CARTERET BANCORP, INC. v. HOME GROUP, INC.

No. 9380

CUBIT CORP. v. HOME GROUP, INC.

No. 9386

Court of Chancery of the State of Delaware, New Castle

January 13, 1988

Plaintiffs alleged that defendants breached certain contractual obligations of a merger agreement requiring them to use their best efforts to obtain necessary regulatory approvals for the merger and to act in good faith so as to complete the transaction before June 30, 1988. Consequently, plaintiffs contended the defendants had anticipatorily repudiated the entire merger agreement and as relief sought specific performance of the best efforts clause of that agreement. Defendants moved for dismissal arguing that the complaint failed to state a claim whereby relief could be granted and that the claim fell outside the court of chancery's equitable jurisdiction.

The court of chancery, per Chancellor Allen, rejected plaintiffs' contentions and granted defendants' motion to dismiss. The court found that the complaint neither alleged an anticipatory breach of the contract sued upon nor alleged a present breach of the defendants' obligation to use their best efforts to effectuate the merger. Furthermore, the court ruled that specific performance to obligate the promisee to proceed in good faith was inappropriate under these circumstances.

1. Contracts ⟹ 313(1)

Under the doctrine of anticipatory repudiation, a promisor's unequivocal statement that he will not perform his promise gives the injured party an immediate claim to damages for the total breach in addition to discharging the promisee of any remaining duties of performance.

2. Specific Performance ⟹ 105(1)

A promisee who seeks specific enforcement of a contract, rather than damages, fails to state a claim under which such relief may be granted unless the promisee can allege that the defendant is

under a present legal obligation to perform the contract and has wrongfully failed to do so.

3. Specific Performance ⟹ 105(1)

An anticipatory repudiation theory will not support specific performance relief prior to the time the parties themselves agreed that the performance was due.

4. Contracts ⟹ 313(2)

An action for breach of contract prior to the contracted-for time of performance is a repudiation only when it is positive and unconditional.

5. Contracts ⟹ 313(1)

A retraction has the effect of nullifying a repudiation and placing the matter in its original position; however, when the repudiation has been detrimentally relied upon by the promisee, the promisor will lose the power to retract the repudiation.

6. Contracts ⟹ 57, 313(1), 313(2)

Specific Performance ⟹ 126

A suit seeking specific performance is an assertion not that the promisee elects to finalize the breach and calculate damages now, but rather that the promisee treats the mutual obligations as still being in force; where the promisee does so, no purpose would be served by treating the filing of suit as cutting off the promisor's power to retract a repudiation.

7. Contracts ⟹ 313(2)

Until such contingencies occur as to violate the best efforts clause of the contract, no present breach of contract exists.

8. Equity ⟹ 41

A court of equity will normally not grant equitable relief such as an injunction or an order of specific performance when it would require constant supervision by the court.

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ALLEN, *Chancellor*

The complaint charges breach of a contractual undertaking by defendants to use their best efforts to cause required regulatory approvals to a corporate merger to be obtained and to otherwise act in good faith to cause that transaction to be accomplished before June 30, 1988, the termination date of the Agreement of Merger. The principal relief sought is the specific enforcement of the best efforts clause of that Agreement. That is, plaintiffs seek an injunction requiring defendants, broadly, to use their best efforts to obtain required regulation approvals and, specifically, to take or refrain from taking certain identified actions.

The complaint has been challenged as failing to state a claim upon which relief may be afforded and as failing to state a claim falling within this court's equitable jurisdiction. For the reasons set forth below, I conclude that the motion addressed to the legal sufficiency of the complaint should be granted. In brief, I conclude

that the complaint does not allege an anticipatory breach of the contract sued upon, nor does it allege a present breach of the obligation to use best efforts to promote the merger transaction contemplated by that agreement. Moreover, I conclude that the remedy of specific enforcement of a contractual obligation to proceed in good faith, while available in appropriate instances, is unavailable where the contract sued upon relates to a future, evolving complex commercial transaction and any attempt to specifically enforce a right to good faith best efforts would necessarily involve either an order of such vague generality as to give little or no specific direction to the person or entity subject to the order or would involve the court in the detailed administration of an ongoing, complex transaction.

A fuller statement of both of these reasons for granting the pending motion to dismiss must await a description of the background facts as they appear in the complaint.

I.

Plaintiffs are Carteret Bancorp, Inc., a Delaware corporation ("Carteret"), and its predominantly-owned subsidiary, Carteret Savings Bank F.A., a federally-chartered savings bank with its principal office in the State of New Jersey. The principal defendant is Home Group, Inc. ("Home"), a Delaware corporation engaged, through subsidiaries, in the business of providing various financial services importantly including property and casualty insurance. Also named as a defendant is Home's wholly-owned subsidiary, JAM Financial Corp.

Home and Carteret have entered into an Agreement and Plan of Reorganization dated as of August 4, 1987. This "Reorganization Agreement" contemplates and appends a separate Agreement of Merger, dated as of the same date, that calls for a cash for stock merger of JAM Financial with and into Carteret. The merger agreement requires the payment of $22.50 cash for each pre-existing share of Carteret common stock. Following effectuation of the merger, Carteret would be a wholly-owned subsidiary of Home.

The merger is or was a "friendly" one negotiated between Carteret's management and Home. Because Carteret controls a federally-chartered depository institution, however, effectuation of the merger is subject to the prior approval of the Federal Home

Loan Bank Board ("FHLBB") which regulates federal savings institutions and their holdings companies. The schedule upon which the merger transaction may move forward is thus not altogether within the control of the parties. Therefore, the Reorganization Agreement provides that the certificate of merger is to be filed as soon as practicable after the receipt of approvals from FHLBB and other governmental agencies from whom approval has been sought and after the required corporate steps are accomplished. Significantly for the present dispute, the Reorganization Agreement provides that the obligations it creates may be terminated prior to effectuation of the merger in a number of circumstances, including (1) the denial of any "necessary or appropriate" application for regulatory approval (specifically including the FHLBB, the Federal Savings and Loan Insurance Corporation) or (2) the failure to effectuate the merger by June 30, 1988.

The Reorganization Agreement requires Home and Carteret to submit necessary or appropriate applications for regulatory approval "as promptly as practicable" and specifically articulates an obligation to use "best efforts in good faith" to promote the consummation of the merger:

> Home Group, Carteret Savings and Carteret shall each use its best efforts in good faith to. . .take or cause to be taken all action necessary or desirable on its part so as to permit consummation of the Merger at the earliest possible date. None [of them] shall take. . .or to the best of their ability permit to be taken any action that would substantially impair the prospects of completing the Merger. . .

By October 19, 1987—the date of a historic stock market decline—an application for FHLBB approval of the change in control of Carteret and its savings bank subsidiary had not yet been filed. Following the general plummet of stock values, Home's ardor for Carteret cooled and relations between the two firms became less friendly. Home's representatives, in an effort to renegotiate the price in light of the fall in Carteret's stock price, allegedly announced the existing deal was "dead" and, according to the complaint, Home began to find or create problems. For example, the complaint alleges that Home thereafter sought to require Carteret to include "malicious and untrue accusations. . . against [Carteret's] Chairman. . ." in Carteret's proxy solicitation materials.

On November 6, 1987 Carteret and Carteret Bank filed a complaint in this court asserting that Home was presently in breach of certain of its obligations under the Reorganization Agreement and had anticipatorily repudiated the entire agreement. Stated generally, the complaint alleges that Home "has attempted to erect barriers to. . .the completion of the transaction" in violation of its obligation to facilitate its effectuation. Specifically, it is alleged that Home:

> (1) ". . .has in bad faith, delayed filing. . .its application . . . with the Federal Home Loan Bank Board. . .";
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> (2) "has maintained that approval of [the merger] is required by the Commissioner of Insurance of Pennsylvania and New Hampshire" even though, allegedly, "such approvals are not required. . .";
>
> (3) has asserted that "completion of the Merger depends upon receipt of financing. . .on terms satisfactory to [Home]," even though the Reorganization Agreement contains a representation that Home has "available to its sources of financing sufficient to fulfill its obligations. . .";
>
> (4) has asserted that if the FHLBB requires as a condition of its approval divestiture of a state chartered bank owned by Home and operated as a "non-bank bank" that such condition "may prevent the transaction from being implemented;
>
> (5) has asserted that Home's ownership of Gruntal Financial Corp. (an underwriter of securities) "presents an obstacle to securing regulatory approval. . ." even though Home earlier took the position that Gruntal was not 'principally engaged' in underwriting (and thus ought to present no such obstacle) and that "in any event, such activity would be limited if necessary.";
>
> (6) has sought "to require that Carteret and Carteret Savings purchase shares of stock of Imperial Premium Finance Co. from Home in order to partially finance the Merger, although such an acquisition is not. . . contemplated by the Agreements."; and, lastly
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> (7) that Home has, in bad faith, raised contentions about what should be included in Carteret's proxy solicitation materials including unspecified "malicious and un-

true accusations about Carteret's business and against its Chairman and Board of Directors."

Stated generally, the complaint seeks an order specifically enforcing Home's contractual obligation to use its best efforts, in good faith, to cause the merger between its JAM subsidiary and Carteret to be accomplished before the June 30, 1988 termination date. More specifically, plaintiffs seek a mandatory injunction requiring Home:

1. to file all necessary regulatory applications;
2. to use its best efforts to seek approval of all such applications, including restricting the activities of its Gruntal Financial Corp. subsidiary so that it would not be deemed to be 'principally engaged' in underwriting securities;[1]
3. to refrain "from demanding that plaintiffs comply with conditions not part of the Agreements or acknowledge that consummation of the merger depends upon such conditions. . ." (see Complaint ¶ I.(B.) as for example that:
(a) the merger must be pre-approved by the insurance commissioners of Pennsylvania and New Hampshire;
(b) the merger is conditioned upon Home obtaining financing on terms satisfactory to it;
(c) that sale or disposition by Home of its interest in a state chartered bank may be a necessity in response to FHLBB requirements;
(d) that Carteret should purchase from Home stock of its Imperial Premium Finance Co. subsidiary in order to partially fund the merger transaction and
(e) that disclosure relating to the foregoing should be included in Carteret proxy solicitation materials.

It is acknowledged that in no event may the transaction be accomplished without FHLBB approval. It is now also acknowledged that Home did file an application for such approval on December

1. Under one of the provisions of the Glass-Steagall Act (*viz.* 12 U.S.C. § 377), a deposit-taking institution may not be affiliated with a firm "principally engaged" in underwriting securities. It is alleged that in its pre-October 19 negotiations, Home took the position that its Gruntal subsidiary did not raise a Glass-Steagall problem but, if it did, "such activities of Gruntal would be limited, if necessary." Complaint ¶ 17d.

7, 1987. The complaint asserts that Home has stated in writing its position that it intends to perform its obligation under the Reorganization Agreement. Home continues to take that position.

II.

Home has now moved to dismiss the complaint on two main grounds. First, it contends that this action is premature—that these allegations amount to neither an anticipatory repudiation of its obligation to cooperate to effectuate the merger upon the satisfaction of the regulatory approval and other conditions to closing of that transaction, nor do they constitute a present breach of any contractual obligation to use its best efforts to cause the merger to be accomplished. Second, Home contends that any failure by it to perform its central obligation under the Reorganization Agreement—to do all that is required to have its subsidiary able, authorized and willing to effectuate the merger on the terms agreed upon—would result in injury to Carteret and its shareholders that is easily and dependably quantified in dollars. This assertion is bottomed on the observation that since Carteret stock is publicly traded on the New York Stock Exchange, any damage that may result from failure to close the merger transaction by June 30, 1988 at $22.50 per share can be accurately calculated. From this premise, Home then argues that this court has no jurisdiction over the matter insofar as it seeks specific performance of an obligation, ultimately, to effectuate the merger at $22.50 per share since, it is argued, the legal remedy for breach of any such duty is full, complete and adequate. *See* 10 *Del.C.* § 342.

Insofar as the complaint purports to seek specific performance, not of the obligation to effectuate the merger at $22.50, but of an obligation to use best efforts to obtain necessary or appropriate regulatory approvals and to otherwise promote and not impede the transaction, it is said by defendants to seek relief that has meaning only insofar as it bears upon the likelihood of the merger itself closing. Since failure to accomplish the merger would, in defendants' view, give rise to a claim for money damages only, it is said the instrumental relief of specific performance of a best efforts obligation cannot itself confer equity jurisdiction.

In brief, plaintiffs reply that Chancery jurisdiction is well-pleaded because this contract does not simply involve the purchase of corporate stock for which there is a ready and dependable market but involves the sale of corporate control—assertedly a unique asset.

Moreover, it is urged that non-performance may lead to damages to Carteret itself that would be difficult to measure. For example, Carteret is restricted, until the June 30, 1988 termination date, from engaging in transactions outside of its normal course of business and, thus, by reason of this obligation to Home, it is not exploring profitable opportunities that may otherwise be available to it. The establishment of any such injury and the quantification of resulting damage would, it is said, be a very difficult project, if feasible at all in any realistic sense. Accordingly, it is suggested that specific performance of the obligation to complete the transaction is an appropriate remedy in these circumstances.

As to the charge that the action is premature—that is that the complaint does not state a claim for breach of a present duty or for anticipatory repudiation of a future contract performance—plaintiffs say that their allegations do legally constitute both and that they should be afforded the opportunity to prove those claims at trial.

III.

For the reasons that follow I conclude that the legal theory of anticipatory repudiation has no application to the facts alleged (*see* IIIA), that no claim for a breach of a present contractual obligation has been stated (*see* IIIB) and that, in any event, the relief sought would be unavailable at this time (IV).

A.

An action for specific performance based upon a theory of anticipatory breach involves special doctrinal problems. The idea of giving *damages* presently for the breach of a promise the time for performance of which has not yet arrived undoubtedly involves a certain logical difficulty. If the promise is to do an act only at a future time, how can it (logically or, perhaps better, how can it linguistically) be broken until that time has come? Farnsworth, *Contract* § 8.20 at p. 629 (1982). Perhaps because of this logical problem, some commentators, most notably Professor Williston, have found it difficult to embrace with any enthusiasm the doctrine of anticipatory repudiation. *See, e.g.*, 11 *Williston on Contracts* (3d ed. 1968) § § 1316, 1319-1322. But, purity of doctrinal analysis aside, there are certain practical considerations supporting the utility of the doctrine. If it is clear that the promisor intends not to perform his promise, there seems little reason to force the parties

to wait to have their rights and obligations determined while markets rise and fall and practical adjustments to the new state of affairs could be made.

[1] Thus, the law generally had acknowledged for more than one hundred years[2] that an unequivocal statement by promisor that he will not perform his promise gives "the injured party an immediate claim to damages for total breach, in addition to discharging his remaining duties of performance." Farnsworth, *Contracts* § 8.20, p. 630 (1982).

[2-3] However, conceptually, a suit for specific performance of a promise to do an act promised to be done at a future date is a very different thing than a suit seeking damages for an anticipatory repudiation. While a court might be justified in discounting to their present value future damages that will occur as of the time of performance, it would in no event be justified in requiring actual performance prior to the time agreed to.[3] To do so would not be to enforce specifically the parties' contract but to make a promisee who seeks specific enforcement of a contract, rather than damages, fails to state a claim upon which such relief may be granted unless he can allege that the defendant is under a present legal obligation to perform the contract and has wrongfully failed to do so. In other words, an *anticipatory* repudiation theory will not support specific performance relief prior to the time the parties themselves agreed that the performance was due.

Accordingly, to the extent the complaint seeks an order specifically compelling the performance of an act due in the future, it fails, in my opinion, to state a claim. However, even assuming that proof of a repudiation could support specific performance relief in this instance, I am content that the allegations disclose that there has been an effective revocation or retraction of any such repudiation.

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2. The doctrine of anticipatory breach first drew breath in the Court of Queen's Bench in 1853; *see Hochster v. De La Tour*, 118 Eng. Rpt. 922 (1853).

3. The authorities are not uniform on this point. The better reasoned opinions tend to so hold. *See, e.g., Friedman v. McAdory*, 4 So. 835, Ala.Supr. (1888); *Miller v. Jones*, W.Va.Supr., 71 S.E. 248 (1911). Some cases have awarded specific performance in land contract cases on the theory of anticipatory breach but, in those cases, while the act constituting the repudiation which gave rise to the liability pre-dated the agreed-upon time of performance, the order requiring performance was entered well after the time for performance had passed. *See, e.g. Derwell Co. v. APIC*, Inc., Del.Ch., 278 A.2d 338 (1971); *Bear v. Fletcher*, Ill.Supr., 96 N.E. 997 (1911).

[4-5] The theory justifying an action for breach of contract prior to the contracted-for time of performance really only holds when the repudiation is, in the language of Professor Williston, "positive and unconditional." *See* Williston, *supra* at § 1322.[4] A repudiation is, of course, the reverse of positive and clear where the promisor before the time of performance retracts the repudiation and announces himself prepared to perform his promise. Thus, when effective, a retraction has the effect of nullifying a repudiation and placing the matter in its original position. There are, however, circumstances that will remove the possibility of retraction. This limitation on the power to retract a repudiation reflects a concern for the awkward situation in which ambiguity concerning performance may place the promisee. If the promisee to whom a repudiation has been given relies upon it in any respect to his detriment—in, for example, contracting for a substitute performance or commencing litigation to have a total breach adjudicated and damages fixed prior to the time of performance—the promisor will lose the power to retract the repudiation for, in such circumstances, his retraction cannot really return the situation to its prior status.

[6] Indeed, the law's concern with the uncertainty faced by a promisee to whom a repudiation has been made is such that it, in effect, gives such a promisee the election to withdraw the promisor's power to retract his repudiation simply by notifying the promisor that he considers the repudiation to be final. *See* Restatement of Contracts 2d § 256(1). Institution of a suit predicated upon an anticipatory repudiation will serve as such notice and will preclude an effective retraction. *See, e.g.*, *Hurwitz v. David K. Richards & Co.*, Utah Supr., 436 P.2d 794 (1968); Comment 1 to Uniform Commercial Code § 2-611. A suit seeking specific performance is, however, in effect, an assertion not that the promisee elects to finalize the breach claimed and calculate his damages now, but rather that the promisee treats the mutual obligations as being still in force. Where the promisee does so, there is no purpose to be served by treating the filing of suit as cutting off the promisor's power to retract a repudiation. *Kentucky Natural Gas Corp. v. Indiana Gas & Chemical Corp.*, 129 F.2d 17 (7th Cir. 1942); *Taylor v. Johnston*, Cal.Supr., 539 P.2d 425 (1975) (repudiator may nullify his repudiation prior to time of performance if the other party treats the

4. *See also Didier v. MacFadden Publications*, N.Y. Ct. of App., 85 N.E.2d 612 (1949); *Gittlitz v. Lewis*, N.Y.Supr., 212 N.Y.S.2d 219, 220 (1961).

contract as still in force); *Hadcock Motors, Inc. v. Metzger*, N.Y.Supr., 459 N.Y.S.2d 634, 638 (1983).

Thus, since the complaint in this matter does not represent an election to rescind the contract or to collect damages for its total breach but does represent an affirmation of the continuing effectiveness of the obligation it creates, it remains within Home's power through retraction to nullify any repudiation it may be deemed to have communicated. This the complaint acknowledges Home has attempted to do. The most fundamental disagreement between the parties is whether that assurance is made in good faith. But, when Carteret elected to contract with Home, it necessarily placed trust in Home (in the way that every bilateral contract involves mutual trust) and the fact that it is now distrustful of Home's intention does not state a legal basis for the relief it seeks—an order requiring the court to attempt to supervise the *bona fides* of the ongoing, preparatory activities of Home.

Accordingly, I am of the view that the complaint states no claim for anticipatory breach of contract. Does it then state a claim for the present breach of an obligation of Home to use its best efforts to permit the merger to be effectuated "at the earliest possible date" and to refrain, to the best of their ability, from taking or permitting any action "that would substantially impair the prospects of completing the merger"?

B.

I conclude from a review of the particular allegations that none of them state a present claim for which relief may be granted. As to the allegation that Home "now maintains" that approval by the Pennsylvania and New Hampshire insurance commissioners is necessary (Complaint ¶ 17c(i)), Article 4.4 of the Reorganization Agreement contemplates the filing of "necessary or appropriate" applications with governmental authorities. No fact alleged would, if proven, support the conclusion that such filings are not "appropriate". More fundamentally, even if one assumes that under Pennsylvania and New Hampshire law such filings are clearly not called for, plaintiffs still have not alleged facts that demonstrate that the "maintenance" of the position that they are necessary or appropriate has materially delayed "consummation of the Merger at the earliest possible date" or that maintenance of such position (or even making the filings involved) "would substantially impair the prospects of completing the Merger." (Reorganization Agreement

Article 4.5.) Since FHLBB approval is required before the merger can be completed, one can in no event say now that maintenance of this position regarding state filings will likely have the effect of delaying the merger.

[7] As to the claim that Home has breached its contract by "maintaining" that ownership of a California "non-bank bank" "may prevent the transactions. . .if the [FHLBB] requires divestiture. . ." (Complaint ¶ 17c(iii)), should the Bank Board require divestiture and should Home elect not to divest and thereby preclude accomplishment of the transaction, a plausible, perhaps likely, violation of the undertaking "to use its best efforts. . .to take. . .all actions necessary. . .on its part so as to permit consummation. . ." will have occurred, however, it seems plain that the allegations made fail to constitute a present breach of contract.

A similar line of reasoning applies to the allegations concerning the position that "Home Group now maintains that its ownership of [Gruntal] presents an obstacle" to securing FHLBB approval (Complaint ¶ 17d). Whether Gruntal is "principally engaged" in underwriting in the view of the Bank Board and thus presents an impediment to Bank Board approval will not be known until the Bank Board acts. Should it decide that Gruntal does present an obstacle, Home will then have to exercise a responsive judgment and act. At that time, Carteret will review that action in light of the requirement of best efforts and good faith. Should all of these contingencies lead to a lawsuit, the court asked to rule on that matter will have a specific contract law question to decide in light of particularized facts. That situation will represent a far cry from the unformed situation that Carteret now seems to bring before the court.

The allegations that Home has sought "to require that Carteret. . .purchase shares of stock of Imperial Premium Finance Co." (Complaint ¶ 17) does not allege a breach of contract. So long as Home has not unequivocally stated that it will not perform its obligation unless this non-bargained for purchase is made, this allegation falls under the "no harm in asking" rubric.

Finally, the disagreements about what should appear in Carteret's proxy solicitation materials, while no doubt clearly communicating between the parties the displeasure of Home with the deal it made in light of subsequent events, and causing understandable anxiety in Carteret, surely do not amount to either delaying consummation of the merger or impairing the prospects of its completion.

Accordingly, I conclude that no breach of a present obligation to use best efforts to promote accomplishment of the merger transaction or to refrain from impeding that transaction has been alleged.

IV.

[8] An additional point should be mentioned. Even were I of the view that the complaint alleged facts that constituted a breach of contract, a review of the nature of the remedy sought in this instance would cause great reluctance to proceed with the case in equity now.[5] One can readily understand why this imaginative complaint has been filed, but the relief it seeks is odd[6] and the litigation that would result would be grotesque. The process of completing the many regulatory, financial and corporate steps required to effectuate the merger is going forward. Carteret fears Home's displeasure with its deal is such that, left to its own devices, it will try, successfully, to torpedo the merger during this process. If that apprehension is well-founded, Home will have myriad opportunities to do so regardless of whether this suit is being litigated concurrently. The shadings of conduct that are possible when exercising judgment will present an unprincipled antagonist (for that is the gist of Carteret's assertion of Home's character) with countless opportunities to try to impede completion of a complex deal.[7] But, while the process goes forward, this uncomfortable, suspicious state cannot be dissipated or remedied by order of this Court. So long

5. While it is the general rule that the facts alleged and not the particular remedy sought are relevant in determining whether a claim has properly been stated, where equity jurisdiction is predicated upon a request for a particular equitable remedy and not on a claimed violation of an equitable right, if the complaint discloses facts which, if true, show that no equitable remedy may be awarded, the complaint should be dismissed for lack of subject matter jurisdiction. While the unavailability of the particular equitable remedy sought in the complaint is not conclusive of the question whether any such remedy may be awarded, it is a relevant inquiry in that connection.

6. For example, the complaint seeks an order that Home refrain "from demanding that plaintiffs. . .acknowledge that. . ." certain facts or developments may properly affect Home's obligation to consummate the merge. (Complaint. ¶ I(B)) That relief, however, if granted in the form requested, would arguably constitute a prior restraint of speech which is, of course, unconstitutional even if the speech, once uttered, would constitute a tort or breach of contract.

7. I put to one side for present purposes Home's assertion that it is proceeding in good faith and that an attempt to renegotiate the price of a pending deal in light of an unexpected market development cannot be equated with bad faith or any other inappropriate motivation.

as Home has not repudiated the contract or refused to file a necessary application, I see no appropriate or even feasible way for the court to specifically enforce a covenant of best efforts while a transaction of this complexity[8] evolves. To involve the court at this stage by the issuance of an order attempting to compel ongoing best efforts in good faith would risk involving the court in the detailed administration of this contract. Absent a strong public interest in such a course, such as has been found by some federal courts to be present in suits arising out of the administration of state correctional institutional or local schools, a court will ordinarily not enter an order, whether an injunction or an order of specific performance, which requires constant supervision by the court. *See* Hanbury and Maudsley, *Modern Equity* (12th ed. by J. Martin, 1985) at 677.

This principle, which guides but does not strictly limit the exercise of discretion, would provide a pertinent consideration here did the complaint state a substantive claim. In *Northern Delaware Industrial Development Corp. v. E.W. Bliss Co.*, Del.Ch., 245 A.2d 431 (1968), this court dismissed an action seeking specific performance of an asserted contractual right to have a certain number of workmen assigned to its construction project. The court concluded, having raised the point itself, that to grant the relief sought would require it to "become committed to supervising the carrying out of a massive, complex and unfinished construction contract," 245 A.2d at 432, which it regarded, on authority, as inappropriate. The case was dismissed with leave to remove the matter to the Superior Court. This case would threaten a similar involvement with a complex unfinished project. While the nature of the parties' undertaking is different here than in *Bliss*, the underlying principle is applicable to both situations.

A final, related point: The order sought, even if otherwise warranted and feasible, would be so broad and unformed[9]—nec-

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8. This matter is decidedly different than the complaint *Beverages, Inc. v. Burnup & Sims, Inc.*, Del.Ch., Civil Action No. 8860, Hartnett, V.C. (August 20, 1987) upon which the court ordered a delaying promisor to promptly file an application for a shelf registration of securities with SEC. That relief was specific and enforceable.

9. The complaint, for example, seeks an order, that, *inter alia*, "defendants shall perform their obligations under the Agreements, including but not limited to: . . .using their best efforts to seek approval of [necessary regulatory] applications including taking all necessary steps with respect to Gruntal." Complaint. ¶ I(A)(2).

essarily because of the open-ended nature of the legal obligation and the evolving facts—as to raise fundamental questions about its appropriateness. As one leading commentator has put a widely-acknowledged point:

> A court will not grant specific performance or an injunction to enforce a contract unless the terms of the contract are sufficiently definite to provide the basis for an appropriate order. This requirement goes beyond the general requirement of definiteness, under which there is no contract at all unless the terms of the agreement "provide a basis for determining the existence of a breach and for giving an appropriate remedy". [Restatement of Contracts Second § 33(2)] A decree of specific performance. . .must be formulated with special precision because of the severity of the contempt sanction.

Farnsworth, *Contracts* § 12.7 at 832-33 (1985) (citations omitted).

An order of the kind sought would require Home to use its best efforts to obtain necessary regulatory approvals. Such an order does not, on the face of it, appear extraordinary, but a moment's consideration of the specifics of what might be entailed—in this particular setting—shows the difficulty. What would such an order require with respect, for example, to the operation of the Gruntal subsidiary? The question of how much underwriting, in what setting may be engaged in, without rendering one "principally engaged" in underwriting for Glass-Steagall Act purposes is a murky question of federal law. If Home is required by circumstances and its legal obligation to exercise a judgment on that question, so be it. In that event, it will be required to do so in good faith. Proof that Home has not acted in good faith would likely entitle Carteret to a remedy of some sort. *See* Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. of Pitt. L. Rev. 1 (1984). But, it would be extraordinary—and arguably a violation of fundamental fairness—to place upon Home the burden of exercising judgments of this kind under a threat that the decision may later be attacked not only as a breach of a covenant, but also as a violation of a court order punishable by contempt.

Thus, the practicalities of the situation raise two independent reasons supporting the conclusion that this suit has been prematurely filed.

V.

The foregoing relates as well to the stockholder class actions that have been filed relating to the merger. Those complaints essentially duplicate Carteret's complaint and fail for similar reasons. Thus, I am relieved of the obligation to decide now whether the Carteret shareholders have standing as third-party beneficiaries to challenge Home's conduct in the same terms as Carteret has done.

Defendants' motion to dismiss shall be granted. IT IS SO ORDERED.

EISENBERG v. CHICAGO MILWAUKEE CORPORATION

No. 9374

Court of Chancery of the State of Delaware, New Castle

December 1, 1987

A class action was brought to preliminarily enjoin a self-tender offer of prior preferred stock as a violation of the defendant's fiduciary duty to disclose with entire candor all material facts relating to the offer and as a violation of defendant's fiduciary duty of loyalty by structuring the offer to impermissibly coerce preferred stockholders to tender their shares. The court of chancery, per Vice-Chancellor Jacobs, held that: (1) plaintiff has shown reasonable likelihood of success in proving that corporate director defendants have breached a fiduciary duty in failing to disclose all facts material to the transaction in entire candor, especially when they must meet the more onerous duty involved in a self-tender; (2) plaintiff has shown reasonable likelihood of success in proving that the offer was wrongfully coercive; (3) plaintiff has shown that shareholders' inability to make an informed, uncoerced decision on the tender offer would be irreparable harm; and (4) the fairest remedy to all competing interests, balancing the equities, is to grant preliminary injunctive relief until the deficiencies of the disclosure statement can be cured by the issuance of an appropriate supplemental disclosure.

Motion for preliminary injunction granted.

1. Injunction ⟹ 132

On a motion for a preliminary injunction, the plaintiff must show a reasonable probability of success on the merits, a reasonable likelihood of irreparable harm if injunctive relief is not granted, and that the harm to the plaintiff if injunctive relief is denied outweighs the harm to defendants if relief is granted.

2. Corporations ⟹ 581

A tender offer is generally regarded as voluntary by its nature and form and will therefore not be enjoined.

3. Corporations ⟹ 581

A tender offer, particularly a self-tender offer, while voluntary in appearance, may be involuntary in matter and substance when (1) materially false or misleading disclosures are made to shareholders in connection with the offer, or (2) where the offer is wrongfully coercive by reason of its terms or the circumstances under which it is made.

4. Corporations ⟹ 187

Corporate directors owe a fiduciary duty to their stockholders to disclose all facts material to the transaction in an atmosphere of entire candor.

5. Corporations ⟹ 187

The standard applicable to a plaintiff's claims of disclosure requires a showing of substantial likelihood that under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.

6. Corporations ⟹ 187

In a self-tender, there is the strictest possible duty of disclosure as the disclosures are unilateral and not counterbalanced by opposing

points of view, and there are built-in conflicts of interest between the fiduciaries responsible for conducting the offer and the stockholders to whom the offer is directed.

7. Injunction ⟹ 126

While individual disclosure deficiencies standing alone may not be sufficient to justify injunctive relief, the totality of the items considered against the background of the transaction demonstrates a failure to meet disclosure requirements under Delaware law.

8. Corporations ⟹ 187

Disclosures suggesting that an offer had a business-oriented, cost-saving rationale are misleading when the purpose of the offer was to take advantage of a stock market crash creating the lowest price of preferred stock in five years.

9. Corporations ⟹ 187

A "technically true" disclosure identifying the "current range" of market prices as "among the factors" considered by the board is misleading when current market prices were either the primary or predominant factor motivating the offer and the price.

10. Corporations ⟹ 187

Where certain directors stood to gain $3.5 million in the book value of their common stock as a result of the tender, failure to disclose this potential conflict of interest is a material omission.

11. Corporations ⟹ 187

Inequitable conversion takes place where directors have taken actions that operate inequitably to induce preferred shareholders to tender their shares for reasons unrelated to the economic merits of the offer.

12. Corporations ⟹ 187

A tender offer (1) purposefully timed to coincide with the lowest market price in five years, (2) against the background of an an-

nounced policy not to pay dividends, despite the financial ability to do so, and (3) coupled with an expressed intention to delist the class of preferred stock, operates in an inequitably coercive manner.

13. Corporations ⟹ 187

A stated intention to request delisting a class of shares, when such a delisting would be an automatic result as a matter of law, is unnecessary, and therefore misleading, making the offer inequitably coercive.

14. Injunction ⟹ 14

Irreparable harm is threatened where shareholders would be forever deprived of their right to make an informed, uncoerced decision.

15. Injunction ⟹ 132

A remedy must be balanced to meet the competing needs of the situation: where deficiencies in the offer make it coercive but the offer may represent the only opportunity for shareholders to realize an above-market premium for their shares, the offer will be enjoined until the disclosure deficiencies are cured.

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JACOBS, *Vice-Chancellor*

On October 28, 1987, Chicago Milwaukee Corp., a Delaware corporation ("CMC") commenced a self-tender offer (the "Offer")

for any and all shares of its $5 Prior Preferred Stock ("the Preferred"), at an offering price of $55 per share cash. Although the Offer was originally scheduled to expire on November 30, 1987, the expiration was extended to midnight, December 1, 1987.

On November 2, 1987, the plaintiff, a preferred stockholder of CMC, commenced this class action against CMC and its directors. He attacks the validity of the Offer and seeks a preliminary injunction to prevent its consummation. Following expedited discovery and briefing, the motion was argued on November 25, 1987 and was considered over the Thanksgiving holiday weekend. This is the Opinion of the Court on the plaintiff's motion for a preliminary injunction.

I. *FACTUAL BACKGROUND*

The critical facts are not in dispute. CMC is a Delaware corporation that is headquartered in Chicago, Illinois. CMC was formed in 1971 through an exchange offer in which CMC became the parent holding company of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company (the "Railroad"). Many of the Railroad's preferred stockholders tendered into the exchange offer and as a result, they became holders of CMC common and preferred stock. In 1977 the Railroad filed a petition for reorganization under the Federal Bankruptcy Act. Because it was sustaining heavy losses, the Railroad sold its railroad operating properties as well as valuable timberland. After the Railroad emerged from bankruptcy in late 1985, CMC and the Railroad sold off most of their assets as part of CMC's announced business plan to abandon previous lines of business and to acquire another business. CMC has retained several investment banking firms to seek out potential acquisition candidates.

CMC's principal assets presently consist of approximately $300 million in cash, plus real estate (including 66,000 acres of timberland) appraised at $90 million. As of September 30, 1987, the common stockholders' equity approximated $369 million.

CMC has two classes of stock. Approximately 2.5 million shares of common stock, and 463,946 shares of the Preferred, are issued and outstanding. As of October 27, 1987 the preferred shares were held of record by 591 preferred stockholders. Both the common and Preferred are listed and publicly traded on the New York Stock Exchange (NYSE), and are registered under the Securities Exchange Act of 1934.

The rights of the preferred stock are limited. The preferred has a $5 per year dividend right, but payable only "when and as declared by the Board of Directors". The dividend is noncumulative. The Preferred also has a liquidation preference of $100 per share, and may be redeemed at a value of $100 per share plus up to $7.50 of unpaid dividends per share. However, CMC is not obligated to redeem the shares (there being no requirement of a sinking fund or that other assets he set aside for that purpose) or to liquidate CMC at any time.

CMC's Certificate of Incorporation prohibits the payment of a dividend on the common stock in any given period, unless the preferred dividend is paid first. But there is (to repeat) no requirement that any dividend be paid, and, in fact, no dividends have ever been paid on either the preferred or the common stock since 1971. The Preferred stockholders may vote, along with common stockholders, for the eight regular members of the Board of Directors. However, if preferred stock dividends are not paid for three semi-annual dividend payment dates, the Preferred, voting as a class, becomes entitled to elect two additional special directors. In 1985 defendants Robert S. Davis and Allesandro di Montezemolo were elected as the special Preferred directors, and presently serve in that capacity.

The Company has declined to pay dividends on the preferred. Although CMC has abundant liquidity (almost $300 million of cash) and although a relatively small percentage of that liquidity (approximately $2.32 million) would be required to pay the $5 dividend, CMC's management has adopted a "no-dividend" policy for the stated purpose of conserving assets for an acquisition. At CMC's most recent annual stockholder meeting held in June of 1987, several Preferred stockholders complained about CMC's refusal to pay dividends on (or to redeem) the preferred. After the meeting, other preferred stockholders wrote to CMC to voice similar protests.

CMC's directors do not own any appreciable amount of preferred shares. The record does indicate, however, that CMC's directors, and the "Schedule 13D" shareholder group with which certain of those directors are affiliated, own a significant percentage of the common stock. As of May 1, 1987, CMC's directors as a group owned directly about 17% of CMC's outstanding common stock. Four of CMC's ten directors (Messrs. Levy, Nash, Sharp, and Zilkha) are members of the "Schedule 13D Group," which includes Odyssey Partners, a partnership of which Messrs. Levy

and Nash are the general partners. As of August 6, 1987, directors and the Schedule 13D Group owned collectively 41% of CMC's common stock. Because Preferred dividends are noncumulative, CMC's policy of retaining earnings rather than paying dividends, operates to benefit the common stockholders generally, and the directors individually, because the directors own significant amounts of common stock.[1]

The trading price of the Preferred has fluctuated widely over the past decade. After the Railroad filed for bankruptcy, the Preferred traded as low as $10. Once the Railroad emerged from bankruptcy in 1985, the market price of the preferred traded from a low of $55 to a high of $80.25. In 1986, the price fluctuated from a low of $57 to a high of $88.50. For the first three quarters of 1987, the price fluctuated from $53 to $78.50. From early 1987 to October 16, 1987, the price moved gradually downward, from a high of $78.80 in March, 1987, to a low of $52.50 on October 16, 1987.

On October 19, 1987, the stock market phenomenon popularly described as "Black Monday" occurred. On that date the Dow Jones Industrial Average as reported by the NYSE declined by 508 points, causing a sudden, significant decline in the market price of many listed securities, including CMC. The record shows that Black Monday was the originating force that motivated the decision to conduct the tender offer presently under challenge. On October 19 the preferred stock price dropped another ten points, and by October 20, it had fallen to $42 per share. On October 27, the day before the Offer was announced, the preferred closed at $41.50 per share.

The tender offer documents represented that "the movement in the market price of the [Preferred] Shares immediately prior to the commencement of the Offer was one of several considerations in the Company's decision to make the Offer." (Supplement to Offer to Purchase, p. 2). The record evidence indicates, however, that that $41.50 market price level—the lowest price at which the preferred had traded since early 1983—was the predominant, if not the sole, factor motivating the directors' decision to make the Offer. Before Black Monday, CMC had never considered making a tender offer for the Preferred.

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1. Because dividends on the Preferred do not cumulate, nonpayment of each preferred dividend operates to increase the retained earnings of CMC, thereby increasing the common stockholders' equity.

On October 20, 1987, defendant Edwin Jacobson, CMC's president, telephoned defendant Jack Nash, a fellow director, and suggested that CMC make a tender offer for the preferred, since the stock price had declined substantially. Mr. Nash agreed and suggested that the Executive Committee consider the matter. A meeting by telephone took place on the following day, October 21, 1987. At that meeting the Executive Committee decided to authorize Mr. Jacobson to retain legal counsel and investment bankers to advise the CMC Board. The Committee also decided that a special meeting of the Board of Directors would be held on October 27, 1987, six days later.

On October 23, 1987, Mr. Jacobson retained PaineWebber, Incorporated ("PaineWebber") as financial advisor, to evaluate and recommend an offering price that would be fair and would maximize the offer's chances of success.[2] PaineWebber performed its entire financial analysis over a three-day period, (the weekend and the following Monday, October 24, 25, and 26). The statistical data supporting PaineWebber's conclusions were presented to the Board for the first time at the scheduled October 27 meeting.[3]

As part of its valuation study, PaineWebber analyzed other securities "comparable" to the Preferred, to determine the yield and an appropriate price for those securities. PaineWebber relied upon certain public financial data and upon management's representations that CMC had no present intention to pay dividends or to redeem the Preferred shares. Based upon its analysis, PaineWebber concluded that the "intrinsic" or "fair" value of the preferred was between $20 and $30—a value significantly lower than the current trading price.[4] Given that valuation, PaineWebber concluded that an offer at the current market price ($41.50) would be fair. PaineWebber recognized, nonetheless, that for a tender offer to succeed, it would have to be at a premium above market. Its study of other self-tenders revealed that the average premium paid in

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2. PaineWebber had been retained by CMC approximately nine months before to search for potential acquisition candidates. According to the Offer to purchase, PaineWebber had previously rendered various investment banking and other advisory services to CMC.

3. No written materials were made available to CMC's directors before the October 27 meeting.

4. PaineWebber's low "intrinsic" valuation presumably flowed from the fact that the preferred carries with it no guaranteed right to dividends or to redemption that would enable a shareholder to receive a certain return on his investment.

those transactions was 14% above market. On that basis, PaineWebber recommended that CMC offer at least a comparable (14%) premium, that is, an offering price of $48 per share.

Although CMC's directors received no written materials before the October 27, 1987 special meeting, PaineWebber's representatives did present their reasoning and conclusions orally at that meeting. When the 1 1/2 hour meeting concluded, the Board approved an "any and all" cash tender offer for the Preferred within a price range of $50 to $55 per share, delegating to the Executive Committee the task of selecting a specific offering price. There is no evidence that at that meeting the Board considered or discussed the need to "delist" or "deregister" the Preferred, the effect of delisting or deregistration upon the preferred shareholders' investment, or the need to reduce CMC's administrative and bookkeeping costs (including costs of communication) relating to the Preferred stockholders.

In a short meeting held later that same afternoon, the Executive Committee fixed the offering price at $55 per share. The following day, October 28, 1987, the Offer was formally commenced, and CMC disseminated to all Preferred stockholders an Offer to Purchase bearing that same date.[5] Although the Offer to Purchase disclosed the opinion of both PaineWebber and the Board of Directors that the $55 offering price was fair, that document also admonished that neither CMC nor its directors were making any recommendation as to whether or not the Preferred shareholders should tender.

II. *APPLICABLE LEGAL STANDARDS*

[1] On a motion for a preliminary injunction, the plaintiff must show a reasonable probability of success on the merits, a reasonable likelihood of irreparable harm if injunctive relief is not granted, and that the harm to the plaintiff if injunctive relief is denied outweighs the harm to the defendants if relief is granted. *Revlon, Inc. v. MacAndrews & Forbes Holdings*, Del. Supr., 506 A.2d 173, 179 (1986); *Gimbel v. The Signal Companies, Inc.*, Del. Ch., 316 A.2d 599, 602-03 (1974); *aff'd*, Del. Supr., 316 A.2d 619 (1974).

5. After this litigation was filed, the defendants disseminated a Supplement to the Offer to purchase dated November 6, 1987 ("Supplement") which contained certain additional disclosures.

The plaintiff's motion for injunctive relief rests primarily upon two grounds. He first contends that the defendants violated their fiduciary duty to disclose with entire candor all material facts relating to the Offer. Second, he argues that the defendants violated their fiduciary duty of loyalty by structuring the Offer so as to impermissibly coerce the preferred stockholders to tender their shares.[6]

The defendants argue that both the Offer and the directors' conduct were proper in all respects, and that no showing has been made that the preferred stockholders will be irreparably harmed if the Offer is allowed to proceed. They further contend that any harm can be remedied in damages, and that an injunction would deprive the preferred stockholders of perhaps their only foreseeable opportunity to realize a premium above market price for their shares.

For the reasons now set forth, the Court concludes that the plaintiff's motion must prevail, and that the Offer should be preliminarily enjoined during the time required to allow its deficiencies to be cured.

[2] By its very nature and form, a tender offer is normally regarded as a voluntary transaction. Unlike a cash-out merger where public stockholders can be involuntarily eliminated from the enterprise, in a properly conducted tender offer the stockholder-offerees may freely choose whether or not to tender. That choice will normally depend upon each stockholder's individual investment objectives and his evaluation of the merits of the offer. Moreover, tender offers often afford shareholders a unique opportunity to sell their shares at a premium above market price. For those reasons, a tender offer that is voluntary (and that otherwise satisfies applicable legal requirements) will not be enjoined. *See, e.g.*, *Lynch v. Vickers Energy Corp.*, Del. Ch., 351 A.2d 570, 573 (1976); *rev'd on other grounds*, Del. Supr., 383 A.2d 278, 279 (1977); *Klein v. Soundesign Corp.*, Del. Ch., C.A. Nos. 6636 and 6643, Marvel, C., (January 21, 1982).

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6. The plaintiff also argues that the Court should enjoin the Offer because CMC's directors approved it with undue haste and without proper deliberation, *i.e.*, in violation of their duty to act with appropriate due care. The argument must be rejected on factual grounds: while the directors did act with haste, there is no showing on this record that their decision to make the Offer was not a reasoned or an informed one.

[3] However, as our Courts have recognized, a tender offer—particularly one made by a corporation for its own shares—may be voluntary in appearance and form but involuntary as a matter of reality and substance. Thus far two classes of situations have arisen that have been found to deprive a tender offer of its voluntary character: (i) cases involving materially false or misleading disclosures made to shareholders in connection with the offer (*e.q.*, *Lynch v. Vickers Energy Group*, 383 A.2d at 281; *Kahn v. United States Sugar Corp.*, Del. Ch., C.A. No. 7313, Hartnett, V.C. (December 10, 1985) at 14; *Joseph v. Shell Oil Company*, Del. Ch., 482 A.2d 335, 342 (1984)), and (ii) cases where the offer, by reason of its terms or the circumstances under which it is made, is wrongfully coercive. (*See Kahn v. United States Sugar Corp.*, *supra* at 15-16; *AC Acquisitions Corp. v. Anderson Clayton & Co.*, Del. Ch. 519 A.2d 103, 114 (1986).)[7] If either circumstance exists, preliminary injunctive relief will follow.[8] Both circumstances are claimed to be present here.

III. *PROBABILITY OF SUCCESS ON THE MERITS*

A. The Claim of Improper Disclosure

[4-5] The standard applicable to the plaintiff's disclosure claims is well established. Corporate directors owe a fiduciary duty to their stockholders to disclose all facts material to the transaction in an atmosphere of entire candor. *Smith v. Van Gorkom*, Del. Supr., 488

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7. The actionable coercion may inhere in either the disclosures or in the terms of the offer itself. In *AC Acquisitions Corp.*, *supra*, 519 A.2d at 114, a corporate self-tender was found to be actionably coercive, and hence was enjoined, because of its timing in relation to a competing offer. In *Lacos Land Company v. Arden Group, Inc.*, Del. Ch., 517 A.2d 271 (1986), the issuance of a new class of "supervoting" preferred stock was enjoined on the ground that a disclosure in the proxy statement soliciting shareholder votes in favor of a charter amendment creating a proposed new class of preferred, was wrongfully coercive. The offending disclosure consisted of a statement that unless shareholders voted to approve the amendments, the corporation's chief executive officer and largest stockholder would oppose transactions that the directors could determine were in the best interests of all stockholders.

8. *See, e.g.*, *AC Acquisitions Corp.*, *supra*, 519 A.2d at 114. (Self-tender by corporation timed so as to discourage shareholder choice between corporation's offer and competing offer by "outside" bidder, enjoined as actionably coercive); *Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 343, (tender by parent corporation for publicly owned shares of 70%-owned subsidiary preliminarily enjoined, because offering documents failed to disclose facts tending to show the unfairness of the offering price and the deficiencies in the process by which the price was arrived at).

A.2d 858, 890 (1985); *Lynch v. Vickers Energy Corp.*, *supra*, 383 A.2d 281. That standard requires:

> [a] showing of substantial likelihood that under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available.

Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944 (1985) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)); *see also*, *Weinberger v. Rio Grande Industries, Inc.*, Del. Ch., 519 A.2d 116, 121 (1986).

[6] Where a corporation tenders for its own shares, the exacting duty of disclosure imposed upon corporate fiduciaries is even "more onerous" than in a contested offer. That is because in a self-tender, the disclosures are unilateral and not counterbalanced by opposing points of view. As Federal District Judge Steel has stated:

> Because of the uniqueness of the instant situation, defendants had a burden of disclosure which was more onerous than it would have been had a contest existed on the tender. This was emphasized in *Broder v. Dane*, 384 F.Supp. 1312, 1318-19 (S.D.N.Y. 1974). There the Court recognized that an issuer making a tender offer for its own shares is "the most inside of insiders" and "the insider par excellence".
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> In the instant case the defendants were not only in a sense insiders but in their capacity as officers and directors of Railroad were fiduciaries for the stockholders. This imposed upon them the heavy responsibility of advising the stockholders fully and impartially about the advantages and disadvantages of the tender, especially in view of the personal interest which the defendants had in the success of the offer.

Blanchette v. Providence & Worcester Co., 428 F. Supp. 347, 356 (D. Del. 1977).

A related reason for requiring the strictest possible standard of disclosure is that corporate self-tenders, by their very nature, involve built-in conflicts of interest between the fiduciaries responsible for conducting the offer and the stockholders to whom the

offer is directed. The interest of the corporate offeror (*qua* buyer) is to pay the lowest price possible; the interest of the stockholders (*qua* sellers) is to receive as high a price as possible. The directors are acting both as the representatives of the corporate offeror and as fiduciaries for the shareholder-offerees. That dual role necessarily gives rise to a potential conflict of the directors, which calls for procedural protections for the stockholders whose interests may not be adequately represented. The onerous disclosure standard described by Judge Steel in *Blanchette* represents one method of affording such protection.[9]

[7] The plaintiff contends that the disclosures in the offering materials are deficient in numerous respects. Having considered plaintiff's disclosure contentions, the Court finds only those items discussed below to have probable merit. Whether each of those disclosure deficiencies standing alone would be so significant as to justify injunctive relief, need not be decided. All of those disclosure items, when taken together and considered against the background of the transaction, clearly demonstrate that the defendants have not met their disclosure obligations under Delaware law. *Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 343.

1. *Disclosures Relating to the Purpose of the Offer*

The Offer to purchase, on the first page, recites three separate purposes for the Offer. These are:

> (i) to acquire the Shares at a price which the Company believes makes the Shares an attractive investment for the Company at this time;
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> (ii) to reduce the number and aggregate market value of the outstanding publicly held Shares and the number of Preferred Stockholders of record in order to effect the delisting of the shares from the NYSE and the deregistration of the Shares under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which should reduce the administrative and bookkeeping costs attributable to the Company's communication and other activ-

9. *See also Plaza Securities Co. v. Fruehauf Corp.*, 643 F. Supp. 1535, 1544 (E. D. Mich. 1986) (holding that "judicial review of disclosures and nondisclosures must be especially rigorous" in context of management leveraged buyout where material facts are "exclusively within" the possession of management, whose interests "are in conflict with those of the shareholders."

ities with its Preferred Stockholders; and

(iii) to provide the Preferred Stockholders with an opportunity to sell their Shares for a higher price than that available in the open market prior to the announcement of the Offer and without the usual transaction costs associated with open market sales, and further to allow qualifying Preferred Stockholders beneficially owning fewer than 100 shares to avoid the payment of brokerage commissions and the applicable odd lot discount payable of a sale of shares in a NYSE transaction.

The "third" purpose adds little, because it is a corollary of, (and is largely indistinguishable from) the first purpose. (For the Offer to succeed, CMC must also offer the Preferred shareholders a premium above the market price.) Thus, the Offer to purchase, fairly read, discloses two separate purposes for the Offer: (1) to enable CMC to buy, and the Preferred shareholders to sell, their shares at what CMC believes is an attractive price for both the buyer and the sellers, and (2) to effect the delisting of the preferred shares from the NYSE and the deregistration of those shares under the Securities Exchange Act of 1934, and to save costs related thereto.

The Offer to purchase conveys the clear impression that the second (delisting/reregistration) purpose is a separate purpose, of coordinate importance with the first purpose, and of equal dignity. That impression is reinforced by the disclosure on page 2 that if, as a result of the Offer, the Preferred shares no longer meet the requirements for continued listing on the NYSE,[10] ". . .the Company [CMC] intends to request delisting of the shares from the NYSE." The Supplement (at p. 2) also discloses that "the movement in the market price of the Shares immediately prior to the commencement of the Offer was *one of the several considerations* in the Company's decision to make the Offer." (Emphasis added.)

[8] These disclosures of the Offer's purported delisting/deregistration purpose are misleading. They clearly suggest that the Offer

10. According to the Offer to purchase, the NYSE's published guidelines indicate that the NYSE "would consider delisting the Shares if (i) the aggregate market value of publicly held Shares should fall below $2 million or (ii) the number of publicly held Shares would fall below 100,000 shares." (*Id.* at p. 2). That document also discloses that registration under the 1934 Exchange Act may be terminated upon certification by CMC to the Securities and Exchange Commission that there are fewer than 300 record holders of preferred Shares. (*Id.*)

had a business-oriented, cost-saving, rationale, separate from and unrelated to the first Offer's purpose, which is to enable CMC to acquire the preferred at an attractive price. Those disclosures further suggest that CMC's directors made a considered business judgment, unrelated to considerations of stock market price, to conduct the Offer in order to effect corporate cost savings.

Neither impression is accurate. The record shows, and at the oral argument defendants' counsel conceded, that the Offer is not being made to effect cost savings. Its purpose, plainly and simply, is to enable CMC to take advantage of the unprecedented "Black Monday" market crash that drove down the price of the Preferred to its lowest level in five years. The $55 offering price for the preferred is attractive, because it is far less than the cost of redeeming the stock ($100 per share), and because the Offer, if successful, would eliminate the only legal barrier to the payment of dividends on the common stock. There was no consideration or discussion at any of the directors' meetings of cost savings that would result from delisting or deregistering the preferred, and any such cost savings would be minimal. In short, cost savings played either no role in the directors' decision to make the offer, or were at best a factor of minimal significance. In either event, it was materially misleading to portray cost savings as being a "purpose" of the Offer.

The shareholder-offerees are entitled to an accurate, candid presentation of why the self-tender offer is being made. *See, Blanchette v. Providence & Worcester Co.*, *supra*, 428 F. Supp. at 354-355. There is nothing *per se* improper in a corporation deciding to make a noncoercive tender for its own stock to take advantage of a decline in stock market prices, so long as the shareholders are fully, candidly and accurately informed of all material facts. The disclosures relating to the cost-savings "purpose" served not to enlighten but to obscure the real reasons motivating the Offer.

2. *Disclosures Relating to the Fairness of the Price*

The plaintiff next contends that the $55 offer price is unfair and that the disclosures relating to that price were calculated to, and did, obscure and divert attention from that fact. If that were the case, the disclosures would clearly be defective. *Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 342. Shareholders are entitled to be informed of information in the fiduciaries' possession that is material to the fairness of the price. *Id.*, *Lynch v. Vickers Energy*

Corp., *supra*, 383 A.2d at 281; *Kahn v. United States Sugar Corp.*, *supra*, at 14. At this stage, the plaintiff has presented no evidence from which it can be found that the price is not fair. Indeed, on this record the Court is in no position to reach any affirmative conclusions one way or the other as to the fairness of the price. Nonetheless, the Court does find, preliminarily, that certain of the disclosures relating to the fairness of the price were less than entirely candid.

That portion of the Offer to purchase which relates to the "Fairness of the Offer" (pp 3-4) discloses that (i) "the Board of Directors of the Company believes that the Offer, including the price to be paid per Share, is fair to tendering Preferred Stockholders" (ii) the Board had considered the analysis by PaineWebber, which had opined that the offering price was fair, and finally, (iii):

> The current range of market prices was among the factors in the Board of Directors' determination. See Section 6. The directors concluded that, based upon recent market prices of the Shares and in light of recent stock market trends, the premium of approximately 33% (which represents the approximate percentage difference between the Offer price of $55 per Share and the reported last sale price of the Shares on the NYSE on October 27, 1987 ($41.50)) was both reasonable from the Company's standpoint and fair to all of its stockholders.

[9] While the quoted disclosure may be technically true, it fails to candidly disclose certain material facts relevant to the fairness of the price. Specifically, the "current range of market prices" was not simply "among the factors" considered by the Board. Rather, current market prices were the primary, if not predominant, factor motivating both the Offer and the $55 offering price. The euphemistic references to "recent stock market trends," the "current range of market prices," and the "premium of approximately 33%" over $41.50, were not counterbalanced by any disclosure of (i) the fact that the $41.50 price at which PaineWebber and the directors had pegged the premium was the lowest price level at which the stock had traded in five years, or (ii) the fact that $55 represented only a 5% premium above the ($52.50) "precrash" price level. Although the role played by PaineWebber (particularly its fairness opinion) was given considerable prominence, the fact that PaineWebber's work was done over a single long weekend was not disclosed. That omission, in these circumstances, was also material.

Joseph v. Shell Oil Company, 482 A.2d at 343; *see also*, *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983).

Had the foregoing facts been disclosed, shareholders would have been given more even-handed presentation of the economic merits of the Offer. The need for such a presentation would appear even more essential, because the directors had concluded that the Offer was fair, yet decided not to recommend that their shareholders tender into it.[11]

The defendants argue (correctly) that it is common knowledge that on October 19, 1987, the stock market (and the price of the preferred) declined precipitously. But what is not common knowledge, and what the directors were obliged to candidly disclose, was the role played by the market decline and the "post-crash" price levels in the directors' conclusion that $55 was a fair offering price. Those facts were exclusively within the CMC directors' knowledge and control, and they were material (*Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 341).

Accordingly the Offer to purchase is materially misleading in this respect as well.[12]

3. *Disclosures Relating to the Directors Interest in the Success of the Offer*

[10] Finally, the Offer to purchase does not adequately disclose that certain of CMC's directors had a potential conflict of interest by reason of their ownership of significant amounts of CMC's common stock. In this case an inherent conflict exists between the class of preferred stock and the class of common. By decreasing

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11. The Court notes with some concern the directors' decision not to make any recommendation. Arguably, the reasons why these fiduciaries chose not to recommend the transaction that they approved would be important to shareholders considering whether or not to tender. Since this matter is not argued as a basis for injunctive relief, the Court need not reach that issue.

12. Although the Supplement improves upon the earlier disclosures, it does not adequately cure the deficiencies of the October 28 Offer to purchase. The Supplement does disclose both the fact and the magnitude of the October 19, 1987 market crash, as well as the "precrash" Preferred stock prices. However, the Supplement does not balance the earlier reference to the 33% premium with a disclosure that the premium being offered above the precrash price is only 5%. Nor does it disclose the primary emphasis given by CMC's directors to the "post-crash" price levels in deciding to offer $55 per share. *See also Blanchette*, *supra*, 428 F. Supp. at p. 354 (holding that supplemental disclosure must specifically identify portions of original disclosure that are erroneous and being corrected).

the amount paid for the preferred in the Offer, the directors correspondingly increase the amount of common shareholders' equity remaining in the corporation. Five of CMC's ten directors (Messrs. Sharp, Zilkha, Nash, Levy and Reed) personally owned over 17.1% of CMC's common shares, and Odyssey Partners, of which Messrs. Nash and Levy were general partners, owned 6.8% of CMC's common shares. The common stock holdings of the entire Schedule 13D group, when combined with the holdings of those directors, is 41%. A successful offer would benefit those directors by increasing the book value of their common stock by $3.5 million. (See p. 26 of plaintiff's Opening Brief).[13]

By its discussion of the CMC directors' potential conflict, the Court does not intend to suggest that those directors, in approving the offer, necessarily acted improperly or placed their individual interests over those of the Preferred stockholders. The only point made here is that in these circumstances, the potential conflict of half of CMC's Board of Directors was a fact that should have been disclosed. The preferred shareholders were entitled to know that certain of their fiduciaries had a self-interest that was arguably in conflict with their own, and the omission of the fact was material. *Blanchette*, *supra*, 428 F.Supp. at 356.

B. The Claim of Inequitable Coercion

[11] The plaintiff also contends that, independent of disclosure, the Offer must be enjoined as being wrongfully coercive.

The standard applicable to the plaintiff's claim of inequitable coercion is whether the defendants have taken actions that operate inequitably to induce the Preferred shareholders to tender their shares for reasons unrelated to the economic merits of the offer. *Ivanhoe Partners v. Newmont Mining Corp.*, Del. Ch., C.A. Nos. 9281 and 9221, Jacobs, V.C. (October 15, 1987) at 47, and cases cited therein; *aff'd*, Del. Supr. Nos. 341 and 345, 1987, Moore, J. (November 18, 1987). Although the issue is not free from doubt, I conclude that the plaintiff has demonstrated a likelihood of ultimate success on the merits of his coercion claim.

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13. Further, a successful self-tender offer would eliminate the Preferred stock, and allow the directors to declare a dividend on the common stock alone. Presently, any dividend declared must first be paid to the Preferred shareholders, and may only then be paid to the common shareholders.

[12] The plaintiff argues that the Offer is inequitably coercive, because: (i) it was purposefully timed to coincide with the lowest market price for the preferred since 1983, (ii) the offer occurs against the background of an announced Board policy of not paying dividends, despite CMC's present ability to do so, and (iii) CMC has announced that it intends to seek the delisting of the preferred shares.

The defendants respond that the Offer, while perhaps "coercive" in the sense that its economic merits may make it more attractive to tender than not to tender, is not "actionably" coercive, because the defendants have committed no wrongful or inequitable coercive act.

In these circumstances the coercion issue is not easy to decide. To be sure, the directors have timed the Offer to coincide with the lowest preferred stock price levels since 1983. They have also made a business judgment (one that at this stage must be presumed valid) not to pay dividends on, or to redeem, the preferred. Given those circumstances, Preferred stockholders may perceive, not unreasonably, that unless they tender, they may not realize any return on or value for their investment in the foreseeable future. In that sense the offer does have coercive aspects. And the coercion may be attributed, at least to some extent, to acts of the directors (namely, their timing of the Offer and their no-dividend policy) rather than to market forces alone.

If these were the only relevant circumstances (and if proper disclosure was made of all material facts), the Court would have difficulty concluding, at least on this preliminary record, that the Offer is inequitably coercive. In what sense do corporate directors behave inequitably if they cause the corporation to offer to purchase its own publicly-held shares at a premium above market, even if the market price is at an historic low? So long as all material facts are candidly disclosed, the transaction would appear to be voluntary. The only arguable inequity is that if the offer is successful, it may result in a decrease in the number and market value of the outstanding shares and in the number of shareholders. That state of affairs, in turn, would create the possibility that shares not tendered will be delisted and/or deregistered. However, that possibility and its disclosure in the offering materials, without more, has been held to be not wrongfully coercive. *See Klein v. Soundesign Corp.*, *supra* at 3; *Fisher v. Plessy Co.*, 559 F.Supp. 442, 451 (S.D.N.Y. 1983).

In this case, however, the defendants have done more than simply acknowledge the possibility of delisting and deregistration;

they have told the Preferred stockholders that CMC "*intends to request* delisting of the Shares from the NYSE." (Emphasis added.) It is that disclosure which tips the balance and impels the Court to find that the Offer, even if benignly motivated, operates in an inequitably coercive manner.

[13] CMC's directors are fiduciaries for the Preferred stockholders, whose interests they have a duty to safeguard, consistent with the fiduciary duties owed by those directors to CMC's other shareholders and to CMC itself. Those directors have disclosed that they intend to seek to eliminate a valuable attribute of the preferred stock, namely, its NYSE listing. That listing is the source of that security's market value, and its elimination will adversely affect the interests of nontendering Preferred shareholders. On what basis are the defendants, as fiduciaries, entitled to do that? Defendants do not claim that they are obliged to seek delisting in order to protect a paramount interest of the corporation or an overriding interest of the common stockholders. What they seem to argue is that the criticized disclosure is not coercive because it is not material, because if the criteria for listing are no longer met, the stock will be delisted automatically, irrespective of and without regard to any action of the directors.

That argument has two infirmities. First, it is inconsistent with the Offer to purchase, which discloses that if the listing criteria are no longer met, the NYSE "would consider" delisting the shares. That disclosure does not say that delisting will be automatic. Second, if the defendants are correct in their argument that delisting will occur automatically as a matter of law, then they need not disclose that CMC "intends to request delisting." Such a disclosure is unnecessary and, therefore, misleading. The only apparent purpose of such a disclosure would be to induce shareholders to tender by converting a possibility of delisting into a likelihood or certainty. On that basis it must be concluded that the Offer is inequitably coercive.

IV. *IRREPARABLE HARM AND BALANCING OF THE EQUITIES*

Since the plaintiffs have shown a reasonable probability that the defendants have breached a fiduciary duty, the inquiry next becomes whether a reasonable probability of irreparable harm has been established, and, if so, whether such harm outweighs whatever harm that might result from the entry of a preliminary injunction.

[14] The defendants argue that any harm to the shareholders is remediable in damages, but that argument overlooks the gravamen of the injunction claim. Here the principal dispute is not that the offering price is unfair. Rather, at issue is the shareholders' right to make an informed, uncoerced decision. That right is specific, and its enforcement requires a specific, not a substitutional, remedy. As this Court has recognized, to permit a deficient offer to go forward might forever deprive the tendering shareholders of their right to be treated fairly. In that event the harm could not easily be undone, and given the nature of the shareholder interests at stake, damages would not be a meaningful or adequate remedy. Therefore, the threatened harm is irreparable. *Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 344; *In Re Anderson, Clayton Shareholders Litigation*, Del. Ch., 519 A.2d 669, 676 (1986). An injunction is the remedy most likely to achieve disclosure of the information necessary to achieve an informed decision and to eliminate the Offer's coercive aspects. *See Sealy Mattress Company of New Jersey, Inc. v. Sealy, Inc.*, Del. Ch., C.A. No. 8853, Jacobs, V.C. (July 20, 1987) at 42-43.

[15] Finally, in balancing the equities, this Court has recognized that the remedy must be tailored to meet the needs of the situation. That is, after all relevant considerations are balanced, the remedy must be as fair as possible to all of the competing interests. *Joseph v. Shell Oil Company*, *supra*, 482 A.2d at 344. What are those considerations and interests?

1. This Court has previously found that the disclosure documents relating to the Offer are deficient in certain respects, and that in at least one respect the Offer itself is coercive. Unless cured, those deficiencies will deprive the Offer of its voluntary character.

2. The Offer, even at its current price level, may be perhaps the only foreseeable opportunity for Preferred stockholders to realize an above-market premium for their shares. Some shareholders will want to avail themselves of that opportunity, even though they might wish that the price were higher. Other shareholders, for reasons best known to them, will choose not to tender. Any relief must be crafted to protect, where possible, the rights of both shareholder groups.

3. The logical approach that would best reconcile and protect the differing interests of the Preferred stockholders, while upholding this Court's duty to prevent breaches of fiduciary duty, is to impose preliminary injunctive restraints for only so long as is necessary to cure the disclosure and coercive deficiencies of the Offer. The

disclosure deficiencies could promptly be cured by the issuance of an appropriate supplemental disclosure. And defendants' counsel has advised the Court that, if directed to do so, CMC will include in the supplemental disclosure a disclaimer to the effect that it will not take any active steps to cause the Preferred stock to be delisted. In *Joseph v. Shell Oil Company*, this Court determined that the offer before it would be held in abeyance and that supplemental notices, containing the information the Court found should be disclosed, would be sent to shareholders. That procedure continues to be appropriate, and the Court will employ it here as well.

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For the foregoing reasons, the plaintiff's motion for a preliminary injunction is granted. Counsel shall promptly confer and submit a proposed order implementing the rulings made herein.

HENLEY GROUP, INC. v. SANTA FE SOUTHERN PACIFIC CORP.

No. 9569

Court of Chancery of the State of Delaware, New Castle

March 11, 1988

Plaintiff, a shareholder in the defendant corporation, sought a preliminary injunction declaring that defendant's Stock Purchase Rights Plan would not be "triggered" and that the so-called "flip-in" rights would not be redeemed by plaintiff having discussions or entering into agreements with other stockholders concerning the voting of defendant's stock or conducting a proxy contest. Subsequent to the filing of plaintiff's original complaint, defendant corporation revised the Stock Purchase Rights Plan so as to eliminate proxy solicitation activity from coverage under the Plan.

Plaintiff amended its complaint and alleged: (1) a breach of fiduciary duty by inequitably manipulating the Rights Plan to obstruct plaintiff from conducting a proxy contest; (2) entering into an illegal "vote buying" scheme with another shareholder; (3) proposing to issue "payment in kind" debentures for the purpose of entrenching current management; and (4) defendant's charter provision authorizing the board of directors to determine the exact size of the board is invalid under DEL. CODE ANN. tit. 8, § 141(b).