida, develops, owns, leases and sells developed and undeveloped real estate directly and through joint ventures and partnerships. It has approximately 7.3 million shares of common stock outstanding, which are held by the company's approximately 8,200 record stockholders, and has assets valued at more than $100 million. Defendant MAC is a corporation newly formed by an affiliate of defendants Stoneridge Resources, Inc. and Samelson Real Estate Partners, Inc. for the purpose of acquiring Major Realty. The individual defendants are directors of Major Realty and defendant Lawing is also the president and chief executive officer of Major.

Major has significant assets consisting of undeveloped real property that do not generate cash flow. As a result, Major's income recently has not been sufficient to meet current expenses, including interest payments on mortgages. Major thus has resorted to selling real estate holdings in order to finance part of its operations and

debt. For a significant period of time, Major has endeavored to sell its "Republic Square" shopping center, comprised of about 11 acres in an area known as the Florida Center in Orlando. After it entered into the merger agreement with MAC, Major received from an unidentified investment group an offer to purchase several properties, including Republic Square, Major Park Plaza, and another parcel of vacant land. Initially, Major's board took no action regarding the offer because the merger agreement with MAC included a covenant that Major would not, without MAC's consent, sell assets for consideration greater than $11 million and MAC's representatives had not had an opportunity to determine whether the proposed purchase price was advantageous to Major. The initial offer for the property expired on April 28, 1989. In early June, Major sold a portion of the Republic Square property for $2.5 million. The investment group then made a new offer for the remainder of the three parcels, for $21 million net of commissions.

Advised of this new offer, MAC's representatives consented to the proposed sale, subject to approval by Major's board. The board approved the sale on June 14 on two conditions: 1) that the investment group propose a definitive sales agreement for a price not less than $21 million, and 2) that MAC assure Major that the sale would not adversely affect MAC's financing commitments for the merger. The investment group eventually increased its offer to $21.5 million net of commissions.

A majority of Major's disinterested board[2] believed the sale to be in Major's best interest because it will enable Major to pay its debts as they become due, because the Republic Square property has been a consistent cash drain to Major, because it was highly unlikely that a substantially higher price could be obtained and because the $21 million price constituted fair value for the properties. In addition, the Florida National Bank has been threatening to foreclose on about $5.8 million in loans secured by the Republic Square property, adding to the board's concern that the property should be sold so as to avoid the reduced price normally occasioned by foreclosure sales. Accordingly, on June 21, 1988, the investment group and Major informally agreed on the essential terms and conditions of a contract for the sale of the subject properties for $21.5

2. Three of Major's eight directors are designees of defendants Samelson Real Estate Partners, Inc. or its affiliates, the entities involved in the effort to purchase Major through MAC.

million net of commissions, subject to approval by Major's board. Plaintiff immediately filed his motion for an order restraining consummation of the property sale until a final hearing on plaintiff's motion to enjoin the merger agreement.

[1] For a party to be entitled to the extraordinary relief of a temporary restraining order it must demonstrate a reasonable probability of success on the merits, a likelihood of irreparable injury if injunctive relief is denied, and that the balance of hardships tips in the moving party's favor. *Revlon, Inc. v. McAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 179 (1986).

Plaintiff's request for temporary injunctive relief is based on his claim that Major's sale of the properties is for an inadequate price, that consummation of the sale will deprive major of valuable assets and thereby possibly affect adversely Central Realty's or other potential purchasers' interest in acquiring all of Major's stock, and that the sale is a subterfuge to assist MAC in meeting its financial commitments under the Major-MAC merger agreement. Based on the undisputed facts and record before me, plaintiff has not met any of the three standards required for issuance of a temporary restraining order.

As recited earlier, plaintiff contends that Major is "frantically attempting to sell" the properties because MAC's financing commitments are contingent upon their sale. The only purpose for the sale, according to plaintiff, is to assist MAC's financing of its allegedly inadequate bid to purchase outstanding shares of Major and to "place road blocks" in the paths of potential third-party bidders (such as Central Realty) who are interested in making a tender offer at a higher price. Without a restraining order preserving the status quo—that is, forcing Major to retain its existing assets and stopping it from selling valuable properties at an allegedly inadequate price—plaintiff will be permanently denied an opportunity to obtain the maximum value for his Major stock as a result of a full and fair arm's-length auction of Major. In effect, plaintiff wants this Court to freeze Major's business (which plaintiff's own complaint describes as involved in the development, sale and leasing of real estate) long enough for other third-party bidders to step forward and make an offer for Major or until this Court has had an opportunity to pass on the merits of plaintiff's underlying complaint attacking the Major-MAC merger agreement.

[2-3] I note initially that the defendants have vigorously challenged many of the most critical factual assertions underlying the plaintiff's application for injunctive relief. The opposing affidavits

submitted by defendants Jorissen and Weaver paint a very different picture of the reasons for the sale and the arm's-length nature of the transaction. I think it is fair to say, however, that there is no dispute that the sale of the property was at arm's-length, involving a party unconnected to any of the principals involved in the merger agreement between MAC and Major. The defendants flatly deny, moreover, that the sale has any connection to the merger or that the $21.5 million sale price is less than full and fair value for the properties. Defendants' affidavits point out that the sale would help Major avert a projected $4 million negative cash flow over the next two years and actually produce a benefit to Major of over $1 million, when reduced to present value. Plaintiff's affidavits, which are largely based on information and belief rather than personal knowledge, only suggest that the properties may be sold for less than fair market value and are actually worth "substantially more" than the price offered. Plaintiffs' affidavits also fail to make it unequivocally clear that Central Realty or any other potential bidder for Major will be deterred from making a bid if the sale of the properties is completed. Defendants' affidavits, in contrast to the plaintiff's, are based on personal knowledge and unequivocally state that the sale price reflects at least full and fair market value. The present record, moreover, supports the view that Major's board has approved the sale of the subject properties as part of the regular conduct of Major's business. Plaintiff admits that Major's business includes the purchase and sale of developed and undeveloped real estate. And the familiar rule in such circumstances is that the conduct of the regular business of a corporation should be left to its directors. Plaintiff has offered no concrete facts sufficient to dislodge the ordinary presumption that the directors of a corporation involved in the sale of real estate have acted in the corporation's best interest in proposing a sale of part of the corporation's assets. *See Auerbach v. Earth Energy System, Inc.*, Del. Ch., C. A. No. 8568, Jacobs, V.C. (Aug. 19, 1986). Plaintiff's contention that the properties are being sold at less than fair market value is not supported by the record.

Nor does the record support the claim that the sale of the properties is intended to enhance MAC's financial ability to carry out the merger agreement. Affidavits by Messrs. Weaver and Jorissen clearly state that the property sale has no connection with MAC's financing commitments. All that plaintiff can manage is the argument that it must be connected because the timing of the sale mirrors the expected closing under the merger agreement. But the affidavits demonstrate that the sale of the properties at this particular time

may actually have caused MAC more difficulties in making its financing commitments because the properties were expected to form part of the collateral for the commitments. Nor is it apparent on the present record how the sale of the properties will prevent third parties interested in acquiring all of Major's outstanding stock from making such an offer. To the extent that Major's financial condition is improved as a result of the sale, that improvement should enhance its attractiveness to any interested third party, including Central Realty. And from a purely economic perspective, why would MAC consent to a sale of properties by Major at a price that was inadequate or clearly below value since its interest would be best served by a sale that maximizes the return on Major's assets. In that sense, a sale of the properties resulting in an improved financial condition for Major redounds equally to the benefit of all interested parties and does not, on its face, appear to benefit the interested defendants to the exclusion of third-party bidders.

It is the case that after the sale Major will have less real estate and more cash, but that is a quite ordinary condition of its business. Plaintiff suggests, however, that third parties will have less interest in Major after the sale because it is a more attractive company with these assets than with cash. A real estate business, however, buys and sells property in the daily course of its business. The relevant question is whether Major's sale of these particular assets brings an attractive rate of return on its investment, that is, will it obtain a beneficial value for the asset? If it does, the company's worth is enhanced, not injured, a fact that should attract potential suitors. Even the affidavit by Mr. Murphy, Central Realty's president, does not state that it will have no interest in Major after the sale; instead, he indicates only that Central Realty will have to "re-evaluate" its position if the sale is consummated. It does not seem reasonably probable, therefore, that plaintiff will prevail on the merits of his claim.

It also does not appear likely that plaintiff can demonstrate that irreparable injury will be caused to Major if the sale is not enjoined. Plaintiff contends that potential bidders for Major will be deterred from making a bid if the properties are sold. The implication is that such deterred bidders might have offered a higher price for shares of Major's stock and, consequently, shareholders will lose an opportunity to obtain a maximum price for their stock. That lost opportunity, plaintiff seems to argue, is an irreparable injury. Although there is some appeal to this argument, there is nothing in the record to support it. As recited earlier, the record supports the