case, the *Smith* Disclosure claim award should also be considered as being part of what the non-dissenting shareholders received.

A similar factor to be considered is the $0.25 per share received from the *Smith* Dividend claim settlement. The class in the *Smith* Dividend claim consists of all of Shell's minority shareholders who did not opt out of the class, including those who did nothing and those who sought an appraisal. Because that settlement resulted in a benefit to all stockholders, it should be considered as being part of the benefit received by the non- dissenting stockholders. Petitioners' counsel, however, have already been amply rewarded for their efforts in pursuing the Dividend claim and to consider it as being part of the value of the appraisal award benefit would result in the payment of double attorney fees for the same work. The *Smith* Dividend benefit of $0.25 should therefore not be considered as being part of the appraisal benefit.

In summary, for the purpose of awarding attorney fees in this appraisal action the Court will assume that those stockholders who did not dissent from the merger and did not seek an appraisal received $62.25, disregarding certain attorney fees and interest. It is further assumed that those stockholders who did seek an appraisal will receive $71.20 per share, disregarding interest and *pro rata* attorney fees.

IV

A more difficult issue, in the determination of an appropriate attorney fee here, is whether the amount of interest received by the appraisal class should also be considered to be part of the value of the benefit awarded to the appraisal class, and if so, what rate of interest is to be used.

[11] This issue is complicated because unless an appraisal action is brought in bad faith the Court is likely to award a fair rate of interest. *See Felder v. Anderson, Clayton & Co.*, Del. Ch., 159 A.2d 278, 286 (1960).

The award of interest here was not, therefore, entirely due to the efforts of petitioners' counsel. On the other hand, counsel had a critical role in convincing the Court of the particular rate of interest awarded.

It would be unfair to petitioners' counsel to eliminate all the interest awarded from the calculation of the value of the benefit resulting from this litigation. In the award here, interest accounted for approximately 40% of the $121.27 per share to be received by each shareholder.

[12] The success of counsel in an appraisal action in obtaining the best possible rate of interest for the client is obviously of critical importance in determining the benefit achieved given the protracted nature of appraisal proceedings. The Court therefore must, on a case-by-case basis, attempt to ascribe an estimated value of the benefit, if any, that accrues from the award of interest.

Nor should the value of the interest benefit here be computed by merely comparing the amount of interest actually awarded with the amount that would have been awarded had Shell's position at trial been adopted by the Court because the award of interest in an appraisal action represents damages for the delay in payment and compensation for the use of petitioners' money. *Francis I. duPont & Co. v. Universal City Studios, Inc.*, Del. Ch., 343 A.2d 629 (1975).

Another way of computing the benefit achieved from an award of interest in an appraisal action would be to measure the difference between the fair interest rate awarded in the appraisal action and the rate of return that could have been achieved by a prudent investor during the time the appraisal action was litigated. These are not necessarily the same because 8 *Del. C.* §262(h) states in part: "In determining the fair rate of interest, the Court may consider all relevant factors, *including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money* during the pendency of the proceeding." (emphasis added).

Basing the value of the benefit received on a mere comparison of the difference between the rate of return and the interest rate actually awarded would also not be justified here, however.

After considering all the testimony at the trial concerning interest, the Court determines in its discretion and, in the unique circumstances in this case, that the value of the interest benefit accruing to the appraisal class that resulted from the activities of petitioners' counsel should be measured as being 25% of the total amount of interest awarded or $12.52 per share.

V

For the purpose of deciding an appropriate award of discretionary attorney fees, and based on the above assumptions, the value of the benefit produced by petitioners' counsel in this appraisal action should be computed as follows. Had a shareholder accepted the merger and waived his appraisal rights, he would have received $60 per share based on the $58 merger price and the $2 *Joseph* settlement. In addition, he also would have received the $2 per share *Smith* Dis-

closure claim award. Finally, he would also have received $0.25 per share from the *Smith* Dividend claim settlement (as did the appraisal class).

Therefore, the total consideration received by a shareholder who waived his appraisal rights and accepted the merger is $62.25 per share, disregarding interest and counsel fees. Because the appraisal action resulted in an award of $71.20 per share before interest, the appraisal action, disregarding interest and counsel fees, produced a benefit to each shareholder who sought an appraisal of $8.95 per share. In addition, the Court has determined that the attorneys in the appraisal action produced an interest benefit with a value of $12.52 per share for a total of $21.47 per share. Because the appraisal class consisted of 1,005,081 shares, the total benefit produced by petitioners' counsel's effort was approximately $21.6 million.

This computation ignores that the appraisal class also received the $0.25 *Smith* Dividend claim settlement because the attorneys have already been awarded attorney fees for that benefit.

V I

Finally to be determined is the percentage of the value of the benefit to be awarded. Petitioners' counsel, while offering a different methodology for computation of the value of the benefit than that adopted here, has suggested that an award of 25% of the benefit would be a reasonable award.

[13] The percentage of the benefit to be awarded, like the application of the other *Sugarland* factors, is discretionary and is necessarily dependent on many factors including the value of the benefit, the stage when the litigation was concluded and the amount of work necessary to obtain the benefit. *Sugarland Indus., Inc. v. Thomas*, Del. Supr., 420 A.2d 142 (1980).

This Court has properly awarded much less than 25% of the benefit, especially where cases have been settled before trial. *See, e.g.*, *In re Crocker Shareholders Litig.*, Del. Ch., C.A. No. 7405-NC (Consolidated), Hartnett, V.C. (May 21, 1985) (fee of $1.75 million on benefit of $35 million to $70 million); *Joseph v. Shell Oil Co.*, Del. Ch., C.A. No. 7450-NC (Consolidated), Hartnett, V.C. (Apr. 19, 1985) (fee of $15 million on benefit of $205 million); *Dow Jones & Co. v. Shields (In re Telerate, Inc. Shareholders Litig.)*, Del. Ch., C.A. No. 11,115-NC, Hartnett, V.C. (Mar. 4, 1992) (fee of $5 million on benefit of $95 million); *North Am. Phillips Stockholders' Litig.*, Del. Ch., C.A. No. 9178-NC (Consolidated), Jacobs, V.C. (Dec. 10,

1987) (fee of $2.5 million on benefit of $30.6 million). Where large judgments have been awarded after a protracted trial, fee awards at or near 25% have often been granted. *See, e.g.*, *Weinberger v. U.O.P., Inc.*, Del. Ch., C.A. No. 5642-NC, Berger, V.C. (Mar. 10, 1987) (fee of $2.3 million on benefit of $8.4 million; *Smith v. Van Gorkom*, Del. Ch., C.A. o. 6342-NC, Berger, V.C. (Oct. 11, 1985) (fee of $5.5 million on benefit of $23.5 million). This is consistent with the Supreme Court's guidance in *Sugarland* that the difficulty of the litigation and the time and effort of counsel are important factors to be considered in determining the discretionary fee award.

[14] Because this litigation, like that in *Weinberger* and *Van Gorkom*, resulted in a judgment after a protracted trial with exhaustive pretrial preparation rather than a quick settlement, those cases represent the better basis of comparison for purposes of determining the appropriate fee. After comparing the *Sugarland* factors in this litigation with those in the *Weinberger* and *Van Gorkom* cases, it is clear that although this litigation may have been somewhat less complex than that in those cases, the other factors are roughly comparable. Accordingly, after considering all the *Sugarland* factors and taking into consideration the significant attorneys' fees already awarded in C.A. No. 8395-NC to the same attorneys seeking fees here, the Court, in its discretion, awards the sum of $5,400,000, being 25% of the value of the true benefit, to petitioner for attorneys' fees and expenses.

SIEGMAN v. COLUMBIA PICTURES ENTERTAINMENT, INC.

No. 11,152

Court of Chancery of the State of Delaware, New Castle

January 12, 1993

Plaintiff, a former shareholder of defendant Columbia Pictures Entertainment, Inc., brought an individual and purported class action suit challenging the legality of the 1989 merger between Columbia and Sony USA Inc. Plaintiff alleged an insufficiency in the disclosures made in connection with that merger. Defendants moved for sum-

mary judgment alleging that there was no legal basis for the challenge to the legality of the merger and the accompanying disclosures and, alternatively, that plaintiff's claims were barred by his acquiescence in the challenged transaction.

The court of chancery, per Vice-Chancellor Hartnett, held that there were material issues of fact as to when Sony became an interested shareholder within the meaning of the Delaware Takeover Statute and as to whether plaintiff acquiesced in the merger.

1. Courts ⟹ 99(1)

Under the law of the case doctrine, a court that makes a decision has the power to reconsider it, so long as the case is within its jurisdiction.

2. Judgment ⟹ 181(2)

To prevail on a summary judgment motion, movant must demonstrate that there are no material issues of fact in dispute, even though the burden is difficult.

3. Corporations ⟹ 584

When an informed minority shareholder either votes in favor of a merger, or accepts the benefits of the transaction, he or she cannot, thereafter, attack its fairness.

William Prickett, Esquire, Michael Hanrahan, Esquire, and Chandlee Johnson Kuhn, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Arthur T. Susman, Esquire, and Terry R. Saunders, Esquire, of Susman, Saunders & Buehler, Chicago, Illinois, of counsel, for plaintiff.

James F. Burnett, Esquire, and Donald J. Wolfe, Jr., Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware; and Marc P. Cherno, Esquire, and Debra M. Torres, Esquire, of Fried, Frank, Harris, Shriver & Jacobson, New York, New York, of counsel, for defendant Columbia Pictures Entertainment, Inc.

Anthony W. Clark, Esquire, Jay W. Eisenhofer, Esquire, and Cathy J. Testa, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and Richard L. Brusca, Esquire, and Janet L.

Goetz, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Washington, D.C., of counsel, for defendants Sony Columbia Acquisition Corporation and Sony USA Inc.

HARTNETT, *Vice-Chancellor*

Joseph Siegman, the named plaintiff, a former shareholder of defendant Columbia Pictures Entertainment, Inc. ("Columbia"), brought this individual and purported class action suit challenging the legality of the 1989 merger between Columbia and Sony USA Inc. ("Sony") and the alleged insufficiency of the disclosures made in connection with that merger. Defendants have moved for summary judgment alleging that there is no legal basis for Siegman's challenge to the legality of the merger and the accompanying disclosures and, alternatively, that plaintiff's claims are barred by his acquiescence in the challenged transaction. Siegman has cross-moved for summary judgment.

Because there are material issues of fact as to when Sony became an interested shareholder within the meaning of the Delaware Takeover Statute and as to whether plaintiff acquiesced in the merger, the cross-motions for summary judgment must be denied.

I

The background facts are set forth in greater detail in the previous opinion in the case, *Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., 576 A.2d 625 (1989). Additional facts are derived from excerpts of the discovery taken by the parties. Some of the facts are disputed and their recitation is not a finding that they are correct.

Prior to September 1989, Coca-Cola Company ("Coca-Cola") owned forty-nine percent of the shares of Columbia. In November 1988, Michael Schulhof, a director and officer of Sony approached the president and CEO of Columbia, and expressed Sony's interest in acquiring Columbia, including the Columbia shares owned by Coca-Cola. Schulhof was referred to Herbert Allen of Allen & Company, Columbia's investment banker and Allen and Schulhof met on several occasions.

On September 22, 1989, Schulhof told Allen that Sony might be prepared to make an offer to acquire Columbia and asked Allen to convene the Columbia Board. On September 25, 1989, Columbia's Board met to consider a $27 per share offer from Sony, but took no action on the offer and adjourned until September 27, 1989.

Earlier on the 25th, representatives of Sony and Coca-Cola met to negotiate an option agreement for Coca-Cola's Columbia shares. Negotiations continued throughout the 25th and 26th and in the early morning hours of September 27th, a draft agreement was prepared but was not signed. This unexecuted draft provided for an option to purchase the Coca-Cola shares that was contingent upon approval of a merger agreement between Columbia and Sony by Columbia's Board and also was contingent upon the approval of the option agreement by the boards of both Columbia and Coca-Cola. Although the draft option agreement was contingent upon approval by the Coca-Cola Board, Coca-Cola's representatives apparently assured Sony on the 26th that they would "enthusiastically recommend" approval of the option agreement if Columbia's Board approved the merger.

On September 27, 1989, the Columbia Board met and approved the merger agreement and the Coca-Cola option. Coca-Cola's representatives signed the option agreement later that day and, on October 2, 1989, obtained the approval of Coca-Cola's Board.

Sony, on October 3, 1989, publicly announced a tender offer for all of the shares of Columbia's stock to be followed by a merger that would "freeze out" any Columbia stockholders who did not tender their shares.

Siegman then brought this suit to enjoin the proposed merger alleging that it violated the Delaware Takeover Statute, 8 *Del. C.* §203. That statute requires an "interested stockholder" (as defined in the statute) to postpone for three years the concluding of a proposed merger with an acquired Delaware corporation unless the transaction meets one of several statutory exceptions. The two exceptions relevant to the Sony-Columbia merger are: (1) the proposed merger receives the approval of the target corporation's board "prior to such date" that the acquiror became an interested shareholder, 8 *Del. C.* §203(a)(1); or (2) the merger is approved by the board of the target and by shareholders representing two-thirds of the shares not owned by the interested shareholder. 8 *Del. C.* §203(a)(3).

Siegman, at the preliminary injunction hearing, contended that Sony became an interested shareholder on September 27, 1989, the date the Coca-Cola option agreement was signed by the officers of Coca-Cola. He argued that because approval of the merger was obtained from Columbia's Board on that same day, approval was not obtained "prior to such date" and, therefore, the safe harbor for mergers with prior board approval as provided by 8 *Del. C.* §203(a)(1) did not apply.

In the prior opinion, this Court agreed that Siegman had established a reasonable probability that Sony had become an interested shareholder on September 27, 1989, when the option agreement was signed by Coca-Cola's representatives notwithstanding that it was specifically subject to subsequent approval by Coca- Cola's Board. *Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., 576 A.2d 625, 630-32 (1989). The Court, however, also found that the words "prior to such date" as used in the statute were ambiguous. *Id.* at 633. Because of this ambiguity, the Court examined extrinsic materials to ascertain the intent of the General Assembly as to the meaning of the disputed words. *Id.* at 633-34. After examining these materials, the Court concluded that the words "prior to such date" as they appear in 8 *Del. C.* §203(a)(1), mean "before the time." The plaintiff did not contend at that time that Sony had become an interested shareholder before the time Columbia's Board approved the merger on September 27, 1989, and this Court denied the motion for a preliminary injunction. *Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., 576 A.2d 625 (1989).

II

In now opposing defendants' motion for summary judgment and in asserting his own cross-motion for summary judgment, Siegman urges this Court to reconsider its earlier holding as to the meaning of "prior to such date" in 8 *Del. C.* §203(a)(1), while defendants argue that the "law of the case" doctrine prevents plaintiff from revisiting that issue.

> Under the doctrine of the law of the case, a decision on an issue of law made at one stage of a case becomes a binding precedent to be followed in successive stages of the same litigation . . . . At the trial court level, the doctrine of the law of the case is little more than a management practice to permit logical progression toward judgment. Prejudgment orders remain interlocutory and can be reconsidered at any time, but efficient disposition of the case demands that each stage of the litigation build on the last, and not afford an opportunity to reargue every previous ruling. 1B MOORE'S *Federal Practice* ¶0.404[1], at 117-18 (1992) (footnotes omitted).

The "law of the case" doctrine has greater force when a case is transferred from one judge to another. *See Frank G.W. v. Carol*

M.W., Del. Supr., 457 A.2d 715, 718-19 (1983). "A judge should hesitate to undo his own work. Still more should he hesitate to undo the work of another judge." *Peterson v. Hopson*, 29 N.E.2d 140, 145 (Mass. 1940).

[1] However, the "law of the case" doctrine "does not require a court to enter an erroneous judgment because the logic of an earlier erroneous ruling would require it." 1B MOORE'S *Federal Practice* ¶0.404[4-1], at 126 (1992) (footnote omitted). "A Court that makes a decision has the *power* to reconsider it, so long as the case is within its jurisdiction." *Id.* ¶0.404[1], at 118 (footnote omitted). *See also Frank G.W.*, 457 A.2d at 719; *Topps Chewing Gum, Inc. v. Fleer Corp.*, Del. Ch., C.A. No. 6781-NC, Hartnett, V.C. (July 31, 1987) (application of "law of the case" doctrine is discretionary). Therefore, I conclude that while a court should be reluctant to revisit an issue it has already decided, the "law of the case" doctrine does not preclude a court from doing so, especially if new facts are present.

Siegman, however, has produced nothing that would persuade this Court that its original holding was erroneous.

The essence of the prior holding was that the words "prior to such date" as used in the statute are ambiguous necessitating a resort to extrinsic materials to determine the General Assembly's intent. *Siegman v. Columbia Pictures Entertainment, Inc.*, Del. Ch., 576 A.2d 625, 633-34 (1989). Having done so, this Court found that the General Assembly intended that "the essential element to avoid a shareholder vote is the approval by the board of the about-to-be-acquired corporation before the board becomes beholden to the acquiror." *Id.* at 634.

Siegman now claims to have discovered new evidence that one of the sources relied upon by the Court in making this determination was inaccurate and incomplete. Assuming, arguendo, that Siegman is correct (which has not been established by competent evidence), the other materials cited in the Court's opinion adequately support the Court's conclusion as to the intent of the General Assembly in enacting the statute. *See id.* at 635.

In short, Siegman has shown no reason for the Court to reverse its original holding as to the meaning of the words "prior to such date" as they appear in 8 *Del. C.* §203(a)(1).

III

A more substantive issue is whether there is now any material issue of fact as to whether Sony became an interested stockholder before Columbia's Board approved the merger agreement.

The Delaware Takeover Statute defines an "interested stockholder": "'Interested stockholder' means any person (other than the corporation and any direct or indirect majority-owned subsidiary of the corporation) that is (i) the owner of 15% or more of the outstanding voting stock of the corporation . . . ." 8 *Del. C.* §203(c)(5).

The Delaware Takeover Statute further defines "owner":

> "Owner," including the terms "own" and "owned," when used with respect to any stock, means a person that individually or with or through any of its affiliates and associates:
> (i) Beneficially owns such stock, directly or indirectly; or
> (ii) Has (A) the right to acquire such stock (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise; provided, however, that a person shall not be deemed the owner of stock tendered pursuant to a tender or exchange offer made by such person or any of such person's affiliates or associates until such tendered stock is accepted for purchase or exchange; or (B) the right to vote such stock pursuant to any agreement, arrangement or understanding; provided, however, that a person shall not be deemed the owner of any stock because of such person's right to vote such stock if the agreement, arrangement or understanding to vote such stock arises solely from a revocable proxy or consent given in response to a proxy or consent solicitation made to 10 or more persons; or
> (iii) Has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting (except voting pursuant to a revocable proxy or consent as described in item (B) of subparagraph (ii) of this paragraph) or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

8 *Del. C.* §203(c)(8).

After additional discovery, Siegman now asserts that Sony became an interested stockholder the day before the Columbia Board approved the merger. The critical issue is whether Sony became an interested stockholder by entering into an "agreement, arrangement or understanding for the purpose of acquiring," the Columbia stock

held by Coca-Cola on September 26, 1989, the day before the Columbia Board approved the merger. Siegman claims that because such an "agreement, arrangement or understanding" came into being on September 26, 1989, the safe harbor in 8 *Del. C.* §203(a)(1) for mergers with prior board approval cannot apply. If this is so, Siegman contends that because a shareholder vote was not sought pursuant to 8 *Del. C.* §203(a)(3), the Columbia-Sony merger was illegal. He further contends that because Sony's tender offer disclosure materials and Columbia's Schedule 14D-9 stated that 8 *Del. C.* §203 had been complied with, these disclosures were both material and misleading.

From the present record, it appears that there is a material issue of fact as to whether Sony became an interested stockholder prior to the Columbia Board's approval of the merger agreement.

Siegman asserts that at a luncheon meeting between Sony's and Coca-Cola's managements on September 26th, the parties effectively reached an "agreement, arrangement or understanding" as to the granting of an option. He claims that Sony's parent corporation publicly announced an agreement in principle between the managements of Sony, Columbia and Coca-Cola four hours prior to the meeting of the Columbia Board on the 27th. Siegman also claims that Columbia's counsel distributed materials to the Columbia Board, prior to the vote on the merger agreement and option agreement, indicating that Coca-Cola had already granted an option to Sony.

Defendants respond that the negotiation of the proposed Coca-Cola option could not, as a matter of law, have constituted an "agreement, arrangement or understanding" within the meaning of 8 *Del. C.* §203(c)(8)(iii) before the Columbia and Coca-Cola Boards approved it, because both the written draft and the later-signed option agreement expressly stated that they were conditioned on the approval of the Columbia and Coca-Cola Boards.

As this Court observed in its previous opinion in this case, the words "any agreement, arrangement or understanding" as used in the statute to define owner or interested stockholder are very broad. *Siegman*, 576 A.2d at 631-32. The Court further observed that the General Assembly intended that the statutory language would encompass "all arrangements, whether formal or informal, written or unwritten," whether or not the arrangement constituted a legally binding contract. *Id.* at 632 (citations omitted). This Court rejected defendants' argument that the Coca-Cola option agreement could not, as a matter of law, have been an "agreement, arrangement or understanding" merely because it stated it was contingent on the

approval of the Coca-Cola or Columbia Board. The opinion also stated that the evidence available at that time indicated that approval by the Coca-Cola Board "was a mere formality which was a foregone conclusion." *Id.* The Court, therefore, found that Siegman had established a reasonable probability that the option agreement was an "agreement, arrangement or understanding" within the meaning of the Delaware Takeover Statute as of September 27, 1987. *Id.* A finding of reasonable probability at the preliminary injunction stage, of course, is not a binding finding of the Court. *See, e.g., Humphreys v. Cain*, Pa. Commw., 477 A.2d 32, 35 (1984).

The development of further facts by discovery over the past three years shows that the question of when Sony became an interested stockholder is a disputed question of fact that cannot be determined from the present record. What occurred at the September 25th, 26th, and 27th meetings between Sony and Coca-Cola and what was agreed is clearly disputed.

The provision in the Option Agreement stating that it was contingent upon approval of the Merger Agreement and contingent upon approval by both the Columbia and Coca-Cola Boards, is strong evidence that no "agreement, arrangement or understanding" came into being until the contingencies were removed. The mere existence of this language in the draft and final agreements, however, does not, as a matter of law, preclude a court, after hearing all the evidence, from finding that this language, for example, was a sham or mere window dressing. If the General Assembly had intended that the words of a formal written contract would be the only evidence to be considered as to whether a potential acquiror was an interested stockholder within the meaning of the statute, it could have so provided. Its use of the words "agreement, arrangement or understanding," however, necessarily imposes a broader standard. The critical factual issue here, therefore, is whether the agreement was truly contingent.

[2] The burden of persuasion at trial will, of course, be upon Siegman to prove the existence of a non-contingent agreement, arrangement or understanding prior to September 27, 1989. That the burden is difficult is not the test on a motion for summary judgment. Although the burden to be met to entitle a movant to summary judgment has recently been lessened, the movant, to prevail, must still demonstrate that there are no material issues of fact in dispute. *Burkhart v. Davies*, Del. Supr., 602 A.2d 56 (1991). Disputed facts exist here that preclude summary judgment.

IV

Defendants also claim they are entitled to summary judgment because Siegman cannot show that he or any members of the class suffered any damages.

Defendants correctly point out that three years have passed since the tender offer was consummated and, therefore, the Delaware Takeover Statute, 8 *Del. C.* §203, no longer could prevent the merger. They also assert that because Sony paid a substantial premium for the shares it acquired there cannot be any injury and without any injury there can be no remedy.

While Siegman indeed has a formidable burden to establish any damages, the Court cannot find, at this stage of the proceedings, as a matter of law, that defendants will clearly prevail on this issue.

V

Regardless of the question of when Sony became an interested stockholder, defendants argue that the complaint must be dismissed because Siegman acquiesced in the merger when he surrendered his shares for the merger consideration.

Siegman brought this action on his own behalf and as a purported class action on behalf of all common stockholders of Columbia except defendants, Coca-Cola, Allen & Company, and their officers, directors, affiliates and subsidiaries. After suit was filed, he tendered half of his shares pursuant to Sony's tender offer and surrendered his remaining shares after the merger had been consummated.

The doctrine of acquiescence in the context of the surrender of shares by a shareholder plaintiff was first discussed in Delaware in *Trounstine v. Remington Rand, Inc.*, Del. Ch., 194 A. 95 (1937). In *Trounstine*, the plaintiff voted against a proposal to reclassify his preferred shares and filed a suit to enjoin the reclassification. He then voluntarily dismissed his suit and surrendered his shares in exchange for other shares authorized by the reclassification. Several months later, he filed another suit in this Court to rescind the reclassification. This Court dismissed his complaint holding that a plaintiff may not complain "against acts in which he participated or of which he has demonstrated his approval by sharing in their benefits." *Id.* at 99.

In another share-surrender case, *Kahn v. Household Acquisition Corp.*, Del. Ch., C.A. No. 6293-NC, Brown, V.C. (Jan. 19, 1982) (*Kahn I*), this Court distinguished that case from *Trounstine* and refused to dismiss the complaint on the grounds of acquiescence. In *Kahn*

I, as in the present case, a plaintiff brought suit, failed in an attempt to obtain a preliminary injunction against the proposed merger, and then surrendered her shares after the merger. *Id.*, slip op. at 1. The Court observed that "[i]t does not follow that by accepting an amount that she was temporarily unable to do anything about the plaintiff thereby acquiesced in all other conduct of the defendants unrelated to the fixing of the merger price." *Id.*, slip op. at 4.

The Court, however, held that *Trounstine* might be applicable if the plaintiff had dismissed her suit and accepted the merger price absent any claim of material misrepresentations. *Id.*, slip op. at 4-5. Because plaintiff continued to prosecute her suit, however, the Court held that that "belies any thought of acquiescence." *Id.*, slip op. at 5.

Similarly, in *Serlick v. Pennzoil Co.*, Del. Ch., C.A. No. 5986-NC, Walsh, V.C. (Nov. 27, 1984), this Court held that where a shareholder filed suit against a proposed merger, voted against the merger and then surrendered her shares after the merger was approved, her suit was not barred by the doctrine of acquiescence. The Court held that because the merger was not conditioned on an approval by a majority of the minority shares, "the approval process takes on an aura of inevitability," and that, under the circumstances, surrendering one's shares "does not constitute acquiescence in the conduct which preceded the merger." *Id.*, slip op. at 6-7. The Court, citing *Kahn I*, distinguished the case from *Trounstine* in that the plaintiff in *Serlick* had not dismissed her suit (as in *Trounstine*) but had actively pursued the litigation against the defendants. *Id.*, slip op. at 6.

[3] The *Kahn I* and *Serlick* opinions have been superseded by the Delaware Supreme Court's decisions in *Bershad v. Curtiss-Wright Corp.*, Del. Supr., 535 A.2d 840 (1987), and in *Kahn v. Household Acquisition Corp.*, Del. Supr., 591 A.2d 166 (1991) (*Kahn II*). In *Bershad*, the Court affirmed the dismissal of the claims of all shareholders who either voted in favor of a challenged cash-out merger or who accepted its benefits by tendering their shares for payment under the merger agreement. It held that "when an *informed* minority shareholder either votes in favor of the merger, or like Bershad, accepts the benefits of the transaction, he or she cannot thereafter attack its fairness." *Bershad*, 535 A.2d at 848 (emphasis added) (citations omitted). The Court in *Kahn II* reiterated the general rule in *Bershad* although it found that equitable factors mandated the broadening of the eligible class based on the peculiar facts in the litigation. *Kahn II*, 591 A.2d at 175-78.

Although *Bershad* and *Kahn II* did not state that they were overruling *Kahn I* and *Serlick*, the holding in *Bershad* does have the effect of precluding a determination of whether a particular shareholder who surrenders his shares intended to acquiesce, as this Court made in *Kahn I* and *Serlick*.

That *Bershad* is controlling in this case, however, does not end the inquiry as to whether Siegman acquiesced in the merger when he surrendered his shares. The prohibition against the right to continue to maintain a suit, as provided in *Bershad*, expressly applies only to an *informed* minority shareholder who voted for the merger or surrendered his shares. *Bershad*, 535 A.2d at 848. Siegman, therefore, argues that *Bershad* is not applicable here because he alleges defendants made a material misrepresentation that 8 *Del. C.* §203 was not triggered by the merger.

Defendants counter-argue that there was no material misrepresentation as a matter of law because defendants had no duty to engage in "self-flagellation." *See, e.g., Weinberger v. United Fin. Corp.*, Del. Ch., C.A. No. 5915-NC, Hartnett, V.C. (Oct. 13, 1983).

Defendants mischaracterize Siegman's argument. While defendants might not have had an affirmative duty to disclose a possible violation of 8 *Del. C.* §203, they affirmatively represented that the statute was not implicated in the transaction. Having done so, they had an obligation to speak truthfully. *Locks v. Schreppler*, Del. Supr., 426 A.2d 856, 862 (1981) ("Although there is no general duty to speak, if a person undertakes to speak, he then has a duty to make a full and fair disclosure as to the matters about which he assumes to speak.").

Because there is a material issue of fact as to whether 8 *Del. C.* §203 was violated, this Court cannot find as a matter of law that defendants' disclosures were accurate and, therefore, cannot find that the shareholders were fully informed and thus acquiesced in the merger if they surrendered their shares.

Defendants take their argument one step further. They argue that the discovery shows that Siegman read Sony's disclosure materials, found them misleading, decided to file suit, and *then* surrendered his shares. Defendants' argument seems to be that Siegman could not have relied on the alleged misrepresentation and, because reliance is an essential element of Siegman's cause of action for misrepresentation, he does not have standing to pursue the disclosure claim. Defendants, therefore, assert that he cannot argue that he was not an "informed shareholder."

The record is unclear as to whether Siegman was fully aware of all the facts and, therefore, there is a material issue of fact as to whether Siegman was an "informed shareholder" at the time which he surrendered his stock. Siegman may not have been aware, when he surrendered his shares, of all that took place in the meetings between Sony and Coca-Cola on September 25-27, 1989. Defendants are, therefore, not entitled to summary judgment on the grounds that Siegman acquiesced in the merger when he surrendered his shares.

Having decided that defendants are not entitled to summary judgment on the issue of acquiescence, there is no need to address Siegman's argument that acquiescence is not applicable because the merger was allegedly illegal and *ultra vires*. For similar reasons, Siegman's argument that *Bershad* and *Kahn II* are applicable only to the quasi-appraisal remedy for inadequate price and not to alleged violations of 8 *Del. C.* §203 need not be addressed.

Siegman's and defendants' cross-motions for summary judgment are, therefore, denied.

IT IS SO ORDERED.

SULLIVAN MONEY MANAGEMENT, INC. v. FLS HOLDINGS INC.

No. 12,731

Court of Chancery of the State of Delaware, New Castle

November 20, 1992

Certain preferred stockholders of FLS Holdings, Inc. (FLS) challenged a proposed merger of FLS with a wholly owned subsidiary of Kyoei Steel Ltd. Plaintiffs beneficially owned shares of FLS Series A cumulative exchangeable preferred stock which, if the merger were approved, would be cashed out at $18.128 per share. Plaintiffs contended that provisions in the corporate charter entitled them to a separate class vote to approve or disapprove the merger as a matter of law.

The court of chancery, per Vice-Chancellor Jacobs, denied plaintiff's motion. The court construed provisions of the corporate charter and concluded that a merger was not a type of corporate action which conferred on Series A cumulative exchangeable preferred stock the right to a class vote on the impending merger.

1. Corporations ⟹ 156

The existence and extent of special stock rights are determined by reference to the issuer's certificate of incorporation; such rights are essentially contractual in nature.

2. Corporations ⟹ 197

Because rights or preferences over common stock are in derogation of the common law, they should be clearly expressed and not presumed.

3. Corporations ⟹ 372

When construing a certificate of incorporation, the task of the court is not simply one of mechanically assigning special words their ordinary meaning, but to construe the certificate in its entirety in order to determine the meaning intended to be given any portion of it.

4. Corporations ⟹ 372

Under the rule of strict construction, any ambiguity must be resolved against granting the challenged preferences, rights, or powers; nothing should be presumed.

Craig B. Smith, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware, for plaintiffs.

Anthony W. Clark, Esquire, and Matthew F. Boyer, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for defendant FLS Acquisition Corporation.

Kenneth J. Nachbar, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Mitchell A. Karlan, Esquire, of Gibson,

Dunn & Crutcher, New York, New York, for defendant FLS Holdings Inc.

Stephen M. Jenkins, Esquire, of Ashby & Geddes, Wilmington, Delaware, for individual defendants.

JACOBS, *Vice-Chancellor*

This action was commenced on September 25, 1992, when certain preferred stockholders of FLS Holdings, Inc. ("FLS" or the "Corporation") challenged a proposed merger of FLS with a wholly owned subsidiary of Kyoei Steel Ltd. ("Kyoei"), FLS Acquisition Corporation ("FLSAC"). The plaintiffs beneficially own shares of FLS Series A Cumulative Exchangeable Preferred Stock (the "Series A Preferred Stock"). The named defendants are FLS, its directors, FLSAC, and Kyoei.[1] Should the merger be approved, all shares of the Series A Preferred Stock will be "cashed out" at $18.128 per share. The plaintiffs seek, among other things, a declaratory judgment that the holders of the Series A Preferred Stock are entitled to vote separately as a class on the merger.

Because the merger was scheduled to close in late November 1992, the plaintiffs moved for an order expediting the proceedings. They simultaneously moved for the entry of a declaratory judgment in their favor as to Count III of the complaint, which asserts the class-vote claim. The parties submitted briefs on the class-vote issue, and oral argument was held on November 13, 1992. Because at that hearing certain contentions were raised for the first time, the plaintiffs (with leave of Court) filed a supplemental memorandum on November 16, 1992. This is the decision of the Court after final hearing on the plaintiffs' motion for entry of declaratory judgment.

I.

The critical facts are undisputed. FLS is a Delaware corporation that holds the entire equity interest of Florida Steel Corporation. Three classes of FLS stock are currently issued and outstanding: 438,987 shares of Class A Common Stock; 61,013 shares of Class

1. All of the named defendants except for Kyoei have entered an appearance. Kyoei contends that it has not been properly served with process. Accordingly, references to the "defendants" in this Opinion shall mean the defendants other than Kyoei.

B Common Stock; and 1,600,806 shares of Series A Preferred Stock. As earlier stated, the plaintiffs beneficially own shares of the Series A Preferred Stock.[2] Under FLS's Restated Certificate of Incorporation dated November 1, 1988 (the "Certificate"), the Class A Common Stock has the right to vote on all matters, while the Class B Common Stock and the Series A Preferred Stock have no voting rights, except as provided in the Certificate.

On or about June 26, 1992, FLS entered into an Agreement and Plan of Merger with FLSAC and Kyoei (the "Merger Agreement"). The Merger Agreement provides that FLSAC will be merged into FLS, with FLS as the surviving corporation. All shares of Class A and Class B Common Stock will be converted into the right to receive $18.845 per share, and all shares of Series A Preferred Stock will be converted into the right to receive $18.128 per share. One condition to FLSAC's and Kyoei's obligation to consummate the merger is the acquisition by Florida Steel Corporation of 90% of its subordinated debentures pursuant to a tender offer. The parties to the Merger Agreement have established November 30, 1992, as the date after which the parties will not be obligated to go forward if the merger is not already consummated.

When the Merger Agreement was executed, FLS delivered to FLSAC the written consents to the Merger Agreement and the merger of the holders of all outstanding shares of Class A Common Stock. The Merger Agreement is not conditioned upon the approval of the holders of either the Class B Common Stock or the Series A Preferred Stock.

II.

This motion rests upon the single contention that the holders of the Series A Preferred Stock are entitled to a separate class vote to approve or disapprove the merger as a matter of law. The provision which governs that question is Section B(1)(H) of the Certificate, which pertinently provides in subparagraph (i) that the Series A

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2. Approximately 27% of the Class A Common Stock is beneficially owned by members of FLS's board of directors, and approximately 46% is owned by Goldman Sachs & Co., two partners of which are members of the FLS board. An additional 4% of the Class A Common Stock is owned by Citicorp Capital Investors, Ltd., an affiliate of Citicorp. One of FLS's directors is an officer of Citicorp, and Citicorp owns 100% of the FLS Class B Common Stock. Thus, members of the FLS board of directors, or their affiliates, own approximately 77% of the FLS Class A Common Stock and 100% of its Class B Common Stock.

Preferred Stock "shall not be entitled to any voting rights except as hereinafter provided in this paragraph (H) or as otherwise provided by law." Thereafter, subparagraphs (ii) and (iii) of paragraph (H) provide for voting rights in specified circumstances. Subparagraph (ii) entitles the Series A Preferred Stock to a class vote to elect two additional directors whenever dividends payable on the Series A Preferred Stock are in arrears and unpaid in an amount equal to six full quarterly dividends, or if FLS has failed to discharge its mandatory redemption obligation for thirty days. The plaintiffs make no claim that subparagraph (ii) applies here. Rather, the plaintiffs rely exclusively upon subparagraph (iii), which provides:

> So long as any shares of the Cumulative Exchangeable Preferred Stock are outstanding, the Corporation will not, without the affirmative vote of the holders of at least two-thirds of the outstanding shares of Cumulative Exchangeable Preferred Stock, voting as a class, change, by amendment to the Certificate of Incorporation of the Corporation or otherwise, the terms and provisions of the Cumulative Exchangeable Preferred Stock so as to affect adversely the rights and preferences of the holders thereof or authorize the issuance of any Senior Securities or Parity Securities or any securities exchangeable or convertible into any Senior Securities or Parity Securities.[3]

The plaintiffs argue that subparagraph (iii) mandates a class vote in connection with the FLS merger, because by converting the Series A Preferred Stock into cash and thereby eliminating it, the merger will "change, by amendment to the Certificate . . . *or otherwise*, the terms and provisions of the . . . Preferred Stock, so as to affect adversely the rights and preferences of the holders thereof . . . ." (emphasis added). Although that provision does not mention mergers expressly, the plaintiffs argue that the phrase "or otherwise" must include mergers by necessary implication.

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3. Section B(1)(B) of the Certificate defines "Senior Securities" as "[a]ll equity securities of the Corporation to which the Cumulative Exchangeable Preferred Stock ranks junior (whether with respect to dividends or upon liquidation, dissolution, winding-up or otherwise)," and defines "Parity Securities" as "[a]ll equity securities of the Corporation with which the Cumulative Exchangeable Preferred Stock ranks on a parity (whether with respect to dividends or upon liquidation, dissolution, winding-up or otherwise)."

The defendants respond that the "or otherwise" language of Section B(1)(H)(iii) cannot be read to include mergers, and that as a matter of law the plaintiffs' interpretation of that Section is misguided. The defendants' position, simply stated, is that the term "or otherwise" is ambiguous and susceptible to an equally plausible but far narrower construction than that argued for by plaintiffs. The defendants argue that "or otherwise" means corporate actions that are the functional equivalent of an amendment of the Certificate.[4]

Thus, defendants conclude, whatever may be the intended meaning of the phrase "by amendment . . . or otherwise," it cannot include a merger. The strict rule of construction applied to stock preferences simply forbids so expansive a reading of "or otherwise." Moreover, the defendants urge, the Certificate, when considered in its entirety, clearly evidences an intention by its drafters *not* to confer a right to a class vote in a merger.[5]

III.

A.

The question presented here—whether a certificate of incorporation entitles preferred stockholders to a class vote in the event of a merger—was recently addressed in *Warner Communications Inc. v.*

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4. When asked at oral argument what those functional equivalents might be, defendants' counsel responded that the term "or otherwise" could refer to the repeal of a provision in the Certificate; a reclassification of preferred stock; the filing of a restated certificate of incorporation; or the filing of a certificate, pursuant to 8 *Del. C.* § 151, that designates the rights, preferences, and other attributes of a series of preferred stock. The first three of those examples require a formal certificate amendment for their accomplishment, and the last of them (filing a certificate of designation) could not validly be utilized to change the attributes of already-outstanding preferred stock. *See* 8 *Del. C.* § 151(g).

5. At oral argument, the defendants also raised for the first time the contention that the plaintiffs lack standing to maintain this action because they failed to prove that they owned shares of Series A Preferred Stock. Since the defendants did not raise that argument in their brief or other filings, or otherwise give fair notice to the plaintiffs that their standing would be challenged, the defendants are precluded from asserting that position at this stage. Nonetheless, the Court permitted the plaintiffs to submit evidence that they beneficially own Series A Preferred Stock and have the right to direct the voting of those shares. The plaintiffs submitted such evidence, which the defendants do not contest. Thus, even if the defendants were procedurally entitled to challenge the plaintiffs' standing, in these circumstances their attack also fails as a matter of substantive law. *Flerlage v. KDI Corp.*, Del. Ch., C.A. No. 8007, Hartnett, V.C., mem. op. at 14 (Jan. 29, 1986).

Chris-Craft Indus., Del. Ch., 583 A.2d 962, *aff'd*, Del. Supr., 567 A.2d 419 (1989). That decision articulates the framework for the legal analysis employed here.

[1-2] "[T]he existence and extent of special stock rights are determined by reference to the issuer's certificate of incorporation; such rights are essentially contractual in nature." *Id.* at 966. The Court will apply principles of contract interpretation, and read the Certificate in its entirety to arrive at the intended meaning of the words employed in any specific provision. *Id.* at 967. Because rights or preferences over common stock are in derogation of the common law,[6] they "should be clearly expressed and not presumed." *Id.*; *see also Waggoner v. Laster*, Del. Supr., 581 A.2d 1127, 1134-35 (1990) (collecting cases); *Rothschild Int'l Corp. v. Liggett Group Inc.*, Del. Supr., 474 A.2d 133, 136 (1984). Under this rule of strict construction, "any ambiguity must be resolved against granting the challenged preferences, rights or powers." *Waggoner*, 581 A.2d at 1135.[7]

Section B(1)(H)(iii), like the disputed certificate provisions in *Warner*, entitles the Series A Preferred Stock to a class vote (requiring approval of at least two-thirds of the outstanding shares) if FLS changes that series of stock's terms and provisions so as to affect adversely the rights and preferences of its holders. In *Warner* the Chancellor found that the provision that conferred a class-vote right did not encompass mergers, in part because the language of the *Warner* provision tracked section 242(b)(2) of the General Corporation Law, which mandates a class vote for classes of stock that would be adversely affected by amendments to a certificate of incorporation,[8]

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6. At common law, and in the absence of any statute or agreement to the contrary, all stock enjoys equal rights and privileges. *Penington v. Commonwealth Hotel Constr. Corp.*, Del. Supr., 155 A. 514, 520 (1931); *Gaskill v. Gladys Belle Oil Co.*, Del. Ch., 146 A. 337, 338 (1929).

7. The requirement that stock voting rights be specified expressly and with clarity has also been codified in the Delaware General Corporation Law:

> Any of the voting powers, designations, preferences, rights and qualifications, limitations or restrictions of any such class or series of stock may be made dependent upon facts ascertainable outside the certificate of incorporation . . . provided that the manner in which such facts shall operate upon the voting powers, designations, preferences, rights and qualifications, limitations or restrictions . . . is clearly and expressly set forth in the certificate of incorporation . . . .

8 *Del. C.* § 151(a).

8. Section 242(b)(2) pertinently provides, "The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment . . . if the amendment would . . . alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely."

but does not create a class voting right in the event of a merger. *Warner*, 583 A.2d at 969-70. This case, however, is arguably distinguishable from *Warner*, because Section B(1)(H)(iii) contains a phrase not involved in *Warner* or found in section 242(b)(2), namely, "by amendment to the Certificate of Incorporation of the Corporation or otherwise."

The meaning of that phrase is the question before the Court. More precisely, the issue is whether that phrase clearly and expressly refers to mergers or (alternatively) a larger category of potential corporate actions that necessarily would include mergers. For the reasons discussed below, I conclude that it does not. First, neither the phrase "by amendment . . . or otherwise" nor Section B(1)(H)(iii) mentions mergers at all. Second, the Certificate expressly confers a class-vote right in the event of a merger upon the holders of a separate series of preferred stock (none of which is outstanding), the Series B Cumulative Redeemable Convertible Junior Preferred Stock (the "Junior Preferred Stock"). The absence of any such provision in Section B(1)(H) evidences an intention of the drafters not to confer such protection upon the holders of Series A Preferred Stock. Third, no other provision in the Certificate, particularly Section B(1)(H)(iv), supports the plaintiffs' broad interpretation of "or otherwise."

B.

As a conceptual matter, "or otherwise" lends itself to two different meanings, one broader than the other. *State ex rel. Waldman v. Miller-Wohl Co.*, Del. Supr., 28 A.2d 148, 152 (1942). The plaintiffs read the phrase broadly, as encompassing "all other corporate actions," which would include mergers. In that case, whatever term precedes the disputed phrase (here, "amendment to the Certificate of Incorporation of the Corporation") would be regarded as a specific example of that larger category. The defendants read the phrase narrowly to mean only those corporate actions that are identical or equivalent to an amendment of the Certificate, thereby excluding mergers. To say it differently, the phrase "or otherwise" if construed broadly, would mean "in any other way," and if construed narrowly, would mean "in like manner." *Id.* The former construction reflects the everyday meaning of the phrase; the latter reflects the rule of construction known as *ejusdem generis*, which is applied when "or otherwise" follows an enumeration of particulars. *Id.*

[3] In this case only one particular—the words "amendment to the Certificate"—precedes "or otherwise." Does it then follow that "or

otherwise" takes the expansive reading argued for by the plaintiffs? I think not. When construing a certificate of incorporation, the task of the Court is not simply one of mechanically assigning specific words their ordinary meaning. Rather, the Court must construe the Certificate in its entirety "'in order to determine the meaning intended to be given any portion of it.'" *Warner*, 583 A.2d at 967 (quoting *Ellingwood v. Wolf's Head Oil Ref. Co.*, Del. Supr., 38 A.2d 743, 747 (1944)). Should the context require that a phrase be interpreted other than in accordance with its commonly accepted meaning, the Court must give the words the meaning derived from construing the Certificate in its entirety. *See Hibbert v. Hollywood Park, Inc.*, Del. Supr., 457 A.2d 339, 343 (1983); *Standard Power & Light Corp. v. Inv. Assocs.*, Del. Supr., 51 A.2d 572, 576 (1947).

Any analysis of the contextual meaning of "or otherwise" must begin with Section B(1)(H)(iii) of the Certificate. That Section entitles the holders of the Series A Preferred Stock to a class vote under two distinct scenarios. The first is where the Corporation desires to "change, by amendment to the Certificate . . . or otherwise, the terms and provisions of the [Series A] Preferred Stock so as to affect adversely the rights and preferences of the holders thereof . . . ." The second (which is described immediately after the above-quoted language and follows the word "or") arises when the Corporation "authorize[s] the issuance of any Senior Securities or Parity Securities or any securities exchangeable or convertible into any Senior Securities or Parity Securities." It is apparent that the drafters of the Certificate were concerned with protecting the holders of Series A Preferred Stock from two kinds of dangers: (i) a change to the terms and provisions of that stock adverse to the holders thereof, and (ii) the issuance of equity securities that would either dilute the Series A Preferred Stock or diminish its relative preferential position in the overall capital structure.

According to one commentator, the contractual rights of a preferred stock (e.g., its rights to dividend arrearages or preferential rights upon liquidation) may be altered in three ways: (i) by direct amendment to the certificate of incorporation, (ii) by merger, or (iii) by the issuance of prior preferred stock. Richard M. Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 Cal. L. Rev. 243, 299 & n.287, 303 (1954). Section B(1)(H)(iii) specifically addresses two of those means—amendment of the Certificate and the issuance of senior (or parity) preferred stock. If (as plaintiffs argue) that Section was intended to protect the holders of the Series A Preferred Stock from all three dangers, then "or otherwise" must be construed to be

synonymous with mergers. That construction, while possible, is far from clear.

Unarguably, had the Certificate's drafters intended expressly to entitle the Series A Preferred Stockholders to a class vote in a merger, they knew fully well how to do so. In Section B(2)(G), the Certificate explicitly confers that very right upon the holders of Junior Preferred Stock in the following language (with emphasis added):

> The holders of shares of Junior Preferred Stock shall have no voting rights whatsoever, except for any voting rights to which they may be entitled under the laws of the State of Delaware, and except that for so long as any shares of the Junior Preferred Stock remain outstanding, the Corporation will not, *either directly or indirectly or through merger or consolidation with any other corporation.*

Section B(2)(G) then enumerates specific actions that the Corporations may not take without affording the holders of Junior Preferred Stock a class vote. Included are actions that would "amend, alter or repeal any of the provisions of the Certificate . . . so as to affect adversely the preferences, special rights or powers of the Junior Preferred Stock . . . ."

This clear and explicit expression of a right to a class vote in the event of a merger stands in stark contrast to Section B(1)(H)(iii), which contains no such expression. If "or otherwise" includes mergers, those two words must do the work of the entire underscored phrase in Section B(2)(G) quoted above. That argument is strained at best. The word "merger" is nowhere found in the provision governing the Series A Preferred Stock. The drafters' failure to express with clarity an intent to confer class voting rights in the event of a merger suggests that they had no intention of doing so, and weighs against adopting the plaintiffs' broad construction of the words "or otherwise." *See Warner*, 583 A.2d at 970-71.

No other provision in the Certificate supports the plaintiffs' broad construction of "or otherwise."[9] At oral argument the plaintiffs

9. As support for their position, the defendants also point to the absence of any reference to a class voting right in the October 19, 1988 Proxy Statement-Prospectus, relating to the issuance of the Series A Preferred Stock (the "Prospectus"). That argument is not persuasive, because the Prospectus only repeats verbatim the language from Section B(1)(H)(iii) at issue here. (Boyer Aff. Ex. A., at 112.) The plaintiffs, however, can hardly gain comfort from that disclosure document, since it provides potential investors with several summary descriptions of the Series A Preferred Stock, yet makes no specific reference to a right to a class vote in the event of a merger. (*Id.* at 12, 16-17, 24, 112.)

suggested (for the first time) that Section B(1)(H)(iv) provides such support.[10] Section B(1)(H)(iv) specifies three kinds of corporate actions that will require a class vote and "shall not be deemed to affect adversely the rights, preferences, privileges and voting rights of shares of [Series A] Preferred Stock." The argument runs as follows: Section B(1)(H)(iii) defines a broad, all-inclusive category of corporate actions that require a class vote, while Section B(1)(H)(iv) (which immediately follows Section B(1)(H)(iii)), carves out three specific exceptions to that broad category. Unless the phrase "or otherwise" carries the more expansive possible meaning, no enumerated exceptions to Section B(1)(H)(iii) would be necessary. I disagree.

The plaintiffs' argument is persuasive only if Section B(1)(H)(iv) cannot be harmonized with a narrow construction of "or otherwise." Even assuming (*arguendo*) that that phrase is surplusage, the first and third categories of corporate actions enumerated in Section B(1)(H)(iv) can be harmonized with Section B(1)(H)(iii) narrowly construed. That is, the creation, authorization or issuance of junior securities, a change in the amount of authorized capital stock, and a change in the par value of any class of stock all require either an amendment to the Certificate or (where permissible under section 151(g)) the filing of a certificate of designation. That leaves only the second enumerated category, "the creation of any indebtedness of any kind of the Corporation." However, that category, upon further analysis, does not support the plaintiffs' position either.

No matter how "or otherwise" is construed, the second B(1)(H)(iv) category is consistent with Section B(1)(H)(iii), which forbids the Corporation from creating "any securities exchangeable or convertible into any Senior Securities or Parity Securities" without a class vote. That quoted language, which is unrelated to the prong

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10. Section B(1)(H)(iv) provides as follows:

(a) The creation, authorization or issuance of any shares of any Junior Securities, or the creation, authorization or issuance of any obligation or security convertible into or evidencing the right to purchase any Junior Securities, (b) the creation of any indebtedness of any kind of the Corporation, or (c) the increase or decrease in the amount of authorized capital stock of any class, including the Preferred Stock, but excluding the amount of Cumulative Exchangeable Preferred Stock, or any increase, decrease or change in the par value of any such class other than the Preferred Stock, shall not require the consent of the holders of Cumulative Exchangeable Preferred Stock and shall not be deemed to affect adversely the rights, preferences, privileges and voting rights of shares of Cumulative Exchangeable Preferred Stock.

of Section B(1)(H)(iii) that includes "or otherwise," would encompass senior or parity convertible bonds or debentures. To that extent the second enumerated category merely excepts from the class-vote requirement of Section B(1)(H)(iii) the creation of such convertible debt securities and is, therefore, irrelevant to the disputed phrase "or otherwise."

Thus, the plaintiffs' position must necessarily rest upon the remaining breadth of the phrase "any indebtedness of any kind." That phrase would include debt that is not convertible into preferred stock. However, the very breadth of that category hurts the plaintiffs' case. "[A]ny indebtedness" would include even routine borrowing such as the purchase of inventory on credit. That kind of borrowing would not change the terms and provisions of Series A Preferred Stock and, therefore, goes beyond the limits of Section B(1)(H)(iii) even when "or otherwise" is construed broadly.

Stated differently, Section B(1)(H)(iv) does not carve out exceptions to a broadly construed Section B(1)(H)(iii). Instead, Section B(1)(H)(iv) describes actions that require no class vote, whether or not a class vote would otherwise be required under Section B(1)(H)(iii). For that reason, the language "any indebtedness of any kind" is so broad as to be superfluous. It denies a class vote in circumstances where no right to a class vote is conferred.[11]

Reading the Certificate in its entirety does not aid the plaintiffs' construction of "or otherwise." Nonetheless, the plaintiffs argue that the phrase itself must encompass mergers. Plaintiffs' argument rests upon the plain meaning of "or otherwise" (i.e., any other actions) and the claimed absence of any plausible alternative construction.

In this case the interpretations advocated by both sides are problematic. The defendants have not persuaded me that "by amendment . . . or otherwise" can, in this context, mean any action other than an amendment to the Certificate. Indeed, the only valid counterexamples that the defendants propose are different forms of amendments to the Certificate (e.g., restatement or repeal of its provisions, or a reclassification of preferred stock).

That does not mean, however, that the only tenable construction of "or otherwise" is a merger. The possibility remains that the phrase could be surplusage, though, to be sure, a construction that gives no substantive effect to a phrase is intellectually unsatisfactory.

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11. Such imprecision could very well explain the use of a phrase as unhelpful as "or otherwise."

Yet the very real possibility exists that the drafters, out of an overabundance of caution, simply wanted to describe in a shorthand way all actions similar in form and effect to an amendment, even though such actions are either already encompassed within the term "amendment" or are legally unavailable. *See supra* note 4.

[4] Although "or otherwise" could conceivably (a) mean a merger or (b) have no substantive meaning, an interpretation of the Certificate cannot rest upon such speculative possibilities. For this and the other reasons already discussed, the analysis must end where it began: by resort to the exacting burden that the plaintiffs must satisfy for their position to prevail. "Under the rule of strict construction, any ambiguity must be resolved against granting the challenged preferences, rights or powers." *Waggoner*, 581 A.2d at 1135. In other words, "nothing should be presumed" in favor of preferences. *Holland v. National Automotive Fibres*, Del. Ch., 194 A. 124, 126 (1937), *cited with approval in Waggoner*, 581 A.2d at 1134. "They ought to be clearly expressed, if not by words of explicit import, then by necessary implication." *Id.*

No words of explicit import clearly express the voting rights the plaintiffs claim exists in this case. No positive evidence supports the claim that the drafters intended to create such a right. Although one might argue (as the plaintiffs do) that that right exists by implication, it does not exist by *necessary* implication. To adopt the plaintiffs' position would amount to presuming a preferential voting right. In the present case, however, where (at least) an ambiguity exists, our law requires that it be resolved *against* creating the preference. Therefore, the plaintiffs' position must be rejected.

IV.

For the reasons discussed, I conclude that the Series A Preferred Stock is not entitled to a class vote on the proposed merger. Because a merger is not a corporate action contemplated by the phrase "or otherwise," I need not decide whether the merger would adversely affect the rights and preferences of the holders of Series A Preferred Stock. Accordingly, this Court must deny the plaintiffs' motion for a declaratory judgment that the holders of the Series A Preferred Stock are entitled to a class vote on the impending merger, because that class of Preferred Stock has no such right.

The Court has entered the attached form of Order implementing the rulings made in this Opinion.

ORDER

For the reasons set forth in the Court's Opinion of November 20, 1992, IT IS HEREBY ORDERED, DECREED, and DECLARED as follows:

1. The plaintiffs' motion for entry of judgment on Count III of the complaint, declaring that the holders of Series A Cumulative Exchangeable Preferred Stock are entitled to vote separately as a class with respect to the proposed merger of FLS Holdings, Inc. with FLS Acquisition Corporation, is denied.

2. Pursuant to Rule 54(b), the Court expressly determines that there is no just reason for delay, and directs the entry of final judgment for the defendants with respect to Count III of the complaint.

THORPE v. CERBCO, INC.

No. 11,713

Court of Chancery of the State of Delaware, New Castle

January 26, 1993

Plaintiffs moved for summary judgment in a stockholder's action brought to enjoin the alleged usurpation of a corporate opportunity of CERBCO, Inc. The relevant transaction was one in which defendants were to sell their CERBCO stock, which carried with it voting control of the company, for a high premium over market price. Although the transaction was abandoned, plaintiffs continued the litigation, claiming that the failure of defendants to achieve the premium for CERBCO itself injured the corporation and its shareholders. This motion does not address that central claim but is directed at a second claim which alleges that defendants acquired voting control over CERBCO as a result of a recapitalization authorized by a 1982 stockholder vote held after the dissemination of false and misleading proxy solicitation materials. Plaintiffs sought to have that recapitalization rescinded, claiming that their suit was not time-barred because CERBCO shareholders could not have known

until 1990 that the 1982 proxy statement was materially incomplete and misleading.

Defendants contended that because plaintiffs were not shareholders of CERBCO in 1982, they had no standing to litigate the claim under the contemporaneous ownership requirement of section 327 of the Delaware General Corporation Law. Plaintiffs countered that this fact alone was not sufficient grounds for summary judgment, arguing that they had standing because (1) they were injured by the alleged failure to disclose, and (2) the wrong itself was a continuing one.

The court of chancery, per Chancellor Allen, held that the allegation that the 1982 proxy materials were misleading was an individual, rather than a derivative, claim and not governed by section 327. However, the court ruled that plaintiffs did not have standing to bring an action to enforce rights allegedly violated in 1982 when they had no ownership interest in the corporation. Nor did plaintiffs have standing to assert the claim as successors in interest to earlier holders of the stock because only those who own shares at the time of the proxy wrong possess rights arising from any disclosure violations. Accordingly, the motion for summary judgment was granted.

1. Corporations ⟹ 320(4)

Where a board of directors wrongfully interferes with or wrongfully impairs the right of a shareholder to vote his stock, it violates an individual, rather than derivative, right of that shareholder.

2. Corporations ⟹ 207

Those who are shareholders at the time of a proxy wrong, and not their successors in interest, possess rights arising from any disclosure violations.

Lawrence C. Ashby, Esquire, Stephen E. Jenkins, Esquire, Keith R. Sattesahn, Esquire, and Richard D. Heins, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Joseph M. Hassett, Esquire, George H. Mernick, III, Esquire, Albert W. Turnbull, Esquire, and Christopher P. Gilkerson, Esquire, of Hogan & Hartson, Washington, D.C., of counsel, for plaintiffs.

Howard M. Handelman, Esquire, and John H. Newcomer, Jr., Esquire, of Bayard, Handelman & Murdoch, P.A., Wilmington, Delaware, for defendant CERBCO, Inc.

Michael Hanrahan, Esquire, and April Caso Ishak, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for defendants Robert W. Erikson and George William Erikson.

ALLEN, *Chancellor*

This is a stockholders' action brought originally to enjoin the alleged usurpation of a corporate opportunity of CERBCO, Inc. The transaction attacked was one in which defendants Robert and George Erikson were to sell their CERBCO stock, which carried with it voting control of the company, for a 700% premium over the market price of the company's traded stock. It was alleged that the buyer did not, in fact, seek control over CERBCO but had originally sought to buy CERBCO's asset control over another entity. After the suit was initiated, the transaction was abandoned. Plaintiffs continue to litigate this central claim, asserting that the failure of defendants to seek to achieve for CERBCO itself the sale of the asset of CERBCO that the potential buyer was allegedly motivated to acquire, was injurious to CERBCO and all of its stockholders. *See Thorpe v. CERBCO, Inc.*, Del. Ch., 611 A.2d 5 (1991).

The pending motion for summary judgment is not addressed to this central claim, however. Rather it is addressed to a second claim purportedly asserted in Count II of the Second Amended and Supplemental Complaint. That claim alleges that the defendants were enabled to acquire voting control over CERBCO as a result of a 1982 stockholder vote held after the dissemination of false and misleading proxy solicitation materials. The 1982 vote amended the certificate of incorporation to authorize a recapitalization that permitted shareholders to exchange their voting stock for either new Class A or new Class B voting stock. Class A stock carries relatively weaker voting rights but greater rights to dividends than does the Class B stock. The Class B shares have the power to elect three of the four members of the CERBCO board of directors. As was expected (and the expectation was disclosed in the 1982 Proxy Statement), most shareholders accepted Class A shares, while Robert and George Erikson accepted Class B shares. On the completion of the recapitalization, the Eriksons did not own a majority of the Class B shares, but over the intervening years, through the conversion of

other Class B shares to Class A stock, they have come to do so.

The claim that is the subject of this motion is the claim that the 1982 Proxy Statement was materially incomplete and misleading in that it, allegedly, failed "to inform [shareholders] in the proxy statement that the Eriksons apparently believed they had no fiduciary obligation to exercise their control for the benefit of CERBCO and all of its shareholders, but instead intended to grant themselves the right to use that control for their personal benefit." Second Am. Compl. ¶ 20. Plaintiffs seek to have the 1982 recapitalization rescinded. They allege that CERBCO shareholders could not have known until 1990, when the Eriksons allegedly used their control of CERBCO to attempt to seize the economic value of CERBCO's assets, of the alleged failure in 1982 to disclose their intention "to use control for their personal benefit." Thus, their suit is, they say, timely.

Defendants have now moved for summary judgment on this claim. Their theory is predicated upon the uncontested fact that plaintiffs were not shareholders of CERBCO in 1982. They assert that this fact disables plaintiffs from litigating the propriety of disclosures made to stockholders at that time.[1] Plaintiffs answer that this fact will not alone support the relief that defendants' motion seeks because: (1) they have been injured and are threatened with future injury as a result of the alleged failure to disclose and that fact accords them standing; and (2) the wrong itself is a continuing one, in all events and they have a current interest in the continuing, planned effect of the 1982 fraud.

I.

At the outset the parties disagree on the question whether the claim that the 1982 proxy materials were false or misleading is a derivative or class claim. Defendants, originally at least, premised their argument that plaintiffs have no standing on the assertion that this claim was derivative in nature. In the event that it were so considered, the contemporaneous stockholding requirement of Section

1. The parties have not raised and I do not address the question whether this allegation states a claim upon which relief could be granted. *See Weinberger v. United Fin. Corp.*, Del. Ch., C.A. No. 5915, Hartnett, V.C. (Oct. 13, 1983), slip op. at 24 (complete candor does not require fiduciary to admit corrupt mental state; "self flagellation" not required). *Accord Ash v. LFE Corp.*, 525 F.2d 215, 220 (3d Cir. 1975); *Missouri-Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 873 (2d Cir. 1974); *Bertoglio v. Texas Int'l Co.*, 488 F. Supp. 630, 649 (D. Del. 1980).

327 of the Delaware General Corporation Law would appear to preclude these plaintiffs from litigating Count II of their complaint. *See Newkirk v. W.J. Rainey, Inc.*, Del. Ch., 76 A.2d 121 (1950). The argument that the claim is a derivative one is premised on the assertion that what was allegedly not disclosed was an intention to use the power that the certificate amendment and recapitalization made possible, to deprive CERBCO of a corporate opportunity. Asserting that such a diversion would itself constitute a derivative wrong, plaintiffs invite the court to regard the voting allegations as extensions of that same type of claim. This reasoning is, in my opinion, mistaken.

[1] The right to vote stock is the individual right of the legal owner of stock. When the board of directors wrongfully interferes with or wrongfully impairs that right, it violates individual rights of stockholders. *See Lipton v. News Int'l*, Del. Supr., 514 A.2d 1075, 1079 (1986); *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929 (1985); *In re Anderson Clayton Stockholders Litig.*, Del. Ch., 519 A.2d 680 (1986); *Freedman v. Restaurant Assocs.*, Del. Ch., C.A. No. 9212, Allen, C. (Oct. 16, 1987), [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 97,221. The wrong is one suffered by all those who vote, but it is not a derivative wrong for that reason, but a direct one. It is analogous to the violation of a contract right. *Cf. Moran v. Household Int'l Inc.*, Del. Ch., 490 A.2d 1059, 1070, *aff'd*, Del. Supr., 500 A.2d 1346 (1985).

Thus, I conclude that, since the claim of proxy non-disclosure is itself not a derivative claim, Section 327 of title 8 has no direct bearing on this motion. I turn then to consider defendants' further argument that plaintiffs have no standing to assert or litigate the existence of a disclosure wrong that may have occurred several years before plaintiffs acquired an interest in the company.

II.

Plaintiffs claim first that they have rights of their own to litigate this claim as persons who will be injured by the final step in the asserted scheme that started with the 1982 vote. I conclude that while plaintiffs may have standing to complain about any breach of duty that occurs while they are shareholders, they have no direct right to be awarded judicial relief for these 1982 acts.[2] I conclude

2. This holding does not, of course, address questions of what constitutes

as well that plaintiffs have no standing to assert this claim as successors in interest to whomever owned their stock at the time of the vote on the 1982 certificate amendment.

In support of their assertion that, as present stockholders, plaintiffs have standing to litigate the quality of the 1982 proxy solicitation materials, they offer a theory that they characterize as "continuing wrong." The idea is that the 1982 failure to disclose defendants' subjective intent or understanding was part of a continuing scheme that has (only recently) resulted in injury to CERBCO and, thus, is a matter that impacts upon plaintiffs, as current shareholders.

This theory is unavailing to confer standing upon plaintiffs to litigate a class action claim seeking relief for a 1982 proxy wrong, since what is at issue on this motion to dismiss that claim is not the capacity of the corporation to recover any loss that may (recently) have been occasioned by defendants' actions. That is the derivative claim. What is at issue here is the ability of the shareholders individually to enforce rights allegedly violated in 1982. Insofar as 1982 acts may, in fact, be relevant in some way to the claimed derivative injury, evidence of them should, other considerations of evidence law aside, be admissible. *See supra* note 2. But to admit that those acts might have evidentiary value with respect to a derivative claim is quite different from saying that those 1982 acts can themselves be a source of liability to these plaintiffs.

[2] Nor is there authority to accord stockholders' standing to plaintiffs in their capacity as successors to the earlier holders of the stock. It has been held that those owning shares at the time of the proxy wrong are the persons who possess rights arising from any disclosure violations and that their successors do not. *See Schwartzman v. Tennaco Mfg. Co.*, 319 F. Supp. 1278 (D. Del. 1970).

Indeed, regardless of the theory asserted, plaintiffs are able to cite no case under the law defining the duties of corporate directors, or under Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78n (1991), in which one who has become a shareholder after allegedly defective proxy solicitation materials were distributed and the vote taken, has been accorded standing to litigate the quality

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relevant and admissible evidence of such legal claims as plaintiffs do have standing to assert. Rather, I here hold that plaintiffs have no standing to prove a violation of a duty in 1982 as a premise for the granting of relief for such breach.

of the disclosures in that proxy statement. Nor has our own research uncovered such a case.[3]

But our search has uncovered a number of instances in which courts have declined to permit one who acquires ownership of shares after a corporate vote has been taken, to challenge the quality of the disclosures made in soliciting proxies for that vote. For example, in the case of *Smillie v. Park Chemical Co.*, 466 F. Supp. 572 (E.D. Mich. 1979), a shareholder plaintiff brought an action seeking to rescind corporate action taken in the years 1973-1976, on the grounds that the proxy solicitations in these actions violated Section 14(a) by failing to disclose certain material facts regarding the company. The district court stated: "[I]t is undisputed that plaintiff . . . did not even own voting stock in 1973, 1974, or 1975. Clearly, she lacks standing to sue for alleged proxy violations occurring during those years. *See Wulc v. Gulf W. Indus. Inc.*, 400 F. Supp. 99, 103-04 (E.D. Pa. 1975)." *Smillie*, 466 F. Supp. at 575. The *Wulc* case involved a suit under Section 14(a) brought by the holder of stock options. In denying the plaintiff standing to pursue the proxy disclosure claim, the court explained:

> As the Court stressed in *Mills [v. Electric Auto-Lite*, 396 U.S. 375, 381 (1964)], § 14(a) was intended to protect corporate suffrage and thus "promote the free exercise of the voting rights of stockholders." Thus, to have standing under § 14(a), the plaintiff is required to be a shareholder with voting rights in order to establish a nexus with the statute.

Wulc, 400 F. Supp. at 104.[4]

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3. In one case a representative plaintiff who was a shareholder at the time of the distribution of one of two proxy statements, both of which "allegedly suffered from the same material omissions," was permitted to attack the adequacy of both. *See Zell v. Intercapital Income Sec., Inc.*, 459 F. Supp. 819 (N.D. Cal. 1978), *rev'd on other grounds*, 675 F.2d 1041 (9th Cir. 1982).

4. The decided cases all go the same way: a shareholder plaintiff must have owned shares at the time of alleged proxy violations in order to have standing to sue under Section 14(a). *See, e.g., In re Penn Cent. Sec. Litig.*, 347 F. Supp. 1327, 1342 (E.D. Pa. 1972); *Murray v. Hospital Corp. of Am.*, 682 F. Supp. 343, 348 (M.D. Tenn. 1988) ("plaintiffs who are not shareholders with voting rights at time of alleged violation lack standing . . . under § 14(a)"); *Werfel v. Kramarsky*, 61 F.R.D. 674, 677-78 (S.D.N.Y. 1974) (denying holder of warrants standing because plaintiff had no voting rights); *District 65, UAW v. Harper & Row Publishers*, 576 F. Supp. 1468, 1486 (S.D.N.Y. 1983) (claim dismissed because plaintiffs not shareholders at the time of purported solicitation); *Daly v. Neworld Bank for Sav.*, C.A. No. 87-0996-Mc, 1988 U.S. Dist. LEXIS 15642 (D. Mass. July 19, 1988) (dismissing

A similar result obtains under Section 12 of The Securities Act of 1933, 15 U.S.C.A. 77*l* (1991), where plaintiffs who have acquired stock from one who bought pursuant to a prospectus are not accorded a right to assert a claim that the prospectus was in some respect false or misleading. *See, e.g.*, *Collins v. Signetics Corp.*, 605 F.2d 110, 113-14 (3d Cir. 1979).

I find this absence of precedent, in the circumstance, to be fatal to plaintiffs' ability to litigate a claim that arose years before they became stockholders. The Delaware precedents that plaintiffs do cite (e.g., *Maclary v. Pleasant Hills, Inc.*, Del. Ch., 109 A.2d 830 (1954); *Elster v. American Airlines, Inc.*, Del. Ch., 100 A.2d 219 (1953)) are not helpful to them. Those cases deal with the question of when does a transaction occur or close for Section 327 purposes. Plainly, under the reasoning they employ, the relevant "transaction" here was completed when the vote was held or, at the latest, when the recap was effectuated. The effect of an act can ripple through decades. But that fact does not mean that the act itself continues for Section 327 purposes so as to entitle later purchasers of the stock to sue on earlier wrongs. Therefore, plaintiffs can draw no comforting analogy to these cases. In no sense were plaintiffs shareholders when the wrongs they purport to allege in Count II occurred.

Plaintiffs' rights are fully protected if the claims that they bring relating to the alleged misuse of power are fairly adjudicated. In addition, their claim to change through rescission the nature or structure of the enterprise in which they invested is one that has not been recognized by the law. The motion to dismiss this claim will, therefore, be granted.

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claim because plaintiff failed to adequately plead that proposed class members owned stock at time of solicitation); *Gabrielson v. BancTexas Group, Inc.*, 675 F. Supp. 367 (N.D. Tex. 1987) (stating in dicta that "14(a) was intended to benefit only . . . individuals whose proxies were actually solicited to approve . . . a particular transaction"); *see also* Louis Loss, Fundamentals of Securities Regulation 297 (2d ed. Supp. 1992); 1 Thomas Hazen, The Law of Securities Regulation 659 (prac. ed. 1990).

IN RE USACAFES, L.P. LITIGATION

No. 11,146

Court of Chancery of the State of Delaware, New Castle

January 21, 1993

In 1989, a class action was brought on behalf of all public holders of a limited partnership interest in USACafes, L.P. (now Cafes One, L.P.). The action was brought against USACafes General Partner, Inc., its directors, controlling shareholders, and Metsa Acquisition Corporation for claims related to the sale of substantially all assets of USACafes to Metsa. Plaintiffs sought to amend their complaint in order to seek damages in a derivative capacity on behalf of Cafes One against defendants for allegedly improper payments made in years prior to the sale of assets.

The court of chancery, per Chancellor Allen, held that the claims in plaintiffs' amended complaint were barred by the three year statute of limitations. The court concluded that shareholders or interest holders need not delve aggressively into the internal affairs of a corporation or limited partnership, but when facts are disclosed that give rise to inquiry, an applicable statute of limitations requires timely action to preserve rights.

1. Limitation of Actions ⟹ 99(1)

Where actionable self-dealing is alleged in a derivative suit against a corporate fiduciary, the statute of limitations applies, but may be tolled until such time as a reasonably diligent stockholder knew or had reason to know of the facts alleged to have constituted the wrong.

2. Limitation of Actions ⟹ 137

Where plaintiff's pleading shows on its face that if applicable statute of limitations were applied the claim asserted would be time-barred, it is plaintiff's burden to plead facts which would support conclusion that running of statute was tolled.

3. Limitation of Actions ⟹ 118(2), 137

If defendant can show by undisputed facts outside pleadings that statute of limitations was not tolled during three year period prior

to the filing of complaint, defendant may be awarded summary judgment.

4. Limitation of Actions ⟹ 104(1)

Generally, in absence of actual steps to conceal a wrong by a corporate director, Delaware courts apply the statute of limitations to stockholders in derivative suits.

5. Limitation of Actions ⟹ 104(1)

Shareholders or interest holders need not delve aggressively into the internal affairs of a corporation or a limited partnership in order to assure that a non-public, self-dealing transaction is not foreclosed from attack by limitations, but when facts are disclosed that give rise to inquiry, an applicable statute of limitations will require timely action to preserve rights.

Joseph A. Rosenthal, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; Scott W. Fisher, Esquire, and Jerald M. Stein, Esquire, of Garwin, Bronzaft, Gerstein & Fisher, New York, New York; and Robert M. Roseman, Esquire, of Spector & Roseman, P.C., Philadelphia, Pennsylvania, for plaintiffs.

John H. Small, Esquire, and Bruce E. Jameson, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; Michael L. Knapek, Esquire, and Michael C. French, Esquire, of Jackson & Walker, Dallas, Texas, for defendants Cafes One, L.P., Cafes General Partner, Inc., Sam Wyly, Charles J. Wyly, C. Jeffrey Rogers, B.B. Tuley, J.D. Francis, and F. Jay Taylor.

Daniel A. Dreisbach, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and David L. Kornblau, Esquire, of Paul, Weiss, Rifkind, Wharton & Garrison, New York, New York, for defendant Metsa, Inc.

ALLEN, *Chancellor*

Pending is plaintiffs' motion pursuant to Chancery Court Rule 15, for leave to file a Second Amended Consolidated and Supplemental Complaint.

Since 1989, plaintiffs have been pursuing class action claims related to the sale that year of substantially all of the assets of USACafes, L.P. to Metsa Acquisition Corp., ("Metsa"). *See In re USACafes, L.P. Litig.*, Del. Ch., 600 A.2d 43 (1991). The class action is on behalf of all of the public holders of limited partnership interests in USACafes, L.P. (now Cafes One, L.P.). The principal defendants are the general partner, USACafes General Partner, Inc., its directors (including its controlling shareholders Sam and Charles Wyly), and Metsa.

Plaintiffs now seek to amend their complaint to seek damages in a derivative capacity, on behalf of Cafes One, L.P., against the directors of the general partner, for allegedly improper payments made to the defendants in the years prior to the sale of assets to Metsa. (¶¶ 41-49) Central defendants in the proposed amended pleading, as in the original pleading, are Sam and Charles Wyly, brothers who own all of the voting stock of the general partner, as well as approximately forty percent of the limited partnership units, and who serve as chairman and president (Sam) and director and officer (Charles) of the general partner.

The new allegations are that in the years 1986 to 1989 the directors of the general partner awarded themselves "excessive directors' fees, salaries, travel expenses, automobile expenses, business allowances, and options grants" that "were unrelated to any services rendered to USACafes." (¶ 94) These fees were paid by the partnership under the Partnership Agreement.

Specifically, plaintiffs allege that in 1988, Sam Wyly attended only one directors' meeting personally and three by telephone and provided no other substantial services to USACafes, while receiving $124,278 in wages and salaries, and $483,000 in "non-employee compensation" from USACafes. (¶ 43) Plaintiffs allege that as compensation for attending these four directors' meetings in 1988, Charles Wyly received $114,305 in wages and salary and $183,000 in "non-employee compensation." For the year 1989, Sam Wyly received payments totaling $684,711[1] and Charles Wyly received $353,865

1. Sam Wyly allegedly received the following payments in 1989:

Salary:	$141,421
Director's Fee:	$339,000
Business Allowance:	$144,000
Auto, Travel & Ins.:	$ 60,490
Total	$684,711

for services of substantially the same character.[2] (¶ 44) This is alleged to be waste or, at least, unfair self-dealing, since the Wylys are alleged to dominate and control the board of directors of the general partner.

In addition, the proposed complaint seeks to add claims that the partnership paid one Don Thomson, who is alleged to be a friend of the Wylys, over $300,000 in fees and expenses in 1988, and loaned him several hundred thousand dollars from 1987 to 1989. These payments are said to constitute waste.

It is also alleged that defendants awarded themselves options to purchase limited partnership units, including 100,000 options to Sam Wyly and Charles Wyly each in 1986 and 200,000 to Sam and 100,000 to Charles in 1988, without compensation to the firm. (¶ 47)

It is further asserted that in an effort to conceal these activities, defendants converted USACafes from a corporation to a limited partnership in 1986, thus avoiding certain disclosure obligations created by the federal securities laws and regulations. (¶ 48) Compliance with these avoided disclosure obligations, in plaintiffs' view, would have resulted in the exposure of defendants' activities to the scrutiny of plaintiffs and the general public, and alerted plaintiffs to bring suit to protect the asserted rights of the limited partnership before the expiration of the statute of limitations.

Finally, plaintiffs seek to add to their complaint, additional detail regarding the Metsa transactions. These new factual allegations are that the business prospects for the Company were quite good at the time of the sale and that, in connection with the sale, the Wyly's diverted $438,000 in fees to Glass and Wyly, a financial advisory firm owned by Evan Wyly, Sam Wyly's son. (¶ 69)

Plaintiffs also claim that the newly alleged acts of corporate waste injured the class of unit holders in the Metsa sale because they had the effect of depressing the market value of USACafes, L.P. and thus decreasing the amount realizable by the unit holders in its sale. The claim that the entity was overreached by the general partners is, however, plainly a derivative and not a class claim. It is one thing to claim that the unit holders might have individually

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2. Charles is alleged to have received the following payments in 1989:

Salary:	$141,421
Director's Fee:	$111,000
Business Allowance:	$ 72,000
Auto, Travel & Ins.:	$ 29,324
Total	$353,865

received more on a liquidation sale if the Company would have been better shopped or if some part of the consideration the buyer was willing to pay had not been improperly diverted. It is rather different to say that more could have been realized if the business had years earlier been run in some other way. The latter claim is plainly derivative and relates to earlier acts and earlier (potential) liabilities. This is a material fact in a motion raising limitation issues.

I.

Defendants oppose plaintiffs' motion to amend, arguing that the proposed additional claims would be stricken on a motion to dismiss and, therefore, should not be added to the complaint. *See Itek Corp. v. Chicago Aerial Indus., Inc.*, Del. Supr., 257 A.2d 232, 233 (1969). Defendants maintain that the proposed derivative claims, contained in Count III of the proposed complaint, cannot survive a motion to dismiss because: (1) the applicable statute of limitations has run; (2) in any event, plaintiff has failed to meet the demand requirement by making demand upon the general partner to pursue these claims or adequately alleging that demand is excused; (3) plaintiffs and their law firm will have fatal conflicting interests if they attempt to represent both the class and derivative claimants simultaneously; and (4) the proposed complaint fails to allege fraud with particularity.

II.

I turn to the limitation issue which I regard as dispositive. Defendants claim that, to the extent that plaintiffs' proposed amended complaint seeks to recover damages for alleged wrongdoing which occurred prior to July 1, 1989, the claims are barred by application of the three year statute of limitations contained in 10 *Del. C.* § 8106 (1991).[3]

[1-3] The application of the statute of limitations by the Court of Chancery, in an action charging a corporate director with actionable self-dealing has been the subject of a recent opinion. *See Kahn v. Seaboard Corp.*, Del. Ch., No. 11,485, Allen, C. (Jan. 14, 1993). In that case, in harmonizing *Bokat v. Getty Oil Co.*, Del. Supr., 262 A.2d 246 (1970), and *Bovay v. H.M. Byllesby & Co.*, Del. Supr., 38 A.2d 808 (1944), I expressed the opinion that where actionable self-dealing is alleged in a derivative suit against a corporate fiduciary,

3. Plaintiff filed the proposed Second Amended Complaint on July 1, 1992.

the statute of limitations applies, but may be tolled until such time as a reasonably diligent and attentive stockholder knew or had reason to know the facts alleged to constitute the wrong. Furthermore, it was there held that where, as here, plaintiff's pleading shows on its face that if the applicable statute were applied, the claim asserted would be time-barred, then it is plaintiff's burden to plead facts which could support a conclusion that, in the circumstances, the running of the statute was tolled. *See Kahn*, No. 11,485, slip op. at 16. Finally, if this is done as a pleading matter, but defendant is able to show by undisputed facts outside of the pleadings that the statute was not tolled during the three year period prior to filing of the complaint, then defendant may be awarded a summary judgment. *See Bokat v. Getty Oil Co.*, Del. Supr., 262 A.2d 246 (1970).

Here the principal question with respect to the impact, if any, of the statute of limitations upon the present assertion of this claim is the question when did class members have reasonable notice of the facts now alleged to constitute the claims that plaintiff wishes to assert derivatively. The parties have submitted certain public filings which I treat as establishing, not the truth of any statements therein, but the fact that the statements therein were made on and after the filing of such documents.

A. Disclosures Concerning Salaries Received by Directors

A review of the 10-K forms and other public documents filed by USACafes with the SEC shows that prior to fiscal year 1988, the Company disclosed the individual salaries paid by the partnership to each of the general partner's directors or principal officers each year. For example, the 1986 prospectus issued by USACafes discloses that in fiscal year 1986 the defendants were paid the following cash compensation: Sam Wyly-$456,000; Charles Wyly- $228,000; C. Jeffrey Rogers-$337,865; Charles B. Brewer-$170,500; Ronald W. Parker-$165,500; Mr. J.D. Francis and Mr. F. Jay Taylor- $30,000 director's fee to each. (DX A at 75)

USACafes 10-K for the fiscal year ending December 31, 1987, shows the following cash compensation: Sam Wyly-$580,144; Charles Wyly-$288,143; C. Jeffrey Rogers-$287,938 salary, $682,948 bonus; Charles B. Brewer-$131,292 salary, $261,906 bonus; Ronald W. Parker-$142,308 salary, $270,085 bonus; Mr. J.D. Francis and Mr. F. Jay Taylor-$30,000 director's fee to each. (DX B at 45)[4]

4. All references to defense exhibits refer to documents attached to defendants' submission of October 21, 1992.

In fiscal year 1988, under the heading "Executive Compensation," the Company reported only the aggregate amount of direct and indirect expenses, incurred by the General Partner on behalf of the partnership, and reimbursed by the partnership. In 1988, these expenses totalled $5,830,000. (DX C at 48) Plaintiffs now assert Sam Wyly received some $610,000 (*see supra* p. 2) that year. While his share of the $5.8 million expense was not reported, note how comparable that amount was to what had been reported for the previous year ($580,000) as payments to him. For fiscal year 1989, the Company reported the direct and indirect expenses incurred by the general partner and paid by the partnership in the same fashion, stating that they totalled approximately $7,200,000. (DX D at 59) Now plaintiffs wish to allege that Sam Wyly received $684,711 (*see supra* note 1) which was not separately disclosed.

B. Disclosures Concerning Loans to C. Jeffrey Rogers

Plaintiffs allege that improper loans were extended to Mr. C. Jeffrey Rogers from 1986 until 1989. (¶ 46) A review of the SEC filings shows that the existence and amount, but not the exact purpose, of these loans was disclosed by the Company. The prospectus issued in 1986 stated that "since October 1983, Mr. Rogers has obtained a series of loans from the Company . . . with the largest principal amount . . . outstanding . . . being $977,455." (DX A at 79) The Company's 10-K for the fiscal year ending December 31, 1987, discloses that Mr. Rogers at that point had two loans of $1,062,176 and $864,911 respectively. (DX B at 48) The 10-K for the fiscal year ending December 31, 1988, disclosed that Mr. Rogers owed the Company $1,131,000 on that date. (DX C at 43) Finally, the 1989 10-K shows that as of October 1989, Mr. Rogers owed $813,000 to the Company and that this debt was forgiven "in conjunction with the sale" to Metsa. (DX D at 25)

The 1986 prospectus and December 31, 1987 10-K form do not describe how Rogers applied the funds he obtained through the loans from the Company, except to note that they included amounts owed under his stock purchase agreement with the Company. (DX A at 79) The 1988 and 1989 10-K forms state that the loans included amounts under stock and unit purchase agreements "and for personal use." (DX C at 40; DX D at 49)

C. Disclosure of Payments to Don Thomson

Don Thomson, a former director of USACafes and later a consultant to the Company, is alleged in the proposed amended

complaint to have received improper cash payments from the Company and to have improperly arranged for the Company to pay hundreds of thousands of dollars in life insurance premiums on his behalf. (¶ 45) The 1986 prospectus stated that in February 1984 Mr. Thomson entered into a seven year contract to provide financial advisory services to the Company in exchange for the Company paying him a fee of $90,000 annually. The document states that the Company was also paying the premiums on an insurance policy on his life.[5] The prospectus discloses that the annual premium on this policy was $124,236 for fiscal year 1986. (DX A at 78) The same document also reveals that Mr. Thomson was indebted to the Company in the amount of $106,390. (DX A at 79) Mr. Thomson's indebtedness to the Company is disclosed on the 1986, 1988, and 1989 10-K forms. (DX B at 39; DX C at 43; DX D at 54) In 1989 Mr. Thomson's indebtedness totalled $317,000 and was forgiven as part of the Metsa sale. That forgiveness is challenged in the existing class action. (DX D at 54)

D. Disclosures of Grants of Stock and Unit Options

The plaintiffs allege in ¶ 47 of the Complaint that "Sam Wyly dispensed huge quantities of options to acquire USACafes securities to himself, his brother, and certain favored executives whenever he deemed it appropriate." Putting to one side the defects of such a pleading from the point of view of vagueness, it must be noted that the following was disclosed in 1986: "On September 22, 1986 the Company granted 200,000 and 100,000 non-qualified stock options to Sam Wyly and Charles J. Wyly, Jr. respectively, at an exercise price of $6.25 per share, the last reported sales price of the common stock on such date." (DX A at 75) The 1986 prospectus also states that C. Jeffrey Rogers received options to buy 257,000 shares while Charles Brewer and Ronald Parker received options to buy 70,000 and all directors and officers received options to buy 452,000 shares. The 1987 form 10-K states that "[d]uring 1987, Mr. Rogers was granted 100,000 options to purchase units . . . at a price . . . which represented fair market value . . . . No other executive officers of the General Partner were granted unit options during 1987." (DX B at 47) The 1988 form 10-K states that "[o]n January 18, 1988,

5. The document also states that USACafes was the beneficiary under the policy to the extent of premiums previously paid, with the remainder being paid to Mr. Thomson's immediate family.

200,000 and 100,000 options were granted to Mr. Sam Wyly and Mr. Charles Wyly, respectively, at $8.00 per unit which approximated fair market value." (DX C at 49) The 1988 10-K also states that on January 17, 1988, Mr. Rogers received options to purchase 120,000 units while Mr. Parker and Mr. Brewer received options on 35,000 and 20,000 units respectively. Mr. Parker also received, according to the 1988 form 10-K, additional options to purchase 17,500 units on November 18, 1988. (DX C at 49) The 1989 form 10-K states that on May 10, 1989, an option to purchase 25,000 units at $9.125 was issued to "an executive officer of the general partner" and later redeemed for the difference between the exercise price and $10.25, totalling $28,125. (DX D at 61)

* * *

[4] Generally, Delaware courts have, in the absence of actual steps to conceal a wrong by a corporate director, applied the statute of limitations to stockholders in derivative actions against corporate directors seeking the award of money. *See Bokat v. Getty Oil Co.*, Del. Supr., 262 A.2d 246 (1970); *Halpern v. Barran*, Del. Ch., 313 A.2d 139 (1973); *Boeing Co. v. Shrontz*, Del. Ch., No. 11,273, Berger, V.C. (Apr. 20, 1992). In *Bovay v. H.M. Byllesby & Co.*, Del. Supr., 38 A.2d 808 (1944), the Court declined to do so where the essence of the claim was fraudulent self-dealing that personally enriched a corporate fiduciary. My understanding of this law when read together is set forth in *Kahn v. Seaboard Corp.*, Del. Ch., No. 11,485, Allen, C. (Jan. 14, 1993).

Here I conclude that the statute of limitations does apply to bar litigation now of these claims that, if they are assumed to be valid, arose prior to July 1, 1989.[6]

I find no basis in the pleading or undisputed facts concerning public disclosures to rebut the application of the statute. The notion that the 1986 conversion to the partnership form had the purpose or effect of "covering up" the alleged wrongs now brought forward—the grant of options and the payment of salaries chiefly— seems palpably to be a lawyers' invention for litigation use. But I here do not now pass on matters of plausibility; plaintiffs' counsel are permitted to advance factual contentions that others take to be implau-

6. I note that these new matters do not arise out of the subject matter of the complaint—the asset sale to Metsa or the disclosure of voting rights in the 1986 Prospectus and thus would not "relate back" under Ch. C. Rule 15.

sible if they have good ground to believe them to be true. *See* Ch. C. Rule 11 (1991). But plaintiffs have pleaded no fact that would support the idea that this reorganization was done for the purpose of concealing future wrongs. More pertinently they have not shown that the conversion resulted in a situation in which a reasonably alert interest holder would not have been placed on notice of conduct of the kind here complained of, during the period when the statute was running but had not run out.

The facts set forth above, derived from publicly filed documents, disclose to reasonably alert interest holders the existence of a practice of paying compensation to the Wylys and the level of those payments and the Wylys involvement in the Company; disclosed the loans to Mr. Rogers; disclosed payments to Mr. Thomson and the insurance arrangements; and disclosed the grants of options at market price. [5] Shareholders or interest holders need not delve aggressively into the internal affairs of a corporation or a limited partnership in order to assure that a non-public, self-dealing transaction is not foreclosed from attack by limitations, but when facts are disclosed that give rise to inquiry, an applicable statute of limitations will require timely action to preserve rights. *See Bokat v. Getty Oil Co.*, Del. Supr., 262 A.2d 246 (1970); *Kahn v. Seaboard Corp.*, Del. Ch., No. 11,485, Allen, C. (Jan. 14, 1993). That in my judgment is the case here.

The motion to file the proposed amended complaint will be denied. The parties are directed to confer and attempt to agree on those parts of the proposed amendment that may be permitted by agreement.