the defendants violated Delaware common law with regards to the Debenture offering and the subsequent merger, as their conduct amounted "to, *inter alia*, fraud, intentional and/or negligent misrepresentation, deceit, negligence, *prima facie* tort, breach of contract and breach of fiduciary duty."

THE STANDARD OF REVIEW ON A MOTION TO DISMISS

II

[1-2] On a motion to dismiss for failure to state a claim upon which relief can be granted, pursuant to Chancery Rule 12(b)(6), all well plead factual allegations must be taken as being true and a court cannot dismiss a claim unless it appears to a reasonable certainty that the plaintiff would not be entitled to relief under any state of ascertained facts. *Del. State Troopers Lodge v. O'Rourke*, Del. Ch., 403 A.2d 1109 (1979). And a court must construe the complaint and all inferences contained therein in the light most favorable to the plaintiff. *Weinberger v. UOP, Inc.*, Del. Ch., 409 A.2d 1262 (1979); *Morgan v. Wells*, Del. Ch., 80 A.2d 504 (1951).

[3-4] The complaint, however, must fairly apprise the defendants as to the facts which are relied upon by plaintiff, *Jefferson Chemical Co., Inc. v. Mobay Chemical Co.*, Del. Ch., 253 A.2d 512 (1969), and inferences or conclusions of law or fact will not be assumed to be true without specific allegations of facts which support the inferences or conclusions. *Bergstein v. Texas Int'l Co.*, Del. Ch., 453 A.2d 467 (1982), *app. den., Texas Int'l Co. v. Bergstein*, Del. Supr., 461 A.2d 695 (1983). While vagueness alone generally does not warrant dismissal of an action, the action may be properly attacked on this ground where the plaintiff alleges fraud. *Mayer v. Adams*, Del. Supr., 174 A.2d 313 (1961); Chancery Rule 9(b).

[5] In considering a Rule 12(b)(6) motion to dismiss, only those matters referred to in the pleadings are to be considered by the Court. *Haber v. Bell*, Del. Ch., 465 A.2d 353 (1983). *Grobow v. Perot*, Del. Supr., 539 A.2d 180 (1988). One of the difficulties in considering these present motions has been the parties' references, in their briefs and at oral argument, to factual assumptions which are not set forth in the Complaint.

[6] This Court has concurrent jurisdiction with the federal courts of offenses and suits brought under the Federal Securities Act of 1933. 15 *U.S.C.* §77v(a).

COUNT I—THE FEDERAL SECURITIES ACT CLAIMS

III

[7-9] The plaintiff claims that Paco, the Paco Directors and the Underwriters violated Sections 11 and 12(2) of the Federal Securities Act of 1933, 15 *U.S.C.* §§77k, 77l(2), because the February 1987 Registration Statement and Prospectus filed in connection with the Debenture offering contained untrue statements of material fact or omitted certain material facts thereby making statements contained in the disclosure documents misleading. Section 11 permits any purchaser who is without knowledge of untruths or omissions to sue every person who was a director of the Issuer and every Underwriter involved in the issuance of the securities. Section 12(2) provides for civil liability against any person who "offers or sells" a security by means of a prospectus or oral statement containing material misstatements or omissions. A plaintiff need not allege scienter to establish a prima facie case under Sections 11 and 12(2). *Seidel v. Public Service Co. of New Hampshire*, 616 F.Supp. 1342 (D.C.N.H. 1985).

[10] Initially, I find that although the allegations of the Complaint are weak, the Complaint does allege sufficient facts which, if proven to be true, could support the conclusion that the Registration Statement and Prospectus were false and misleading with respect to the contemplated use of the proceeds of the offering.

The plaintiff claims that Paco sold the Debentures solely to raise cash with the intention of making the company an attractive takeover target. The fact that Paco was taken over by Scherer less than a year after the Debenture offering, combined with the fact that approximately 80% of the offering proceeds remained essentially in cash, raises a reasonable inference that the Prospectus and Registration Statement may not have fully and adequately disclosed the intended use of the proceeds. On a motion to dismiss, all well-plead factual allegations must be taken as true and I must construe the Complaint and all inferences contained therein in the light most favorable to the plaintiff. *Weinberger v. UOP, Inc.*, supra.

[11] I agree with the defendants, however, that the Complaint fails to allege facts sufficient to support the claim, asserted only in plaintiff's brief, that the Prospectus contained material misrepresentations about the characteristics, particularly the conversion features, of the Debentures. I find that even if that claim was adequately alleged in the Complaint, the Prospectus clearly states that in the event of a merger, "the Debentures then outstanding will thereafter

be convertible into the kind and amount of shares of stock or other securities or property (including cash) to which the holders thereof would have been entitled if they had converted such Debentures into [c]ommon [s]tock *immediately prior to such . . . merger.*" (Emphasis added) (Prospectus, p. 22.) Therefore, as a matter of law, I find that the Prospectus was not misleading with regards to the possible loss of the Debentures' conversion feature in the event of a merger or other reorganization and this claim (if it was validly asserted) must be dismissed.

IV

The defendants also claim that the plaintiff failed to plead facts sufficient to demonstrate compliance with Section 13 of the Federal Securities Act, 15 U.S.C. §77m, which requires that a Section 11 or Section 12(2) action be brought within one year of the discovery of the untrue statement or omission or within one year of the time discovery should have been made through the exercise of reasonable diligence.

Section 13 states, in relevant parts:

> "No action shall be maintained to enforce any liability created under section [1] or 12(2)3 of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . ."

The defendants cite *Glaser v. Norris et al.*, Del. Ch., C.A. No. 9538-N.C., Chandler, V.C. (July 13, 1989), for the proposition that in order to satisfy Section 13 the plaintiff must especially plead (1) the time and circumstances of the discovery of the fraudulent statements, (2) the reasons why discovery was not made earlier, if more than one year has elapsed since the allegedly fraudulent conduct occurred and (3) the diligent efforts which plaintiff undertook in making or seeking such discovery. *Glaser v. Norris et al.*, supra, at 16 citing *Hill v. Der*, 521 F.Supp. 1370, 1389 (D.Del. 1981). They claim that the plaintiff's allegation that he brought this action "within one year of the date plaintiff could have conceivably known of any wrongdoing alleged herein" does not meet the pleading standard as articulated in *Hill v. Der*, supra.

On the other hand, the plaintiff argues that his assertion of compliance with the rule, coupled with the factual assertions made in the Complaint, satisfies the requirement that sufficient facts be

affirmatively plead to demonstrate compliance with Section 13. He cites *In Re Storage Technology Corp. Securities Litigation*, 630 F.Supp. 1072 (D.Colo. 1986); *Woods v. Homes and Structures of Pittsbury, Kansas, Inc.*, 489 F.Supp. 1270 (D.C. Kan. 1980).

In *In Re Storage Technology Corp.*, supra, the Court found that an affirmative assertion that the action was commenced within three years of the alleged fraud and within one year after discovery of the untrue statements and omissions was sufficient in itself to defeat a motion to dismiss. As here, the plaintiffs asserted that they could not have discovered the fraud any earlier. Moreover, the Court determined that the question whether plaintiffs could have made an earlier discovery of the fraud in the exercise of reasonable diligence was not a question properly disposed of on a motion to dismiss. *In Re Storage Technology Corp.*, supra, at 1078. See also *Pfohl v. Pelican Landing*, 567 F.Supp. 134 (D. Ill. 1983).

In any event, I find that whether this Court applies the more stringent pleading requirements of *Hill v. Der*, supra—as did Vice Chancellor Chandler in *Glaser v. Norris et al.*, supra—or the more relaxed standards of *In Re Storage Technology Corp.*, supra, the plaintiff has plead sufficient facts to demonstrate compliance with Section 13.

The Complaint on its face shows that the plaintiff could have had no reason to suspect the alleged misrepresentations and omissions in the Prospectus until the repurchase by Paco of its Debentures and common stock in November 1987. Until that time, the proceeds of the Debenture offering were not put to any use that could be construed as being inconsistent with the representations made in the Prospectus. The Complaint was filed on November 1, 1988, which was necessarily within one year of the buyback of the securities.

This case therefore can be distinguished from the factual scenario confronting Chief Judge Latchum in *Hill v. Der*, supra. In that case, although the Complaint stated that the fraud could not have been determined before April 5, 1979, the Court found that certain events occurring shortly after January 1979 should have placed the plaintiffs on inquiry notice of a potential claim and, therefore, a duty to investigate was imposed upon them. 521 F.Supp. at 1389. The Court found that the burden was on the plaintiff to allege in detail the reasons why discovery of the alleged fraud was not made in the period between January and April, 1989, and what diligent efforts each of the plaintiffs undertook to apprise themselves of those facts which came to their attention concerning the alleged fraud. *Id.*

In the instant case, however, the record itself shows that the plaintiff could not have known of the alleged misrepresentations or

omissions prior to the buyback of the securities in November 1987. Therefore, there is no reason to go through an unnecessary exercise of requiring the plaintiff to show what diligent efforts he undertook to discover defendants' fraudulent conduct. But see *Glaser v. Norris et al.*, supra.

[12] Therefore, construing the Complaint in the light most favorable to the plaintiff, as I must pursuant to Chancery Rule 12(b)(6), I find that the plaintiff has plead sufficient facts to survive defendants' motions to dismiss on the grounds that he has failed to adequately plead compliance with Section 13 of the Federal Securities Act.

V

Paco, the Paco Directors and the Underwriters also assert that the plaintiff has failed to allege the requisite privity required for the maintenance of a Section 12(2) Federal Securities Act claim.

Paco and the Paco Directors cite the plain language of Section 12(2) for the proposition that a purchaser not in privity with an Issuer of securities has no Section 12(2) claim against that Issuer.

Section 12(2) states in pertinent part:

> "Any person who . . . (2) offers or sells a security by use of any means or instruments of transportation or communication in interstate commerce or the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

They claim that because Paco sold the Debentures directly to Underwriters, and not to the plaintiff or the purported class of Debenture holders, no Section 12(2) action can be asserted against Paco and the Paco Directors.

The Underwriters join Paco and the Paco Directors in further claiming that the Complaint somehow fails to allege that the plaintiff class purchased the Debentures directly from them.

As previously stated, on a motion to dismiss all well plead inferences must be construed in favor of the plaintiff and the Complaint may not be dismissed unless it appears that the plaintiff would not be entitled to relief under any set of facts which could be proved in support of his claim. *Weinberger v. UOP, Inc.*, Del. Ch., supra.

Paragraph 6 of the Complaint alleges, "Pursuant to a Registration Statement and Prospectus dated February 6, 1987 ("Prospectus"), *Paco* and the Underwriters of the Offering sold to plaintiff and other investors $51.75 million of 6 1/2% convertible subordinated debentures, due March 1, 2007 ("Debentures")." (Emphasis added.) In referring to the Prospectus in the Complaint, the plaintiff has put the Prospectus in the record for purposes of the Court's considering the Motion To Dismiss. *Lewis v. Straetz*, Del. Ch., C.A. No. 7859-NC, Hartnett, V.C. (Feb. 12, 1986). It is clear from the Prospectus, and not contested by plaintiff, that all the Debentures were sold by the Underwriters and not by Paco.

[13] Although Paco and the Paco Directors did not sell debentures directly to the purchasers, they may still be subject to suit pursuant to Section 12(2) of the Federal Securities Act. Although a reading of the Prospectus clearly shows that the Underwriters agreed to purchase all the debentures pursuant to a firm underwriting commitment for resale to the public, the recent United States Supreme Court case of *Pinter v. Dahl*, U.S. , 108 S.Ct. 2063 (1988), extends "seller" liability under Section 12 to those parties who successfully solicit purchases of securities whether or not in direct privity with the purchasers. Plaintiff, therefore, claims that Paco and the Paco Directors could be held liable under Section 12(2) because they were allegedly responsible for the preparation and dissemination of the allegedly fraudulent Prospectus used in the marketing of the Debentures and because their involvement in the solicitation process served their own financial interests.

On the other hand, the defendants claim that the extension of statutory "seller" status to Issuers applies only to Section 12(1) claims because the *Pinter* Court expressly stated that it was not taking a position on the scope of a statutory "seller" for purposes of Section 12(2). *Pinter*, 108 S.Ct. at 2076, n. 20.

Since the *Pinter* decision, however, an overwhelming majority of courts dealing with the scope of Section 12(2) liability have extended the *Pinter* analysis to Section 12(2) claims, concluding that

the same definition of "seller" should apply to both Sections 12(1) and 12(2). See, e.g., *Wilson v. Saintine Exploration and Drilling Corporation*, 872 F.2d 1124 (2d Cir. 1989); *Capri v. Murphy*, 856 F.2d 473 (2d Cir. 1988); *Jackson v. First Federal Savings of Arkansas, F.A., et al.*, 709 F.Supp. 863 (E.D. Ark. 1988); *In Re Worlds of Wonder Securities Litigation*, 694 F.Supp. 1427 (N.D. Ca. 1988); *Ballay v. Legg Mason Wood Walker, Inc.*, C.A. No. 88-6867 (E.D. Pa. Dec. 21, 1988) (1988 U.S. Dist. LEXIS 14414). But see *In Re Craftmatic Securities Litigation*, 703 F.Supp. 1175 (E.D. Pa. 1989). As one Court observed, "... for this Court to hold that the purchase requirement under Section 12(2) limits the class of defendants to those individuals with whom the plaintiff is in strict privity, yet discard that requirement in a case prosecuted under Section 12(1) would give rise to an absurd statutory inconsistency." *Ballay v. Legg Mason Wood Walker, Inc.*, supra, at 6.

[14] Even under the *Pinter* analysis, a party who is not in direct privity with a purchaser may still be deemed a "seller" if the party successfully solicits a purchase of securities, so long as he is motivated at least in part by a desire to serve his own financial interests. *Pinter*, 108 S.Ct. at 2079. The *Pinter* Court made plain that the Section 12 "purchase from" requirement is defined by reference to common usage. If a buyer would commonly think that he had purchased securities from someone, then the statutory requirement is met. *Mercer v. Jaffe, Snider, Raitt and Heuer, P.C.*, Nos. 688-380 CA1, 688-582 CA2, slip op. (W.D. Mich. May 3, 1989).

The *Pinter* analysis still leaves unsettled, however, the question whether an Issuer can be held liable under Section 12(2). Some courts have apparently had little difficulty in determining that Issuers and their officers who prepare and disseminate a materially false and misleading prospectus, even though they do not actually sell the security, may be liable under Section 12(2). *Buppa v. Montano* [Current] Fed. Sec. L. Rep. [CCH] Para. 94,348 (W.D. Mo. Feb. 28, 1989); *In Re Professional Financial Management Ltd.*, 692 F.Supp. 1057 (D. Minn. 1988). As the United States Court of Appeals for the Fifth Circuit recently noted:

> Like automobile manufacturers, issuers create distribution chains composed of independent businesses aligned for a single purpose: to sell the product. Just as Ford and General Motors never sell directly to consumers, many issuers never sell their securities directly to investors. Nonetheless, automobile manufacturers engage in extensive marketing cam-

> paigns to convince the public to buy their products from dealerships readily identified with the manufacturer. Consequently, one often hears that someone "has bought a new car from Ford." To the extent that issuers and underwriters use an analogous system to distribute securities, they too may be sellers from whom one buys products.

Abell v. Potomac Ins. Co., 858 F.2d 1104, 1114, n. 8 (5th Cir. 1988), *appeal pending*.

However, other courts have been reluctant to extend seller liability under 12(2) to an issuer who would be presumptively liable under Section 11. See *In Re Thortec Securities Litigation*, No. 88-2470-FMS (N.D. Cal. Jan. 25, 1989) (1989 U.S. Dist. LEXIS); *Jackson v. First Federal Savings of Arkansas, F.A., et al.*, supra; *Laven v. Flanagan et al.*, 695 F.Supp. 800 (D.N.J. 1988). See also *In Re Craftmatic Securities Litigation*, supra.

[15] At this stage of the proceedings, however, I must deny the Paco defendants' motion to dismiss the Section 12(2) claims asserted against them. Even if the Paco defendants were not in direct privity with the plaintiff, it seems that the application of *Pinter* to plaintiff's Section 12(2) claim might include the Paco defendants within the statutory definition of "seller" if they had any role in the preparation and dissemination of the allegedly fraudulent Prospectus used to market the Debentures. At this stage their role must be assumed.

In summary, defendants' motions to dismiss on the grounds that the plaintiff has failed to allege the requisite privity to maintain a Section 12(2) claim must be denied.

THE COMMON LAW CLAIMS

VI

[16] In light of *Simons v. Cogan*, Del. Supr., 549 A.2d 300 (1988), which held that a convertible debenture holder does not have a cause of action predicated on a breach of fiduciary duty claim, plaintiff's cause of action against the defendants for breach of fiduciary duty must clearly be dismissed.

VII

The defendants also seek the dismissal of plaintiff's breach of contract claims on the ground that the plaintiff has failed to satisfy the contractural prerequisites to maintaining an action to enforce the Indenture.

Section 7.06 of the Indenture states that a Debenture holder cannot pursue any judicial remedy unless: (1) written notice of the alleged default is given to the Trustee; (2) a written request is made to the Trustee by not less than 25% of the principal amount of the Debenture to institute legal proceedings; (3) the Debenture holders offer to indemnify the Trustee against any loss, liability or expense; and (4) the Trustee fails to comply with the request within 30 days of its receipt and the receipt of the offer of indemnity.

Although the plaintiff readily admits that he has failed to comply with Section 7.06 of the Indenture, he claims he is not required to meet the requirements because the face of the Debenture fails to give the Debenture holders adequate notice of their existence. See *Freidman v. Airlift International, Inc.*, 44 A.D.2d 459, 355 N.Y.S.2d 613 (1974); *Morgan Stanley & Co. v. Archer Daniels Midland Co.*, 570 F.Supp. 1529 (S.D.N.Y. 1983).

I find, however, that the face of the Debenture—that is, the Certificate itself—does in fact give the Debenture holders adequate notice of the restrictions contained in Section 7.06 of the Indenture. Paragraph 4 on the reverse side of the Debenture certificate explicitly states that the Debentures were made subject to the terms of the Indenture and Paragraph 15, titled "Defaults and Remedies," specifically provides that the Debenture holders can not enforce the Indenture or the Debentures except as provided in the Indenture. I find, therefore, that the Debenture holders had adequate notice that, in the event they sought to enforce the terms of the Indenture or Debentures, they would be subject to all the conditions recited in the Indenture. A cursory review of the Debenture certificate alerts any Debenture holder to this fact. I also disagree with plaintiff's contention that the Indenture provision conflicts with statements made on the Debenture certificate.

[17] I therefore find that the plaintiff has failed to show that he has complied with the conditions specified in Section 7.06 of the Indenture and, therefore, he has no standing to maintain an action based on a breach of the provisions of the Indenture. See *Simons v. Cogan*, Del. Ch., 542 A.2d 785 (1987), *aff'd*, Del. Supr., 549 A.2d 300 (1988). Plaintiff's breach of contract claim therefore must be dismissed.

VIII

As to plaintiff's claim for fraud and deceit, the defendants contend that the plaintiff has failed to allege the requisite elements

to maintain an action for fraud and has failed to plead fraud with particularity as required by Chancery Rule 9(b).

[18] A reading of the Complaint as a whole, however, gives the defendants adequate notice of the basis of their alleged wrongdoing. As discussed previously with regards to the Federal Securities Act claims, the Complaint describes certain alleged misrepresentations and omissions in the Prospectus relating to the use of the proceeds of the Debenture offering. The Complaint also alleges that the defendants made these false representations knowingly, with the intent that the plaintiff and the other purchasers would be deceived, and that the plaintiff relied on the alleged false representations by purchasing the Debentures to his detriment. The plaintiff, therefore, has stated a *prima facie* case of fraud. See *Simons v. Cogan*, Del. Supr., supra; *Harmon v. Masoneilan Int'l, Inc.*, Del. Supr., 442 A.2d 487 (1982).

[19-20] Courts are generally reluctant to dismiss a claim of fraud where the matter is peculiarly within the knowledge of the defendant or where the plaintiff cannot be expected to have personal knowledge of the specific facts constituting the wrongdoing. See *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433 (9th Cir. 1987); *Taggart v. George B. Booker*, Del. Super., 35 A.2d 499 (1943). Additionally, it is well-settled that conditions of the mind, such as knowledge and intent, need not be plead with particularity, but may be averred generally. Chancery Court Rule 9(b).

In sum, I find that the plaintiff has adequately stated a claim of fraud against the defendants and, therefore, their motions to dismiss on these grounds must be denied.

IX

As I have already found that the Complaint alleges sufficient facts to state a claim under Sections 11 or 12(2) of the Federal Securities Act for alleged misrepresentations regarding the use of the Debenture offering's proceeds and a common law claim for fraud, I likewise find that plaintiff has adequately stated a claim for intentional or negligent misrepresentation against Paco, the Paco Directors and the Underwriters.

[21] I find, however, that the plaintiff has not adequately stated an action for intentional or negligent misrepresentation against the Scherer defendants. In fact, Paragraphs 73 and 74 of the Complaint expressly exclude the Scherer defendants from complicity in the preparation or dissemination of the offering Prospectus. That part

of the Complaint which alleges misrepresentation against the Scherer defendants must therefore be dismissed.

X

Lastly, the Scherer Directors seek dismissal of Count II as to them on the grounds that this Court has no basis to assert personal jurisdiction over them. They claim that 10 *Del. C.* §3114, the directors consent to service of process statute, which was used by plaintiff to serve the Scherer defendants, can only be invoked to bring nonresident directors within the jurisdiction of this Court if a breach of fiduciary claim has been stated. The Scherer Directors contend that because a breach of fiduciary duty claim has not been stated against them, they are not subject to the jurisdiction of this Court.

Plaintiff retorts, however, that the plain language of the statute, and "the controlling authority of the Delaware Supreme Court" does not require this Court to construe Section 3114 so narrowly. No Delaware Supreme Court cases on point have been cited, however.

10 *Del. C.* §3114 provides, in pertinent part:

> (a) Every nonresident of this State who after September 1, 1977, accepts election or appointment as a director, trustee or member of the governing body of a corporation organized under the laws of this state ... shall, by such acceptance or by such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation (or if there is none, the Secretary of State) as his agent upon whom service of process may be made in all civil actions or proceedings brought in this State by or on behalf of, or against such corporation in which such director, trustee or member is a necessary or proper party, or in any action or proceeding against such director, trustee or member for violation of his duty in such capacity, whether or not he continues to serve as such director, trustee or member at the time suit is commenced.

The plaintiff contends that Section 3114 reaches nonresident directors of Delaware corporations where the director is a "necessary or proper party" in an action brought against a Delaware corporation even if no breach of fiduciary duty is alleged. This Court, however, has consistently rejected this argument.

In *Hana Ranch, Inc. v. Lent*, Del. Ch., 424 A.2d 28, 30 (1980), Chancellor Marvel stated:

> [I]n my opinion, the statute [10 *Del. C.* Section 3114] must be read as applying only to actions against directors as a class of persons who have been made subject to being sued in Delaware as such, being persons who could not be subjected to the jurisdiction of a Court of Delaware were they not directors. Thus, it is the rights, duties, and obligations which have to do with service as a director of a Delaware corporation which makes a director subject to personal service in Delaware under the terms of 10 *Del. C.* Section 3114 and not simply that he or she may be both a proper party as well as a director.

[22] Likewise, in *In re Cambridge Financial Group, Ltd.*, Del. Ch., C.A. No. 9279-N.C., Hartnett, V.C., slip op. at 8 (Nov. 9, 1987), I held that this Court "may not exercise personal jurisdiction over a nonresident director pursuant to 10 *Del. C.* §3114 for a breach of contract claim wholly unrelated to his fiduciary obligations as a director in a Delaware corporation."

I see no reason to depart from Chancellor Marvel's well-reasoned analysis with regards to the reach of Section 3114 and, therefore, I find that this Court has no basis upon which to assert personal jurisdiction over the Scherer Directors. The Scherer Directors' motion to dismiss Count II must therefore be granted.

XI

In summary, I deny all the defendants' motions to dismiss the Federal Securities Act claims asserted in Count I.

I grant the defendants' motions to dismiss the breach of fiduciary duty and breach of contract claims contained in Count II.

I also grant the Scherer Directors' Motion To Dismiss as to all the claims asserted in Count II against them because this Court has no basis to exercise personal jurisdiction over them. I further grant the Scherer Directors' Motion To Dismiss the claims of intentional and negligent representation asserted against them.

I deny the motions of Paco, the Paco Directors and the Underwriters to dismiss the claims of fraud and intentional or negligent misrepresentations asserted against them.

IT IS SO ORDERED.

PORTER v. TEXAS COMMERCE BANCSHARES, INC.

No. 9114

Court of Chancery of the State of Delaware, New Castle

October 12, 1989

Plaintiffs initiated this class action suit on behalf of all owners of common stock of the defendant corporation against Texas Commerce Bancshares, Inc., Chemical New York Corporation, and the directors of both corporations, challenging the merger of defendant with Chemical New York. Plaintiffs sought rescission of the merger or, in the alternative, damages. Plaintiffs alleged that the defendants breached their fiduciary duties of loyalty and care by (1) approving questionable loans, (2) failing to conduct a diligent investigation prior to approving the merger, (3) disclosing false and misleading information in shareholder proxy statements, (4) omitting material information from proxy statements, (5) agreeing to an inadequate merger price, (6) approving a merger for improper business purposes, and (7) failing to pursue legal claims against themselves as well as certain lawyers, appraisers, and accountants, who caused damage to the corporation. Defendants filed a motion to dismiss, on the grounds that an appraisal action is the correct and exclusive proceeding in which to address plaintiffs claims.

The court of chancery, per Chancellor Allen, denied defendants' motion to dismiss. The court held that because the transaction was a negotiated arm's-length merger, plaintiffs exclusive remedy in challenging the adequacy of the merger price lies in an appraisal right. Moreover, the court held that plaintiffs' claim of a misleading proxy statement did state a claim upon which relief could be granted.

1. Pleading ⟹ 354(25)

Pretrial Procedure ⟹ 622, 679

In order to grant a motion for failure to state a claim, the court must conclude, with reasonable certainty, that a plaintiff would not be entitled to relief under any set of facts that could be proven under the allegations she has made.

2. Corporations ⟹ 182.4(4), 307, 584

In *Rabkin*, the Delaware Supreme Court held that a complaint which avers "specific acts of unfair dealing constituting breaches of

fiduciary duties which, if true, may have substantially affected the merger price'' was adequate to survive a motion to dismiss; however, the court also held that henceforth, shareholder complaints that the price offered in a merger is inadequate are to be adjudicated in an appraisal proceeding absent litigable claims of unfair dealing affecting price.

3. Pleading ⟸ 354(1), 354(25)

Pretrial Procedure ⟸ 622, 679

It is not a technical defect in the complaint that it does not lucidly set forth theories of legal liability. It is sufficient for purposes of a motion to dismiss if the complaint sets forth facts which, if true, would entitle plaintiff to relief.

4. Pleading ⟸ 354(25)

Pretrial Procedure ⟸ 622, 679

Analysis of a motion to dismiss is made considerably easier if the complaint does make plain the legal theories that the pleader has in mind; otherwise, the court is required to attempt to apply arguably pertinent theories and to rule upon the sufficiency of the pleaded facts in light of the requisites of such theories.

5. Corporations ⟸ 310(1), 370(1), 581

The obligation to pay a ''fair price'' in a negotiated, arm's-length merger transaction does not arise.

6. Corporations ⟸ 182.4(4), 584

While a stockholder has a statutory right designed to assure that ''fair value'' is afforded, there is no right to a fair price in the merger itself and thus no right to enjoin an arm's-length merger on the grounds that an *ex post facto* judicial review would conclude that the negotiated price did not represent a ''fair'' or ''adequate'' price.

7. Corporations ⟸ 189(1), 584

The appraisal remedy creates the only right there is, in the context of an arm's-length merger, which is to examine the value of the shares in the merging corporation.

8. Equity ⟸ 55

When there is no right, there can be no remedy.

9. Corporations ⟸ 307, 310(1), 376, 581

In the context of a self-dealing merger, there is no independent, "business purpose" test that a merger must satisfy in order that the fiduciary duty of a controlling shareholder be respected.

10. Corporations ⟸ 307, 312(5), 581

A self-dealing merger does not constitute a breach of a controlling shareholder's fiduciary duty by reason of the fact that it is effectuated for a business purpose of the parent and for no purpose distinctive to the subsidiary.

11. Corporations ⟸ 307, 310(1)

The board's duty of "entire fairness" defines the obligations of the fiduciary in a self-dealing merger.

12. Corporations ⟸ 307, 310(1)

In a negotiated, arm's-length merger, the existence of a business purpose requirement is implied by the root obligation of a director to authorize corporate action only in the good faith pursuit of corporate interests.

13. Corporations ⟸ 307, 310(1), 314(1)

Plainly a merger that served a private interest of directors, but no corporate or shareholder interest, would constitute or reflect a violation of duty.

14. Corporations ⟸ 584

A merger in which a corporation's shareholders received stock in another corporation, other securities, or cash will always result in termination of the right of the pre-merger shareholders to sue on behalf of the company.

15. Corporations ⟸ 182.4(1), 182.4(4)

If a company has substantial and valuable derivative claims, they, like any asset of the company, may be valued in an appraisal.

16. Corporations ⟸ 202, 584

Shareholders are not, in theory, exposed to risk that they will be injured by the timing of a merger with respect to the possible filing of derivative claims nor, from the company's point of view, does the occurrence of the merger affect the ability of the surviving or resulting corporation to bring suit against those who previously had been directors of a constituent corporation.

17. Corporations ⟸ 182.4(4), 584

Where the merger is a self-dealing one, and where there is pending derivative litigation that will, as a practical matter, be left by the merger without a plaintiff, a claim that such an effect was the principal purpose of the merger might constitute a claim of unfair dealing upon relief could be granted.

18. Corporations ⟸ 189(11), 307

A claim for breach of a duty of candor requires an allegation of an omission to state, or the misstatement of, a material fact which the directors knew or, by the exercise of their duty to be appropriately informed relevant to the transaction, ought to have known.

19. Pretrial Procedure ⟸ 531, 681

Application of a relevant legal test that is highly contextual will rarely be an appropriate issue for resolution on a motion to dismiss.

20. Pleading ⇨ 354(25)

Pretrial Procedure ⇨ 622, 680, 681

A complaint that alleges that prices in the when-issued market were substantially less than values that the shareholders had allegedly been led to believe does plead enough to survive a motion to dismiss.

21. Corporations ⇨ 310(1), 584

Securities Regulation ⇨ 119

A claim that a proxy statement is false or misleading in a material way is not a claim for which appraisal provides an exclusive remedy; by a parity of reasons, a claim that directors were actionably negligent in valuing securities to be received in a merger also will not generally be relegated to appraisal.

22. Corporations ⇨ 307, 310(1), 320(4), 584

It would be anomalous, a Catch-22, to hold that a non-dissenting shareholder, who relied upon a reasonable assumption that directors negotiated and recommended the proposed merger with appropriate care and deliberation, should be foreclosed, by the existence of an unavailable appraisal remedy, from suing the directors for their assumed breach of duty to exercise care and deliberation.

23. Corporations ⇨ 198(1), 310(1), 584

Securities Regulation ⇨ 119

It is settled law in Delaware that a proxy statement need not be a forum for directorial confessions of past mismanagement; the failure to make such admissions is not a material omission in a proxy statement.

24. Pleading ⇨ 354(16)

Pretrial Procedure ⇨ 679, 681

In a motion to dismiss a complaint because no relief may be afforded, if one claim is properly asserted, the complaint may not be dismissed.

25. Pleading ⇨ 368

Pretrial Procedure ⇨ 679, 681

Where a complaint does not set forth separate claims in separate counts, the locution of granting a motion to dismiss in part and denying a motion to dismiss in part, is not helpful.

R. Bruce McNew, Esquire, and Lisa J. Rodriguez, Esquire, of Greenfield & Chimicles, Wilmington, Delaware, and Haverford, Pennsylvania, for plaintiffs.

Richard L. Sutton, Esquire, Thomas C. Grimm, Esquire, and Mary B. Graham, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Cravath, Swaine & Moore, New York, New York, for defendants Chemical New York Corporation and Walter V. Shipley.

R. Franklin Balotti, Esquire, and Jesse A. Finkelstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Baker & Botts, Houston, Texas, for defendants Texas Commerce Bancshares, Inc. and Ben F. Love.

ALLEN, *Chancellor*

Plaintiffs Ronald Porter and Robert A. Faneuil owned common stock of Texas Commerce Bancshares, Inc. ("Texas Commerce"), a bank holding company incorporated in this State, when, on May 1, 1987, pursuant to a merger approved by a vote of the Texas Commerce shareholders, their stock was converted into a right to receive an amalgam of cash and securities. In the merger, Texas Commerce ceased to exist as an independent bank holding company and became a subsidiary of Chemical New York Corporation ("Chemical"), one of the largest U.S. bank holding companies. In the merger, Chemical increased its assets from less than $57.9 billion to $79 billion.

Messrs. Porter and Faneuil felt aggrieved by the merger. On July 16, 1987, they filed a complaint in this court naming both corporations and the members of both boards of directors as defendants. Their suit seeks rescission of the merger or in the alternative, damages. Defendants rather promptly moved to dismiss Counts I

and III of the complaint on the ground that neither of those counts state a claim upon which relief may be granted.[1] Specifically, defendants contend that those counts essentially alleged only that the price paid in the merger did not reflect the fair value of plaintiffs' stock. The exclusive forum in which plaintiffs could litigate a claim that their Texas Commerce stock was worth more than the consideration paid in the merger, however, is said to be an appraisal action under Section 262 of our corporation law.

While plaintiffs admit that the fairness or adequacy of the price is a central concern of theirs, they actively resist the notion that their complaint entails nothing more. Rather, they assert that their complaint includes valid claims of breach of duties of loyalty and care which, when proven, will entitle them to relief unavailable in an appraisal form of action.

For the reasons that follow, I conclude that plaintiffs are in some respects correct, but that important aspects of their complaint are nothing more than charges that the merger price was inadequate, for which the exclusive remedy is provided by Section 262 of our corporation law. Before turning to a statement of the reasons for this conclusion, it will be helpful to set forth the facts as alleged.[2]

I.

According to the complaint, as of December 31, 1986, Texas Commerce was the 29th largest banking organization in the United States measured by assets. Messrs. Porter and Faneuil were among its 20,000 shareholders. Defendant Ben F. Love is chairman and chief executive officer of Texas Commerce. Numerous other individual defendants were, at all relevant times, directors of Texas Commerce.[3]

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1. Count II of the complaint purports to state a claim under the Securities Act of 1933, 15 USC § 77a, *et seq.* It is not involved in the pending motion.

2. In some respects, the complaint cannot be understood without reference to the Joint Proxy Statement/Prospectus/Offering Circular and the supplement to that document (*see, e.g.*, Cplt. Count III) which have been submitted only as exhibits to defendants' brief. Where the complaint does repeatedly refer to the proxy statement but neglects to attach a copy of it, and where there can be no dispute concerning the authenticity of the proxy statement, it should, in my opinion, be permissible on a motion to dismiss to refer to that document, although not appended to the complaint, to set forth uncontroversial facts such as the terms of the merger or the precise disclosures made.

3. These include J. Rudney Atalla, Thomas D. Barrow, Donald L. Bentsen,

Chemical is a bank holding company incorporated in Delaware. It conducts a worldwide financial services business through its subsidiaries. Numerous individual defendants were, at all relevant times, directors of Chemical and Chemical Bank, a New York chartered bank which is Chemical' principal subsidiary bank.[4]

Pre-Merger Activities

The complaint attempts to outline a story of directorial mismanagement and corporate decline. During the years immediately preceding the merger, Texas Commerce acquired numerous banks in Texas. Many of these banks, plaintiffs allege, had poor controls and minimal lending standards. By the fall of 1984, about 55% of Texas Commerce's $3.5 billion real estate loan portfolio was concentrated in Houston and the surrounding area. The value of these investments declined, along with the rest of the Texas economy. Many of these loans were, say plaintiffs, in "high-risk" construction and land development projects not covered by third party commitments to pay when construction was to be completed. On December 31, 1985, Texas Commerce's reserve for possible loan losses was 8316 million, almost double that of a year earlier. As of December 31, 1986, the loan loss reserve was $271 million. Texas Commerce's earnings declined $130 million between 1984 and 1985.

Large portions of Texas Commerce's losses were caused, according to plaintiffs, by the negligent operation of Texas Commerce and its subsidiaries. The Texas Commerce directors and officers approved high-risk or questionable loans with inadequate prospects of timely repayment and with insufficient collateral. Further, plaintiffs

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Jack S. Blanton, Charles C. Butt, John D. Byram, Berry R. Cox, Jr., H. Creekmore, Harlan R. Crow, John H. Duncan, Eugenio Garza Laguera, James B. Goodson, Paul R. Haas, William C. Harvin, Forest E. Hoglund, Harold S. Hook, Barbara Jordan, Don D. Jordan, Donald R. Keough, Henry H. King, Terry A. Kirkle, R. Bruce LaBoon, Kenneth L. Lay, James R. Lesch, R.W. Moncrief, Robert Mosbacher, Jon P. Newton, Constantine S. Nicandros, Travis H. Petty, James L. Powell, Kenneth W. Reese, J. Hugh Roff, Jr., Charles Sapp, Fred D. Schneider, Marc J. Shapiro and Cyril Wagner, Jr.

4. These include Robert G. Goelet, Henry L. Hillman, Donald C. Platten, Rawleigh Warner, Jr., Richard D. Wood, Charles L. Brown, Franklin H. Williams, Emil Mosbacher, Jr., Martha Redfield Wallace, Richard R. Pivirotto, William A. Marquard, George Weissman, Andrew C. Sigler, W. Michael Blumenthal, Edward G. Jefferson, Michael I. Sovern, Walter V. Shipley, A. Paul Funkhouser, Robert J. Callander, Thomas S. Johnson, Lawrence G. Rawl, Richard S. Simmons, George V. Grune and Melvin R. Goodes.

say, the directors and officers recklessly relied upon "excessive" appraisals.

Certain subsidiaries of Texas Commerce made or maintained "questionable loans" to certain Texas Commerce directors, members of their families, or affiliates. Loans to two directors or affiliated persons are specified in the complaint. According to the complaint, Texas Commerce holds claims against the Texas Commerce directors worth in excess of $100 million.

The Merger

The merger challenged here was the largest interstate banking merger in United States history, plaintiffs say, creating a bank holding company with assets of $79 billion and equity capital of almost $4 billion.

Defendants announced the proposed merger on or before December 15, 1986; it was effectuated on May 1, 1987. Pursuant to the merger, all common shares of Texas Commerce were acquired by a wholly owned subsidiary of Chemical. According to paragraph 28 of the complaint, Texas Commerce shareholders received consideration consisting of (i) Chemical common stock, (ii) Chemical Class B common stock, (iii) an elective portion consisting of cash and/or Chemical Series C Preferred stock, and (iv) National Loan Bank[5] stock. (*But see* Cplt. ¶ 16 for a different formulation). In a supplement to the prospectus, Texas Commerce suggested, according to plaintiffs, that the value of the package at the time of the merger was $36, utilizing a "hypothetical" fair market value. (*See* Cplt. ¶ 16, *but see* Cplt. ¶ 17 ("price per share paid by Chemical . . . was purportedly $65")).

Further, according to plaintiffs, Texas Commerce represented on March 29, 1987 that, prior to the effective date of the merger and the distribution of the merger consideration to the Texas Commerce shareholders, there would not be a public market for the National Loan Bank stock and other newly-issued shares. It is alleged however that Goldman Sachs & Co. did maintain a "when-issued" market in such securities prior to their distribution. Texas Commerce knew, plaintiffs aver, that the market was being made and that the

5. $300 million book value of Texas Commerce's non-performing assets were transferred to a newly organized national bank, National Loan Bank, whose stock was distributed to Texas Commerce shareholders in the merger.

securities to be issued were traded at prices substantially less than defendants' estimated values for such shares.

The value paid by Chemical for each Texas Commerce share is, according to plaintiffs, a great deal less than these shares were worth. It is alleged that Texas Commerce owns claims against its directors for mismanagement, and because of malpractice claims against appraisers, accountants and lawyers. It is implied that the value of such claims was not reflected in the price paid. Moreover, the consideration paid is alleged not to have been worth what plaintiffs were led to believe because, it is alleged, Chemical's reported assets, earnings and net worth as of December 31, 1986 were overstated.

Plaintiffs allege that the merger was designed solely to eliminate members of the plaintiff class from continued equity participation in Texas Commerce at a price which defendants knew or should have known was unfair and inadequate. The acquisition was, plaintiffs say, designed to transfer from plaintiffs to Chemical the financial benefits of Texas Commerce's projected growth and ultimate recovery.

Further, it is said that the Texas Commerce directors agreed to the merger terms without conducting a thorough due diligence investigation of Chemical. In particular, according to plaintiffs, the directors failed to satisfy themselves fully that Chemical's financial statements accurately reflected its true assets, earnings and net worth as of December 31, 1986 and thereafter.

The Texas Commerce directors approved the merger, according to plaintiffs, in order to protect themselves against derivative litigation which would assert claims for reckless mismanagement and insider loans.

In Count III, plaintiffs allege claims relating to the supplement to the prospectus. In particular, plaintiffs assert that certain information should have been disclosed in the supplement's discussion of Proposal (3). That proposal sought a vote by Texas Commerce shareholders to amend Texas Commerce's restated certificate of incorporation in connection with the merger. The amendment would eliminate monetary liability of directors for any breach of their duty of care. In that connection, plaintiffs claim that Texas Commerce and its directors failed to disclose the extent to which their acts caused Texas Commerce to sustain losses, failed to respond to shareholder demands, and did not pursue legal claims against themselves, as well as certain lawyers, appraisers and accountants who caused damage to Texas Commerce.

Plaintiffs purport to bring this action in behalf of a class consisting of all owners of shares of common stock of Texas Commerce

on May 1, 1987, the effective date of the merger, except for defendants and their affiliates, officers, directors and members of their immediate families.

II.

[1-2] In order to grant a motion to dismiss for failure to state a claim, the court must conclude, with reasonable certainty, that a plaintiff would not be entitled to relief under any set of facts that could be proven under the allegations she has made. *Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Supr., 498 A.2d 1099, 1104 (1985); *Harman v. Masoneilan International, Inc.*, Del. Supr., 442 A.2d 487, 502 (1982). Here, defendants move to dismiss on the ground that appraisal is the correct and exclusive proceeding in which plaintiffs' claims could be judicially addressed. In *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983), the Delaware Supreme Court outlined principles relating to the exclusivity of appraisal. In *Rabkin*, the Court applied those principles and found adequate a complaint which averred "specific acts of unfair dealing constituting breaches of fiduciary duties which if true may have substantially affected the offering price." *Rabkin, supra*, at 1100; *see Weinberger, supra*, at 703. The Supreme Court nonetheless made it clear that henceforth it would be as it had been (*see Stauffer v. Standard Brands Incorporated*, Del. Supr., 187 A.2d 78 (1962))—shareholder complaints that the price offered in a merger is inadequate are to be adjudicated in an appraisal proceeding absent litigable claims of unfair dealing affecting price.

III.

[3-4] It is not a technical defect in the complaint that it does not lucidly set forth theories of legal liability. It is sufficient for purposes of a motion to dismiss if the complaint sets forth facts which, if true, would entitle plaintiff to relief. Analysis of a motion of this kind is made considerably easier, however, if the complaint does make plain the legal theories that the pleader has in mind. Otherwise—as here—the court is required to attempt to apply arguably pertinent theories and to rule upon the sufficiency of the pleaded facts in light of the requisites of such theories. The agglomeration of facts presented here necessitates this course.

As I read the complaint, it may arguably allege several possible theories of liability.

First: the merger price "did not reflect the intrinsic value" of the shares (Cplt. ¶ 20) because it failed to reflect the value of claims

held by the Company against its directors and agents. These purported claims allegedly have arisen from losses (realized or yet to be realized) suffered by the bank because of alleged mismanagement and negligence. *See* Cplt. ¶¶ 17, 18, 20, 22.

Second: the merger served no purpose of Texas Commerce but was accomplished simply to protect the directors from possible future derivative claims that would attempt to establish liability for past losses or lost opportunities. ("... a merger at this time will frustrate the Company's shareholders' ability to commence and maintain derivative litigation and minimize the possibility of any claims being asserted . . .). Cplt. ¶ 21.

Third: the proxy materials pursuant to which shareholder approval was given were untrue or misleading in an important respect—they failed to inform the shareholders that a "when-issued" market was being made by Goldman Sachs in the securities to be distributed as merger consideration, and that the value reflected in the when-issued market of the package of securities to be received was substantially less than the value suggested by a "hypothetical" example apparently contained in the Supplement to the Prospectus. Cplt. ¶ 16.

Fourth: the directors did not adequately investigate the value of the consideration offered in the merger to the Texas Commerce shareholders. Cplt. ¶ 18.

Fifth: the proxy supplement which discussed a proposal to amend Texas Commerce's certificate of incorporation (which amendment was proposed to be effectuated in the merger) to eliminate potential director liability for future breaches of the duty to exercise care was materially incomplete. It is asserted that a correct disclosure would have included a description of prior breaches by the Texas Commerce directors of that duty, specifically referring to at least those matters pleaded elsewhere in the complaint. Cplt. ¶ 45-46.

I turn then to an evaluation of the legal adequacy of these pleadings.

IV.

A.

[5-7] Plaintiffs attempt to plead a claim premised on allegations that the merger consideration was less than the "intrinsic value" of the Texas Commerce stock or was unfair, inadequate or words to that effect. These allegations may be disposed of summarily. Ac-

cepting the well-pleaded allegations of the complaint as true, it is plainly the case that the merger complained of was a negotiated, arm's-length transaction. The obligation to pay a "fair price" in such a merger does not arise. The rights of the Texas Commerce shareholders in such a setting are legal[6] and equitable,[7] but they do not include a right to a price in the merger that is "adequate" or "fair," etc. If a shareholder does not find the merger consideration appealing, she is provided with a statutory alternative designed to substitute "fair value" for the merger consideration.[8] Thus, while a stockholder has a statutory right designed to assure that "fair value" is afforded, there is no right to a fair price in the merger itself and thus no right to enjoin an arm's-length merger on the ground that an *ex post facto* judicial review would conclude that the negotiated price did not represent a "fair" or "adequate" price. The appraisal remedy creates the *only right* there is, in the context of an arm's-length merger, to examine the value of the shares in the merging corporation.

[8] Having this view of the law, I am constrained to conclude that plaintiffs' repeated allegations of the inadequacy of the merger price do not themselves create a claim, in the context of an arm's-length transaction, upon which relief may be granted. Where there is no right, there can be no remedy.

B.

[9-11] With respect to the allegations concerning the purpose of the board of Texas Commerce (*see* ¶ "Second," *supra*), I conclude that the relevant, well-pleaded facts fail to state a claim. It has, of course, been established in the context of a self-dealing merger that there is no independent, "business purpose" test that a merger must satisfy in order that the fiduciary duty of a controlling shareholder be respected. *Weinberger*, *supra*. In this aspect of its holding, *Weinberger* may be seen simply as a generalization of the holding of *Tanzer v. International General Industries, Inc.*, Del. Supr., 379 A.2d 1121 (1977). *Tanzer* held that a self-dealing merger does not constitute a breach

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6. Most importantly, the right to vote on a merger, or to dissent and demand appraisal.

7. The right in equity to require directors to act in an informed manner in the good faith pursuit of corporate or shareholder interests.

8. That is, more precisely, the "fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any . . . ." 8 *Del. C.* § 262(h).

of a controlling shareholder's fiduciary duty by reason of the fact that it is effectuated for a business purpose of the parent and for no purpose distinctive to the subsidiary. Under *Weinberger*, rather than a focused obligation regarding purpose, the board's duty of "entire fairness" defines the obligations of the fiduciary in a self-dealing merger.

[12-13] A negotiated, arm's-length merger is, in some respects, different. In such a context, the existence of a business purpose requirement is implied by the root obligation of a director to authorize corporate action only in the good faith pursuit of corporate interests.[9] Plainly, for example, a merger that served a private interest of directors, but no corporate or shareholder interest, would constitute or reflect a violation of duty.

[14-17] This is the principle that plaintiffs seek to call upon when they allege that the Chemical merger served no purpose of Texas Commerce, but did serve directors' interests by frustrating "the Company's shareholders' ability to commence and maintain derivative litigation . . . ." This claim does not state facts that are legally significant. A merger in which a corporation's shareholders received stock in another corporation, other securities or cash, will always[10] result in termination of the right of the pre-merger shareholders to sue on behalf of the company. That fact does not mean that either those shareholders or the company may be injured as a consequence. If the company has substantial and valuable derivative claims, they, like any asset of the company, may be valued in an appraisal. *See, e.g., Harnett v. Cavalier Oil Co.*, Del. Supr., 1989 Del. LEXIS 325, Walsh, J. (September 5, 1989). Thus, shareholders are not, in theory, exposed to risk that they will be injured by the timing of a merger with respect to the possible filing of derivative claims. Nor from the company's point of view does the occurrence of the merger affect the ability of the surviving or resulting corporation to bring suit against those who previously had been directors of a constituent corporation. *See* 8 *Del. C.* § 259.[11]

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9. In some instances, "corporate interests" will include interests of all of the corporation's shareholders even where the corporation itself is not affected by the action, and indeed the holdings of *Tanzer* and *Weinberger* on this point may be interpreted to mean that where there is a controlling shareholder, for these purposes "corporate interests" include the interests of such person.

10. Excepting the arguable possibility of so-called double derivative claims.

11. Where the merger is a self-dealing one, and where there is pending derivative litigation that will, as a practical matter, be left by the merger without

Here, the complaint does not plead that the directors of Texas Commerce will control Chemical after the merger. Nor does it claim that an agreement was reached in which Chemical agreed that no claim would be brought against former Texas Commerce directors for alleged mismanagement. Thus, all that is pleaded is that prior to the merger, there may have been grounds to bring a derivative claim for mismanagement (but no one apparently had attempted to do so), and after the merger, there still may be a basis to do so. In these circumstances, I cannot conclude that facts have been pleaded which, if true, would constitute the approval of this largest banking merger in our history as a breach of the Texas Commerce directors' duty to act in good faith in pursuit of corporate, rather than personal, interests. If there is any value to the corporation of the claims of mismanagement alluded to (rather than stated) in the complaint, that value would be reflected in an appraisal award.

C.

[18] I turn now to the third theory that can be distilled from the complaint which relates to the alleged existence of a "when-issued" market for the securities offered as part of the consideration in the merger. *See* ¶ "Third," *supra*. The claim purports to be one for breach of a duty of candor. Such a claim requires the allegation of an omission to state (or the misstatement of) a material fact which the directors knew or, by the exercise of their duty to be appropriately informed relevant to the transaction, ought to have known. *Lynch v. Vickers Energy Corp.*, Del. Supr., 383 A.2d 278 (1977); *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929 (1985).

Here, it is alleged that the Texas Commerce directors knew that a "when-issued" market was being made by a major investment banking firm in securities to be issued, and it is further alleged that defendants knew that in that "when-issued" market, those securities traded at values substantially less than the value allegedly implied by defendants. Cplt. ¶ 16.

[19-20] Defendants assert that the existence of a "when-issued" market does not make incorrect the proxy material's statement that no trading market was expected to exist in the securities until their issuance—which was, they say, true. The "when-issued" market is

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a plaintiff, a claim that such an effect was the principal purpose of the merger might constitute a claim of unfair dealing upon which relief could be granted. *See Merritt v. Colonial Foods, Inc.*, Del. Ch., 505 A.2d 757 (1986).

not, they imply, a market "in the securities," but in certain rights respecting those securities. They further imply that what may occur in that market has no pertinence. While factually, the specific characteristics of the "when-issued" market might be such that it would not be material to one asked to authorize the merger or to act on a right to dissent from it (*see Rosenblatt v. Getty Oil, supra*; *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)), I cannot say on this motion that the existence of a "when-issued" market and the specific characteristics of that market (size, prices, etc.) would not have been material. Application of the relevant legal test is highly contextual; it will rarely be an appropriate issue for resolution on a motion to dismiss. *E.g.*, *Glassman v. Wometco Cable TV, Inc.*, Del. Ch., C.A. No. 7307, Hartnett, V.C. (June 19, 1985). Here, while the complaint offers little from which one could conclude that the existence and particulars of a "when-issued" market would have been material, it does plead enough, in my opinion, to survive a motion to dismiss when it alleges that prices in the when-issued market were substantially less than values that the shareholders had allegedly been led to believe were applicable. What "substantially" means in this setting may perhaps be established beyond contest by affidavit or discovery. If so, perhaps judicial resolution of this issue may be reached before trial. But for present purposes, I am satisfied that the complaint does state a claim upon which relief may be granted with respect to the claimed non-disclosure of the "when-issued" market in the circumstances alleged.

D.

The fourth theory that appears from the complaint involves a claim that the Texas Commerce directors failed to exercise due care in investigating Chemical before recommending the merger in which the Texas Commerce shareholders received Chemical securities. Defendants' motion in this instance, as in others, is directed entirely to the exclusivity of the appraisal remedy. It is, therefore, that argument upon which I principally have focused.

Defendants' specific argument is hardly more textured than the statement that if the directors were negligent (or grossly so) and the shareholders were injured, this injury may be compensated in an appraisal action. Therefore, they conclude that that remedy is fully sufficient and is the exclusive remedy. I cannot accept this argument.

[21-22] A claim that a proxy statement is false or misleading in a material way is not a claim for which appraisal provides an

exclusive remedy.[12] By a parity of reasoning, a claim that directors were actionably negligent in valuing securities to be received in a merger also will not generally be relegated to appraisal. In both instances, shareholders presumably rely upon the directors meeting their obligations (of candor in one instance, of care in the other) in electing to accept the merger consideration and eschew appraisal. *Cf. Sealy Mattress Co. of N.J. v. Sealy, Inc.*, Del. Ch., 532 A.2d 1324 (1987). It would be anomalous, a Catch-22, to hold that a non-dissenting shareholder who relied upon a reasonable assumption that the directors negotiated and recommended the proposed merger with appropriate care and deliberation, should be foreclosed, by the existence of an unavailable appraisal remedy, from suing the directors for their (assumed) breach of duty to exercise care and deliberation. Whether this complaint does allege a claim of this type has not been presented—defendants opting to prevent only the exclusivity of the appraisal remedy as a basis for their motion. In denying the motion, I reject defendants' argument but intend to go no further.

E.

[23] Plaintiffs' allegations in Count III boil down to an assertion that the proxy supplement's discussion of a proposal to eliminate liability for future breaches of due care should have disclosed prior directorial acts of wrongdoing. It is settled law in Delaware, however, that a proxy statement need not be a forum for directorial confessions of past mismanagement. The failure to make such admissions is not a material omission in a proxy statement. *Margolies v. Pope & Talbot, Inc.*, Del. Ch., C.A. No. 8244, Hartnett, V.C. (December 23, 1986); *Columbia Pictures Industries, Inc. v. Kirk Kerkorian, MGM Grand Hotels, Inc.*, Del. Ch., C.A. No. 6394, Marvel, C. (December 16, 1980); *Williams v. Geier*, Del. Ch., C.A. No. 8456, Berger, V.C. (May 20, 1987).

V.

[24-25] The motion is to dismiss the complaint as one upon which no relief may be afforded. So long as one claim is properly

12. This is the case because the alleged wrong, if proven, will establish both that the vote authorizing the merger was flawed and the election to accept the merger or to dissent from it was similarly taken on information that was incorrect in a material respect.

asserted, the complaint may not be dismissed. Therefore, the motion will be denied. Nevertheless, the foregoing does include rulings with respect to some aspects (theories) of the complaint and such rulings will constitute the law of this case, unless reversed on appeal. In some cases, this court has spoken of a motion to dismiss being granted in part and denied in part. This locution is not helpful here where the complaint does not set forth separate claims in separate counts.

RAND v. WESTERN AIRLINES, INC.

No. 8632

Court of Chancery of the State of Delaware, New Castle

September 11, 1989

Plaintiffs, former shareholders of defendant Western Airlines, Inc. (Western) brought this purported class action against Western, most of its directors, and Delta Airlines (Delta) following the merger of the two airlines. Plaintiffs claimed various breaches of fiduciary duties owed by Western's directors and claimed that Delta had aided and abetted Western in the alleged wrongs. Defendants moved to dismiss the action on the grounds that the lawsuit raised derivative claims which plaintiffs no longer had standing to pursue, or in the alternative, that plaintiffs were limited to an appraisal remedy.

The court of chancery, per Vice-Chancellor Berger, granted in part and denied in part defendants' motions, holding (1) that plaintiffs' allegations constituted a direct attack on the validity of the merger, and thus could not be dismissed for a lack of standing; (2) that certain allegations made by plaintiffs were sufficient to state a claim against Western and its directors and, therefore, should not be dismissed; and (3) that plaintiffs had failed to state a claim against Delta.

1. Corporations ⇐ 207 1/2

The fact that claims which are derivative in nature are raised in the context of a merger does not transform such claims from being derivative to direct.

2. Corporations ⇐ 182.4(4), 202, 590(1)

Direct attacks against a corporate transaction, involving fair dealing or fair price, give complaining shareholders standing to pursue individual actions even after they are cashed-out through the effectuation of a merger.

3. Corporations ⇐ 202, 590(1)

Where a complaint directly attacks a merger transaction through allegations that the merger consideration was grossly inadequate, that the allegedly inadequate price resulted from the failure of the defendant directors of the acquired corporation to "shop" the company and from their grant of a stock option to the acquiring company, and that defendants solicited approval of the merger without full disclosure of certain facts relating to the value of the company, the allegations cannot be dismissed for lack of standing in light of the consummation of the merger.

4. Corporations ⇐ 307, 584

Where a complaint does not allege that the acquiring company in a merger transaction controlled the target, or stood on both sides of the transaction, or owed any fiduciary duties to the stockholders of the acquired firm, and only a small minority of the members of the board of the acquired firm are alleged to have any interest in the transaction, the complaint provides no basis to invoke the entire fairness standard.

5. Corporations ⇐ 310(1)

In the absence of divided interests, the judgment of the majority stockholders and/or the board of directors is presumed made in good faith and inspired by bona fides of purpose; but when the persons who control the making of a transaction and the fixing of its terms are on both sides, then the presumption and deference to sound business judgment are no longer present, and intrinsic fairness, tested by all relevant standards, is the criterion.

6. Corporations ⇐ 310(1)

In the conduct of an auction for the sale of corporate control, the most scrupulous adherence to ordinary principles of fairness is required, and the board may not allow any impermissible influence,

inconsistent with the best interests of the shareholders, to alter the strict fulfillment of its duties.

7. Corporations ⟸ 189(2), 310(1)

Under Delaware law, where the grant of an auction-ending lock-up option or no-shop clause is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts.

8. Corporations ⟸ 310(1)

Where there are competing bidders, and the companies do not treat all of the bidders equally, the board's action must be reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests. Only after satisfying the standard will the directors' actions be accorded the protection of the business judgment rule.

9. Corporations ⟸ 307, 310(1)

It is settled Delaware law that the directors of a corporation being offered for sale owe a duty of complete candor to their stockholders and to satisfy this obligation all material facts must be disclosed.

10. Securities Regulation ⟸ 63, 119

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.

11. Securities Regulation ⟸ 63, 119

Where there is no allegation that any of the decisions made by defendant directors were motivated by concern of a possible takeover attempt, or that the merger terms were intended to address the possible takeover attempt, a reasonable stockholder would not find the omitted information important in deciding how to vote on the merger.

12. Conspiracy ⟸ 1, 15

There are three elements to an aiding and abetting claim: (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's

duty, and (3) a knowing participation in that breach by the defendants who are not fiduciaries.

13. Corporations ⇐ 310(1), 370(1)

Lock-ups and no-shop clauses are permissible under certain circumstances.

14. Corporations ⇐ 310(1)

The fact that the acquiring company requested and obtained lock-up and no-shop concessions in a merger transaction does not, without more, give rise to an inference that the acquiring company was aware of any wrongful conduct by the acquired company or its directors.

Kevin Gross, Esquire, of Morris, Rosenthal, Monhait & Gross, Wilmington, Delaware; Stull Stull & Brody, New York, New York, of counsel; Law Offices of Joseph H. Weiss, New York, New York, of counsel; and Kaufman Malchman Kaufmann & Kirby, New York, New York, of counsel, for plaintiffs.

Steven J. Rothschild, Esquire, Kevin F. Brady, Esquire, and John G. Day, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for defendant Delta Air Lines.

Allen M. Terrell, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Davis Polk & Wardwell, New York, New York, of counsel, for defendants Western Air Lines, Inc. and the individual defendants.

BERGER, *Vice-Chancellor*

This is the decision on a motion to dismiss a purported class action that was precipitated by the merger of Western Airlines, Inc. ("Western") and a wholly-owned subsidiary of Delta Airlines ("Delta"). The amended complaint (hereafter the "complaint"), filed by former stockholders of Western, names as defendants Western, most of its directors and Delta. Defendants argue that the complaint must be dismissed because it raises derivative claims, which plaintiffs no longer have standing to pursue. Alternatively, defendants argue that the former stockholders of Western are limited to an appraisal proceeding.

The relevant facts, as alleged in the complaint, may be summarized as follows. Prior to the merger at issue, Western had approximately 48 million shares of common stock outstanding, and only three of its thirteen directors were employed by the company. During the summer of 1986, representatives of Western and Delta began to negotiate a possible merger of Western into Delta. In connection with those negotiations, Delta requested, and was granted, an option to purchase up to 32.7 million authorized but unissued Western shares (approximately 30% of the outstanding stock on a fully diluted basis) (the "stock option"). In addition, Western agreed to a provision in the merger agreement that allegedly deprived it of the ability to "shop" the company or even to provide information to an unsolicited third party concerning an acquisition of the company (the "no-shop" clause). The merger agreement, announced in September, 1986, provided that the stockholders of Western would receive $12.50 per share, consisting of $6.25 in cash and Delta stock of an equal value.

The complaint charges that the Western directors' negotiation and approval of the merger was wrongful in several respects. First, the Western directors allegedly had information that the company was worth $28 per share but failed to disclose that information to the Western stockholder. Complaint, ¶12. Second, the Western directors allegedly failed to exercise due care by agreeing to the stock option and no-shop clause. *Id.* Third, they allegedly obtained "no substantive value opinions from [Western's] financial advisors that the option price was within the range of fair value, and failed to seek and analyze the documents that underlay any opinions that [they] did obtain." Complaint, ¶23. There is also a suggestion that the Western directors wrongfully agreed to the stock option and no-shop clause in consideration for accelerated rights under Western's stock option agreements, "golden parachute" employment agreements and lucrative employment contracts with Delta. Complaint, ¶¶12, 26. Finally, the Western directors failed to disclose their alleged concern that Carl Icahn might make a hostile bid for the company. Delta allegedly aided and abetted the various breaches of fiduciary duty by the Western directors.

It is also worth noting what the complaint does not allege. There is no claim that Delta owned any Western stock prior to the merger or that it exercised any control over Western's board. There is no allegation that any of the ten Western directors identified as "outside" directors had stock options that were accelerated in the merger, received golden parachute employment contracts or obtained any

employment position with Delta following the merger. In short, it appears from the complaint that a majority of the Western directors were disinterested and that the merger was negotiated as arm's-length.[1]

[1] Defendants' primary argument in favor of dismissal is that the complaint states only derivative claims. They point out that similar claims, attacking the improvident grant of stock options, golden parachute employment agreements and other alleged mismanagement have been found to be derivative claims. *See, e.g., Penn Mart Realty Co. v. Perelman*, Del. Ch., Civil Action No. 8349, Hartnett, V. C. (April 15, 1987) (claims over severance payments are derivative); *Elster v. American Airlines*, Del. Ch., 100 A.2d 219, 222 (1953) (claims challenging the grant of stock options are derivative). The fact that similar claims are raised here in the context of a merger does not transform those claims from being derivative to direct.

[2-3] Defendants' position would be well founded if this Court were able to conclude that the complaint does not directly attack the merger. In *Kramer v. Western Pacific Indus.*, Del. Supr., 546 A.2d 348 (1988), a former stockholder was held to have no standing following a cash-out merger to pursue claims of mismanagement. Plaintiff had argued that the alleged wrongs (excessive stock options, fees and termination bonuses) directly affected the price paid in the merger and that, as a result, the complaint should be read as a direct attack on the fairness of the merger terms. Although the Court found otherwise, it recognized that direct attacks on corporate restructurings may be maintained even after the transaction has been completed:

> As recognized by this Court in [*Cede & Co. v. Technicolor, Inc.*, Del. Supr., 542 A.2d 1182 (1988)], direct attacks against a given corporate transaction (attacks involving fair dealing or fair price) give complaining shareholders standing to pursue individual actions even after they are cashed-out through the effectuation of a merger. Specifically, this Court stated that "[n]o one would assert that a former owner suing for loss of property through deception or fraud has

1. I am aware that ¶22 makes reference to the Western directors' alleged concern that Carl Icahn might make a hostile bid for the company. However, the complaint does not allege that any of the Western directors' actions were motivated by that purported concern. The complaint charges only that defendants failed to disclose this information. Accordingly, I am treating the Carl Icahn matter as a disclosure claim.

> lost standing to right the wrong that arguably caused the owner to relinquish ownership or possession of the property." [citation omitted].

Id. at 354. The complaint here, unlike the one in *Kramer*, does directly attack the Western/Delta merger. Plaintiffs claim that the merger consideration was grossly inadequate (Complaint, ¶¶24, 25); that the allegedly inadequate price resulted from the Western directors' failure to "shop" the company and their grant of the stock option to Delta (*See* Complaint, ¶¶20, 26, 27); and that defendants solicited approval of the merger without full disclosure of certain facts relating to the value of the company (Complaint, ¶21, 22). These allegations, if they state a claim at all, constitute direct attacks on the validity of the merger and, thus, cannot be dismissed for lack of standing in light of the consummation of the merger.

The next issue is whether the complaint should be dismissed for failure to state a claim. Defendants seem to assume that, if plaintiffs are not raising derivative claims attacking the golden parachutes and stock option, for example, they must be trying to allege an "entire fairness" claim. *See Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983). Plaintiffs seem to embrace the idea that theirs is an entire fairness claim, and the parties' respective arguments centered upon whether appraisal is plaintiffs' exclusive remedy. *See Weinberger, supra*; *Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Supr., 498 A.2d 1099 (1985).

[4-5] However, Delta did not control Western and did not stand on both sides of the transaction. Indeed, there is no allegation that Delta owed any fiduciary duties to the stockholders of Western, and only a small minority of the members of Western's board are alleged to have any interest in this transaction. In short, the complaint provides no basis to invoke the entire fairness standard—the special scrutiny given to transactions effectuated by stockholders or directors who have divided loyalties. *See David J. Greene & Co. v. Dunhill Int'l, Inc.*, Del. Ch., 249 A.2d 427, 430-31 (1968) ("In the absence of divided interests, the judgment of the majority stockholders and/or the board of directors ...is presumed made in good faith and inspired by a bona fides of purpose. But when the persons, be they stockholders or directors, who control the making of a transaction and the fixing of its terms, are on both sides, then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness, tested by all relevant standards, is then the criterion.")

[6] Although plaintiffs have not stated an entire fairness claim, the allegations in the complaint must be reviewed to determine whether there are any other claims that are viable. I conclude that the complaint states two claims that cannot be resolved on a motion to dismiss. The first is a "Revlon" claim. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 182 (1986), the Delaware Supreme Court held that, once a board of directors determines that the company is for sale, the directors become "auctioneers charged with getting the best price for the stockholders. . . ." The *Revlon* holding was explained most recently in *Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1285 (1988):

> At a minimum, *Revlon* requires that there be the most scrupulous adherence to ordinary principles of fairness in the sense that stockholder interests are enhanced, rather than diminished, in the conduct of an auction for the sale of corporate control. This is so whether the "sale" takes the form of an active auction, a management buyout, or a "restructuring". . . . The sole responsibility of the directors in such a sale is for the shareholders' benefit. The board may not allow any impermissible influence, inconsistent with the best interests of the shareholders, to alter the strict fulfillment of these duties.

[7-8] It is not necessarily inconsistent with these responsibilities for directors to grant lock-up options (for stock or assets) or agree to no-shop clauses. However, "[i]f the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts." *Id.* at 1284. Where there are competing bidders, and the company's directors do not treat all of the bidders equally, "the board's action must be reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests." *Id.* at 1288. Only after satisfying this standard will the directors' actions be accorded the protection of the business judgment rule.

There were no competing bidders in this case. However, the principles summarized above apply here with equal force. The complaint alleges that Delta was granted a stock option for 30% of Western's outstanding stock on a fully diluted basis and that no "fairness" opinion was obtained on the price of the stock option. In addition, the merger agreement allegedly contains a no-shop clause and the merger price was slightly less than Western's recent trading

price and approximately half of its alleged asset and synergy value. These facts, if true and not explained, could form the basis for a finding that the Western directors failed to act in the best interests of the stockholders in conducting the sale of the company. Accordingly, defendants' motion to dismiss this aspect of plaintiffs' complaint is denied.

[9-10] The complaint also raises disclosure claims that cannot be resolved without a more developed record. It is settled law that the Western directors owe a duty of complete candor to their stockholders and that, to satisfy this obligation, all material facts must be disclosed. *See Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 944 (1985). "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Indus., Inc. v. Northway, Inc.*, 426 U. S. 438, 449 (1976). The facts allegedly withheld from Western's stockholders relate to the company's value, independently and to Delta. As compared with the merger price of $12.50, plaintiffs allege that Western's value to Delta was approximately $25 per share and that Western's system replacement cost was $28 per share. Defendants argue that the "synergy values" are merely unreliable estimates and future earnings projections that are speculative and need not be disclosed. However, the cases they rely upon in support of this general proposition were decided after a factual record had been developed. *See Weinberger v. Rio Grande Indus., Inc.*, Del. Ch., 519 A.2d 116 (1986); *Repairman's Service Corp. v. National Intergroup, Inc.*, Del. Ch., Civil Action No. 7811, Walsh, V. C. (March 15, 1985); *Lewis and Markewich v. Charan Indus., Inc.*, Del. Ch., Civil Action No. 7738, Berger, V. C. (September 20, 1984); *Biechele v. Cedar Point, Inc.*, 747 F.2d 209 (6th Cir. 1984). Here, the Court has no information as to how the Western directors arrived at the values allegedly withheld from the stockholders. Without that factual development, it is impossible for this Court to rule on these disclosure claims.

[11] The Carl Icahn non-disclosure, by contrast, can be dismissed. Plaintiffs allege only that the Western directors were "concerned" about a possible takeover attempt by Icahn. Complaint, ¶22. There is no allegation that any of the decisions made by the Western board were motivated by that concern or that any of the merger terms were intended to address the "Icahn threat." Without such a connection, I find that a reasonable stockholder would not find the omitted information important in deciding how to vote on the merger.

There remains Delta's motion to dismiss for failure to state a claim. As noted earlier, Delta is charged with aiding and abetting the Western directors in their alleged breaches of fiduciary duty. Specifically, the complaint charges that Delta was a "direct and integral participant and architect of the transaction in dispute and the beneficiary of the lock-up option and the 'no-shop/no-talk' clause." Complaint, ¶33.

[12] There are three elements to an aiding and abetting claim: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty and (3) a knowing participation in that breach by the defendants who are not fiduciaries." *Weinberger v. Rio Grande Indus., Inc.*, Del. Ch., 519 A.2d 116, 131 (1986). Assuming, for purposes of this motion, that the first two elements have been established, the question becomes whether plaintiffs have sufficiently pled a "knowing participation" by Delta. Plaintiffs argue that Delta's knowing participation may be reasonably inferred from the fact that Delta requested the stock option and no-shop clause.

[13-14] If any of the actions taken by the Western directors were illegal *per se*, plaintiffs' argument would be more compelling. Likewise, if there were objective evidence that the transaction benefits the fiduciaries at the stockholders' expense, knowing participation by a third party might be inferable. *See Gilbert v. El Paso Co.*, Del. Ch., 490 A.2d 1050, 1057 (1984). Here, however, there is nothing alleged that would necessarily alert Delta to the Western directors' alleged wrongs. Lock-ups and no-shop clauses are permissible under certain circumstances. Thus, the fact that Delta requested and obtained those concessions does not, without more, give rise to an inference that Delta was aware of any wrongful conduct by Western or its directors. *See L A Partners, L.P., et al. v. Allegis Corp., et al.*, Del. Ch., Civil Action No. 9033, Berger, V.C. (October 22, 1987).

Based upon the foregoing, Delta's motion to dismiss for failure to state a claim is granted and the remaining defendants' motions are granted in part and denied in part in accordance with this decision. IT IS SO ORDERED.

ROSENBERG v. OOLIE

No. 11,134

Court of Chancery of the State of Delaware, New Castle

October 16, 1989

Plaintiffs, stockholders of the defendant corporation, requested a preliminary injunction to restrain defendant directors from exercising their warrants or conversion rights. Plaintiffs alleged that the individual defendant directors illegally obtained the warrants and conversion rights by negotiating loan transactions in such a way as to personally benefit from inside information. Plaintiffs claimed that if the warrants and conversion rights were exercised, the defendant directors would have voting control of the company, and a potential $12 million windfall profit.

The court of chancery, per Vice-Chancellor Berger, held that plaintiffs did not establish a probability of success on the merits. Specifically, plaintiff's motion was denied because (1) the evidence did not support the claim that the directors entered into the loans due to inside information; (2) the testimony that no valuation was made was not enough to show that the directors were grossly negligent in their failure to become informed prior to entering into the loan transaction; and (3) the terms of the contested loans appeared to be comparable to the terms offered to third parties.

1. Corporations ⊂ 307, 314(1), 316

If a person in a confidential or fiduciary position, in breach of his duty, uses his knowledge to make a profit for himself, he is accountable for such profit.

2. Corporations ⊂ 310(1), 314(1), 316

Officers and directors cannot retain for themselves profits which they have derived solely from exploiting information gained by virtue of their inside position as corporate officials.

3. Corporations ⊂ 307, 310(1), 314(1)

One in a fiduciary position to a corporation and its shareholders is not absolutely prohibited from dealing in all transactions in which

his corporation may have an interest; it is only a misuse of the fiduciary position that is prohibited.

4. Corporations ⇐ 310(1), 316, 320(10)

It must be shown that each sale by each individual defendant was entered into and completed on the basis of, and because of, adverse material nonpublic information.

5. Corporations ⇐ 310(1), 310(2), 316, 320(11)

Injunctions ⇐ 137(1)

Testimony that no valuation was made of warrants and conversion rights does not necessarily mean that the directors were uninformed as to the value of the warrants, and simply is not enough to establish a likelihood of success on a claim that directors were grossly negligent in their failure to become informed prior to entering into the loan transactions.

6. Corporations ⇐ 310(1), 320(9), 320(11), 510

Injunction ⇐ 137(1)

At the stage of a requested preliminary injunction, where defendants have come forward with evidence suggesting that the transactions are entirely fair and where plaintiffs have offered nothing concrete to suggest otherwise, then the plaintiffs have failed to establish a likelihood of success on the merits.

Norman M. Monhait, Esquire, of Morris, Rosenthal, Monhait & Gross, P.A., Wilmington, Delaware; and Kevin J. Yourman, Esquire, and Ms. Lori E. Colangelo, of Law Offices of Curtis V. Trinko, New York, New York, for plaintiffs.

Robert K. Payson, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; and Allan Pepper, Esquire, of Kaye, Scholer, Fierman, Hays & Handler, New York, New York, for defendants Sam Oolie, Morton Salkind, and John Janas.

Jesse A. Finkelstein, Esquire, and Gregory V. Varallo, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendant J. David Wargo.

Lawrence C. Ashby, Esquire, of Ashby, McKelvie & Geddes, Wilmington, Delaware, for nominal defendant The Nostalgia Network, Inc.

BERGER, *Vice-Chancellor*

This is the decision on a motion for a preliminary injunction brought by certain stockholders of defendant, The Nostalgia Network, Inc. ("NNET"). Plaintiffs allege that the individual defendants, directors of NNET, illegally obtained warrants and conversion rights which, if exercised, would give them voting control of the company and, possibly, a $12 million windfall profit. Because it appears that NNET is about to be sold to a third party, plaintiffs ask that the defendant directors be restrained from exercising their warrants or conversion rights. However, for the reasons that follow, I find that plaintiffs have not established a probability of success on the merits and that, therefore, their motion must be denied.

NNET was founded in 1983, under another name, by Sergio Bosco ("Bosco") who, until 1987, was its Chairman and Chief Operating Officer. The company operates the Nostalgia Channel, a basic cable television service offering a variety of programming to cable television systems throughout the country. Revenues are generated by charging cable operators a fee based upon the number of subscribers in each system that carries the Nostalgia Channel. Although NNET's subscriber base has been increasing, it has not yet reached the break-even point and NNET has operated at a loss since its inception.

At all relevant times, defendant Sam Oolie ("Oolie") has been Chairman of the Board of NNET and a major stockholder. Defendant John A. Janas ("Janas"), a "turn around" specialist and former consultant to NNET, is the company's President and Chief Executive Officer. Defendants J. David Wargo and Morton Salkind ("Salkind") are also NNET directors and stockholders.

It appears that NNET has been undercapitalized from the outset. For example, in early December, 1986, Oolie claims to have received an emergency telephone call from Bosco requesting a wire transfer of $67,000 in order to pay the monthly fees for the use of a satellite

to transmit NNET's signal. The company had to make two private placements in 1987 to obtain operating cash. By the beginning of 1988, NNET needed $750,000 in bridge loans and attempted a $4 million private placement of convertible subordinated debentures.

The board meeting minutes indicate that several of the early bridge loans were at interest rates of 12% or higher and included 8,000-10,000 warrants per $100,000 borrowed. In June, 1988, when the company was again attempting to obtain a bridge loan, the board authorized the issuance of $1.5 million of notes carrying a 14% interest rate together with 300,000 warrants exercisable at $2.00 per share. By August, 1988, the directors authorized NNET to raise up to $1 million in bridge financing with an interest rate of 16% and 30,000 warrants (again exercisable at $2.00 per share) per $100,000 of principal. Efforts at long term financing, although undertaken, apparently were not successful in 1988.

Oolie claims that, by December, 1988, NNET's cash situation had again become critical. The monthly satellite fee was due by the first of January and NNET did not have sufficient funds to both make that payment and meet its payroll. Salkind suggested to the board that he and Oolie would lend the company sufficient funds to refinance existing short term loans and provide operating capital. Oolie claims that the terms of the loan were negotiated between Oolie and Salkind on the one hand and the non-lending directors on the other.

The two lenders and the company entered into a letter of intent, dated December 24, 1988, that provided for a total of $2.55 million in financing on the following terms: (1) both the Operating Loan in the amount of $1.2 million and the Refinancing Loan in the amount of $1.35 million carried an interest rate of 16% unless the loan were prepaid or converted during the first six months, in which case the interest rate was 12%; (2) the company had the right to convert all or part of the principal to common stock at any time and the lenders had the same right after six months, with the conversion rate set at $.6875 per share (the market price of the NNET stock on the date the terms were agreed upon); and (3) the lenders were to receive 30,000 warrants to purchase common stock, exercisable at $1.25 per share, per $100,000 principal, with the Refinancing Loan warrants being issued only upon the takedown of the Refinancing Loan.

Oolie claims that during the first few months of 1989 NNET tried unsuccessfully to find anyone who would provide financing on the same terms as the Oolie/Salkind loans. Merrill Lynch & Co.

("Merrill Lynch"), the investment banking firm retained in July, 1988 to obtain long-term financing for the company, had been unsuccessful and, according to Oolie, had exhausted most of its sources. As a result, the board decided, in the spring of 1989, to explore the possibility of selling the company. A different investment banker, Donaldson, Lufkin, Jenrette & Co. ("DLJ"), was retained for this purpose in May and, by June, DLJ was working on the assignment but had not yet secured any proposals.

Before any offers had been made, and at a time when DLJ estimated that it would take another three months to secure any cash, NNET again ran out of money. According to Oolie, at a June, 1989 board meeting, all of the directors were offered the opportunity to advance funds to the company in exchange for notes and warrants. Only Oolie and Salkind accepted the invitation, committing to lend an additional $1.7 million at an interest rate of 16% per year in consideration for the receipt of 90,000 warrants, exercisable at $2.00 per share, per $100,000 committed. DLJ was asked whether any of its clients would be interested in making a loan on the same terms, but DLJ knew of no one who would be interested.

Approximately two weeks after Oolie and Salkind committed to the June, 1989 loans, NNET received a proposal made on behalf of Gold'N M Communications, Inc. ("GMC") to acquire the company for $30 million in cash, less outstanding debt. Sometime before August 25, 1989, the GMC proposal was increased to $32 million. The GMC bid is subject to several conditions and has not yet been accepted or rejected. According to Oolie, the company is now talking to other possible purchasers and attempting to generate competitive bidding.

The facts, as described above, are not entirely undisputed. Plaintiffs submitted affidavits suggesting that NNET should have been able to obtain financing from banks and other financial institutions without difficulty. In addition, although Oolie specifically stated in his affidavit that NNET was not for sale during 1988, there is some evidence to contradict this statement. *See, e.g.*, Oolie Aff., Exhibit H (Draft Board Meeting Minutes from July 7, 1988).

On this record, plaintiffs claim that they are likely to succeed on at least one of three claims: (1) that defendants, primarily Oolie and Salkind,[1] breached their duty of loyalty by negotiating the loan

1. Although neither Messrs. Wargo nor Janas participated in any loan

transactions in such a way as to benefit from inside information as to the "imminent" sale of NNET; Complaint, ¶57; (2) that defendants breached their duty of care by issuing warrants without first valuing them; and (3) that the terms of the self-dealing transactions between defendants and the company were so unfair to the company as to amount to waste. Each of these claims will be addressed in turn.

In support of their insider trading claim, plaintiffs rely on *Brophy v. Cities Service Co.*, Del. Ch., 70 A.2d 5 (1949), for the proposition that an individual who acquires confidential information while acting in a fiduciary capacity may not use that information for his or her personal gain. The parties address this claim by arguing about materiality. Defendants say that, unless their purported confidential information was material, there can be no basis for plaintiffs' claim. They go on to point out that, under *Bershad v. Curtiss-Wright Corp.*, Del. Supr., 535 A.2d 840, 847 (1987), intentions to sell a company, like proposed mergers, are immaterial until the firms participating in the transaction have agreed on its price and structure. Here, the evidence indicates that no such agreement existed at the time the warrants were issued. Plaintiffs respond that, under *Brophy*, all the plaintiffs need establish is that defendants acquired securities of NNET for profit with knowledge of confidential information. Even if there is a materiality requirement, plaintiffs argue that the flexible standard set out by the United States Supreme Court in *Basic, Inc. v. Levinson*, ___U.S. ___, 108 S.Ct. 978 (1988), rather than the "bright-line" test of *Bershad* is the one that should be followed.

[1] I am not convinced that these questions need be addressed. Plaintiffs' insider trading claim seems to suffer from a more fundamental defect. It is apparent from *Brophy* that some causal link must be established between the confidential information the corporate insiders possess and any profits they accumulate. In *Brophy*, a confidential employee of Cities Service Company had purchased stock in that corporation with the non-public knowledge that the company was going to go into the market to repurchase its own shares in such large quantities as to cause a rise in the stock price. The employee profited by his purchases when the market price did

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transactions, they, as well as Oolie and Salkind, received NNET warrants in lieu of compensation for their service as directors. However, plaintiffs focus on the loan transactions involving Oolie and Salkind for purposes of this motion and the Court will do likewise.

rise after the company instituted its repurchase program. *Brophy*, 70 A.2d at 7. The principle, as announced in *Brophy*, is that, if "a person 'in a confidential or fiduciary position, in breach of his duty, *uses his knowledge* to make a profit for himself, he is accountable for such profit. . . .'" *Brophy*, 70 A.2d at 8, citing Scott on Trusts, §505.1 (emphasis added).

[2-4] The causality requirement recognized in *Brophy* is consistent with "black letter" law and was recently reaffirmed by this Court. Fletcher's Cyclopedia of Corporations, for example, states that "officers and directors cannot retain for themselves profits which they have *derived solely from exploiting information* gained by virtue of their inside position as corporate officials," and that they "may be required to account to the corporation for any profits *derived from the information.*" 3 W. Fletcher Cyclopedia of the Law of Private Corporations §857.1 (rev. perm. ed. 1986) (emphasis added). This Court expressed the same thought in *Field v. Allyn*, Del. Ch., 457 A.2d 1089, 1099, *aff'd* Del. Supr., 467 A.2d 1274 (1983):

> One in a fiduciary position to a corporation and its shareholders is not absolutely prohibited from dealing in all transactions in which his corporation may have an interest. It is only a misuse of the fiduciary position that is prohibited. For instance, it is implicit in *Brophy* . . . that so long as a fiduciary is not profiting by inside information he is free to trade in the market place in his company's stock.

See also Stepak, et al. v. Ross, et al., Del. Ch., Civil Action No. 7047 (Consolidated), Hartnett, V. C. (September 5, 1985), Mem. Op. at 13, ("[I]t must be shown that each sale by each individual defendant was entered into and completed on the basis of, and because of, adverse material non-public information."); *Tuckman v. Aerosonic Corp.*, Del. Ch., Civil Action No. 4094, Hartnett, V. C. (May 20, 1982) Mem. Op. at 23, ("[P]laintiff . . . must establish . . . inside information and the use thereof for personal gain.")

In applying these principles to the facts presented here, I assume, for purposes of discussion, (i) that Oolie and Salkind did have confidential information that the company was being put up for sale and (ii) that the GMC offer will be accepted with the result that the directors will reap a profit from the conversion of their loans and/or the exercise of their warrants. The question remains, however, whether there is any evidence that the directors entered into the loans on the basis of or because of their inside information. If the company did not need the funds, it might be reasonable to infer

that the loans were merely a vehicle through which the directors were exploiting their confidential information. However, as noted above, NNET was in dire need of financial support and, apparently, was unable to obtain those funds elsewhere. Under these circumstances, it seems unlikely that the Court would find, after trial, that the undisclosed plan to sell NNET was linked in any way to the defendant directors' decision to lend needed funds to the company.

Plaintiffs also claim (in their brief rather than their complaint) that defendants breached their duty of due care because the directors did not know the value of the NNET warrants and conversion rights that they granted as part of the loans. Plaintiffs apparently base this claim on the fact that defendants have not produced any formal valuation done of the warrants and on Janas' deposition testimony that, to his knowledge, no one ever did a valuation of any of the issued warrants. Plaintiffs argue that, without this information, the board's decision to issue warrants was necessarily uninformed and therefore a violation of the fiduciary duty of due care articulated in *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985).

[5] In advancing this argument, plaintiffs read a lot into Janas' testimony. The fact that no valuation was made of the warrants (to Janas' knowledge) does not necessarily mean that Janas and his co-directors were uninformed as to the value of the warrants. First, Janas may have been thinking of a formal valuation performed by an investment banker when he stated that no valuation was made. Second, even if no in-house valuation was undertaken, it does not necessarily follow that the directors were uninformed on this point. Given their backgrounds, and their experience working with NNET, they may have reached their own conclusions as to the value of the warrants. In short, Janas' testimony that no valuation was made simply is not enough to establish a likelihood of success on a claim that the directors were grossly negligent in their failure to become informed prior to entering into the loan transactions.

The record with respect to plaintiffs' third claim—that the loan transactions were not entirely fair—likewise, is insufficient to establish a probability of success on the merits. Although defendants argue that the board's decisions are protected by the business judgment rule pursuant to 8 *Del. C.* §144(a)(1), I am assuming, for purposes of this analysis, that defendants will lose the burden of proof argument and will be required to establish the intrinsic fairness of the loans. *See Marciano v. Nakash*, Del. Supr., 535 A.2d 400 (1987); *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983). Even if this exacting standard is applied, it appears from the present record that defendants

will prevail. For several years prior to the transactions at issue, NNET had been trying to obtain both long and short term financing. A large investment banking firm was brought in to assist in those efforts, but neither the board of directors on its own nor the investment banker was particularly successful. Periodically, NNET faced such serious cash shortages that it would have had to cease operations within a matter of days or weeks if additional funds were not obtained. Thus, there is little, if any, basis for questioning whether NNET truly needed the infusion of funds provided by defendants' loans.[2]

Notwithstanding plaintiffs' protests, the present record also indicates that the terms of the disputed loans are likely to satisfy the entire fairness test. As noted earlier, NNET had been attempting to secure financing at ever-increasing interest rates, and with the grant of larger and larger numbers of warrants, during the year prior to the loans in question. The terms of the contested loans appear to be comparable to the terms offered to third parties. For example, in August, 1988, the board attempted to raise bridge financing at the same interest rate as agreed to in the two contested loans[3] and at the same number of warrants per $100,000 of principal. The exercise price went down from $2.00 per share to $1.25 per share, but the new exercise price still represented almost twice the then current market value.

It is true that the Oolie/Salkind loans included a conversion right that the earlier loans did not. However, the conversion rate was set at the market price and the company would have been able to eliminate that conversion rate had it been able to refinance within six months. The more recent Oolie/Salkind loans included a more substantial grant of warrants, but at the higher exercise price of $2.00 per share. It appears, from this record, that the second set of loans also was fairly priced inasmuch as two of the four directors

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2. Bosco, in his affidavit, claims that Janas never mentioned, during the telephone conversations the two men had between December, 1988 and February, 1989, that NNET was experiencing financial difficulty. Accordingly, Bosco surmises that the company did not really need any funds. In addition, Bosco opines that NNET could have obtained "normal means of financing, through established financial institutions." Bosco Aff., ¶17. I find that Bosco's affidavit is conjectural and of very limited evidentiary value. The board minutes and SEC filings, prepared before this litigation was instituted, indicate that NNET did, indeed, need additional financing.

3. Actually, the first of the two contested loans called for a substantially lower interest rate if it were prepaid within six months.

and another major investor declined the opportunity to participate in the transaction. In addition, DLJ apparently knew of no one interested in investing on those terms.

[6] It is not a foregone conclusion that, after the record has been fully developed, these loans will survive scrutiny. However, at this stage, where defendants have come forward with evidence suggesting that the loans are entirely fair and where plaintiffs have offered nothing concrete to suggest otherwise, I am satisfied that plaintiffs have failed to establish a likelihood of success on the merits. Based upon the foregoing, plaintiffs' motion for a preliminary injunction is denied.

IT IS SO ORDERED.

STROUD v. MILLIKEN

No. 8969

Court of Chancery of the State of Delaware, New Castle

October 6, 1989

Plaintiffs sought injunctive and other relief against the corporation and its directors to prevent proposed amendments to the charter and bylaws from being adopted. The Milliken Board of Directors subsequently withdrew the proposed amendments and the court of chancery dismissed most of the claims in the original complaint. Plaintiffs, owners of stock in Milliken Enterprises, Inc., sought the court of chancery's approval for attorney's fees and advanced costs despite the fact that the Delaware Supreme Court had dismissed the case on appeal as being moot.

The court of chancery, per Vice-Chancellor Hartnett, held that plaintiffs were entitled to reasonable attorney fees for work performed on meritorious claims up to the date the complaint became moot. The vice-chancellor found that the claim was meritorious when filed, that the defendants took action benefitting the shareholders prior to a judicial resolution of the suit, and that the benefit was causally related to the lawsuit. Because the more favorable amendments re-

sulting from the lawsuit provided a substantial benefit to the shareholders, recovery of attorney fees was permitted.

1. Corporations ⟸ 189(14), 214, 525

Costs ⟸ 171

In litigation brought on behalf, or for the benefit, of shareholders, recovery of attorney's fees may be had if there is a specific and substantial benefit to the corporation or its shareholders.

2. Corporations ⟸ 189(14), 214, 525

Costs ⟸ 171

When a claim is settled or moot, counsel fees may still be granted if: (1) the claim was meritorious when filed, (2) the defendants took action benefitting the corporation or its shareholders prior to a judicial resolution of the suit, and (3) the benefit was causally related to the lawsuit.

3. Corporations ⟸ 189(14), 525

Costs ⟸ 171

On a motion for counsel fees resulting from a claim that was settled or mooted, defendants bear the burden of demonstrating the lack of a causal connection between the plaintiff's suit and the defendant's subsequent actions benefitting the corporation or its shareholders.

4. Corporations ⟸ 189(14), 214

Costs ⟸ 171

Where a stockholders' action charging that proposed charter and bylaw amendments are invalid results in the defendant corporation proposing less detrimental amendments than those originally pro-

posed, the stockholders have received a benefit from the filing of the complaint.

5. Corporations ⟸ 189(14), 214, 525

Costs ⟸ 171

Where plaintiffs have received a benefit from the filing of their complaint and defendants have failed to meet the burden of demonstrating a lack of causal connection between the plaintiff's suit and defendant's subsequent action, the plaintiffs are entitled to reasonable attorney fees for work performed on the meritorious claims up to the date the original complaint became moot; however, plaintiffs are not entitled to any attorney fees for work done after the date the original complaint became moot.

6. Corporations ⟸ 189(14), 214

Costs ⟸ 171

Because the stockholders' economic benefits resulting from the defendant's actions taken subsequent to the filing of plaintiff's lawsuit are either nonexistent or are not determinable, the reasonableness of the counsel fees must be based on the time actually spent on those claims, prior to the complaint becoming moot, which were meritorious when filed.

William Prickett, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiffs.

Andrew B. Kirkpatrick, Jr., Esquire, and Mary B. Graham, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Milliken Enterprises, Inc.

Clark W. Furlow, Esquire, and David A. Jenkins, Esquire, of Lassen, Smith, Katzenstein & Furlow, Wilmington, Delaware, for the individual defendants.

HARTNETT, *Vice-Chancellor*

Plaintiffs seek this Court's approval for attorney fees, notwithstanding that this case was dismissed on appeal by the Delaware

Supreme Court as being moot. *Stroud v. Milliken Enterprises, Inc.*, Del. Supr., 552 A.2d 476 (1989).

I find that plaintiffs are entitled to some, but not all, of the attorney fees they seek because some of plaintiffs' claims were meritorious when filed.

I

Plaintiffs, owners of stock in defendant Milliken Enterprises, Inc. ("Milliken"), filed this action asserting individual and stockholders' derivative claims shortly after Milliken distributed to its stockholders a Notice of the April 28, 1987 Annual Meeting. The Notice advised that the directors of Milliken had proposed charter and bylaw amendments to be considered at that meeting and also contained a solicition of proxies for use by management at the meeting. The proposed amendments included a change in the authorized size of the Board of Directors, the imposition of qualifications for becoming a director, the adoption of provisions limiting director liability pursuant to 8 *Del. C.* §102(b)(7), and revisions to the director indemnification provisions in the charter.

Plaintiffs sought injunctive and other relief against the corporation and its directors to prevent the proposed amendments being adopted. Plaintiffs charged, in essence, that the proxy solicitation letter was insufficient and inaccurate. They also claimed that some of the proposed amendments were invalid as a matter of Delaware law and were proposed as part of an unlawful entrenchment scheme. Plaintiffs primarily focused their challenge on the amendments which would have imposed limitations on the manner of nomination for directors and would have set severe limits on who could be nominated.

Plaintiffs applied for a temporary restraining order to restrain the voting on the proposed amendments at the April 28, 1987 annual meeting. At a hearing held on April 23 to consider the application, Milliken consented to a temporary restraining order pending further proceedings. Milliken's counsel asserted at the hearing that:

> "[T]he corporation's purpose in agreeing to postpone a vote on these proposals ... is to provide the corporation with time to consider the points that have been raised in the complaint and to determine whether [to] go forward with those proposals or perhaps with modified proposals . . . ."

On the same day, just prior to the hearing, Milliken filed a motion to dismiss because of plaintiffs' failure to have made a pre-

suit demand pursuant to Rule 23.1. That motion was never ruled upon by the Court.

At a meeting of the Milliken Board of Directors held on June 4, 1987, the directors withdrew the proposed amendments and adopted resolutions proposing different amendments. They also approved a *proposed* Notice of a reconvened annual meeting which included the substitute amendments and a notification that the earlier proposals were withdrawn.

The proposed Notice stated that the earlier proxies in connection with the aborted April 28 meeting were no longer valid and would not be used at any reconvened meeting. It further stated:

> "that Management neither solicits nor intends to solicit proxies from stockholders in connection with the Annual Meeting noticed herein."

and that:

> "Stockholders are encouraged to attend the Annual Meeting in person. Management believes that the matters to be presented at such meeting are best discussed at the Annual Meeting, where questions can be responded to promptly and fully."

By letter to the Court and plaintiffs dated June 10, 1987, Milliken reported the Board's action at the June 4 meeting, and enclosed the substitute proposals and a *proposed* Notice to stockholders. In view of the existence of the temporary restraining order, Milliken stated it would delay action on the new proposals for a brief period in case plaintiffs wished to amend their complaint to attack the revised proposals.

On July 8, 1987, plaintiffs filed a supplemental complaint challenging Milliken's revised proposals and the *proposed* notice was therefore never sent.

On March 18, 1988, I rendered a decision on defendants' motion to dismiss the supplemental complaint, essentially dismissing most, but not all, of the claims raised in the original complaint and in the supplemental complaint. *Stroud v. Milliken*, Del. Ch., C.A. No. 8969-N.C., Hartnett, V.C. (March 18, 1988). The decision dismissed as moot the claims of the original complaint relating to the original amendments proposed for consideration at the April 28 meeting. I also dismissed the claims in the supplemental complaint charging a threatened violation of the temporary restraining order. I further dismissed the claims asserted derivatively because of the failure of

the plaintiff to have made a pre-suit demand pursuant to Chancery Rule 23.1. Other claims were also dismissed for failure to have stated a claim upon which relief could be granted but I did not dismiss the claims as to the insufficiency of the *proposed* Notice. Plaintiffs apparently regarded the decision as tantamount to a final judgment against them and accordingly proposed an order to that effect which was unopposed and therefore entered. The order permitted plaintiffs to proceed with an immediate appeal.

In their appeal, plaintiffs attacked only the dismissal of the following claims:

(1) Count VI Of the supplemental complaint attacking the *proposed* Notice of meeting;

(2) Count VII Of the supplemental complaint to the extent it alleged the invalidity of *proposed* Article 11(c) of the charter and proposed Bylaw 3(f);

(3) the claim that the *proposed* revisions to existing charter Articles 9 and 11 required a supermajority vote; and

(4) Count II(H) of the original complaint alleging an entrenchment scheme.

The Supreme Court held, *sua sponte*, that the litigation was premature stating that it was "not persuaded that the present record is a final record for determining at this time the significant issues raised by the parties"; and "[t]he issues raised also appear to pose questions of law which may be significantly influenced by the facts," because "there are few facts which are undisputed and we suspect further facts will emerge before the controversy is ripe for judicial intervention." *Stroud v. Milliken Enterprises, Inc.*, Del. Supr., 552 A.2d at 481 (1989). The Supreme Court concluded by stating:

> "For the foregoing reasons, we dismiss the appeal, remand the case to the trial court, and direct the court to vacate its decision and *dismiss the proceedings below* on the several grounds stated." (Emphasis added)

(552 A.2d at 482)

Following the issuance of the Supreme Court mandate, plaintiffs filed a motion seeking approval by this Court of attorney fees in the sum of $300,000 plus advanced costs.

Subsequently defendants proposed a revised version of the amendments to be considered at the April 1989 Annual Meeting. Significantly, the Notice of this meeting corrected the oversights found to exist in the 1987 Notices and it contained much greater information than had the original April 1987 Notice or the proposed

June 1987 Notice. Plaintiffs have again challenged these amendments in another lawsuit which is pending. See *Stroud v. Grace*, Del. Ch., C.A. No. 10719-N.C., Hartnett, V.C. (April 21, 1989).

II

[1-3] In litigation brought on behalf, or for the benefit, of shareholders, recovery of attorneys' fees may be had if there is a specific and substantial benefit to the corporation or its shareholders. *Chrysler Corp. v. Dana*, Del. Supr., 223 A.2d 384 (1966). *Initio Partners v. Tandycrafts, Inc.*, Del. Supr., A.2d (1989). When a claim is settled or mooted, counsel fees may still be granted if: (1) the claim was meritorious when filed, (2) the defendants took action benefitting the corporation or its shareholders prior to a judicial resolution of the suit, and (3) the benefit was causally related to the lawsuit. *Allied Artists Pictures Corp. v. Baron*, Del. Ch. 395 A.2d 375 (1978), *aff'd* Del. Supr., 413 A.2d 876 (1980). Defendants bear the burden of demonstrating the lack of a causal connection. *Id.*

Defendants, in effect, argue that because the Delaware Supreme Court held that the case was not ripe for adjudication, the case was not meritorious when filed and therefore plaintiffs are not entitled to any attorney fees.

As I understand the Supreme Court opinion, however, the lack of ripeness was based on the fact that the challenge before it was to the June 4, 1987 *proposed* notice of a *proposed* annual meeting and therefore the Court held there was not an actual pending controversy.

The case on appeal, however, was dramatically different from the case originally brought which sought to enjoin the about-to-take-place April 28, 1987 Annual Meeting for which notices had been sent and proxies solicited. In the absence of plaintiffs' challenge, the 1987 Annual Meeting would have gone forward and the amendments would have been adopted because the individual defendants controlled a majority of the shares of Milliken.

The mootness arose when defendants, in apparent direct response to plaintiffs' suit, on June 4, 1987, abandoned the charter and bylaw amendments previously proposed, withdrew the former notice of annual meeting, and terminated the proxies received in response to it. The supplemental complaint lacked ripeness because the Notice being attacked was only a proposed notice subject to change.

[4] I find, however, that the stockholders received a benefit from the filing of the original complaint because the original April 1987 Notice was defective and because the 1989 amendments (still

under challenge) are less detrimental to the stockholders than were the originally proposed amendments. The 1989 Notice also gives significantly more information to the stockholders than did the prior notices in apparent response to the concerns expressed by the Supreme Court in *Stroud v. Milliken Enterprises, Inc.*, supra.

[5] Under the rule of law in *Allied*, defendants have the burden of demonstrating the lack of causal connection between plaintiffs' suit and defendants' withdrawal of the challenged charter and bylaw amendments and cancellation of the adjourned April 1987 annual meeting of the corporation. Defendants have failed to meet that burden and therefore I find that plaintiffs are entitled to reasonable attorney fees for work performed on meritorious claims up to June 11, 1987, the date the original complaint became moot. See *Initio Partners v. Tandycrafts, Inc.*, supra. Plaintiffs, however, are not entitled to any attorney fees for work done after that date because the original suit became moot upon the withdraw of the original amendments and the challenge to new proposed amendments was premature, as the Supreme Court held.

[6] Because the economic benefits to the stockholders of the withdrawal of the originally proposed amendments and the cancellation of the 1987 Annual Meeting are either non-existent or are not determinable, the reasonableness of the counsel fees must be based on the time actually spent before June 11, 1987, on those claims which were meritorious when filed.

Plaintiffs will therefore have to submit additional justification for the fees and costs which occurred before June 11, 1987 from plaintiffs' prosecution of the claims not dismissed by the March 18, 1988 Opinion of this Court.

IT IS SO ORDERED.

IN RE TRI-STAR PICTURES, INC. LITIGATION

No. 9477 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

September 26, 1989

Plaintiff, a shareholder of Tri-Star Pictures, Inc. filed this action on behalf of a class of public shareholders of Tri-Star and derivatively

on behalf of Tri-Star alleging violation of fiduciary duties by Home Box Office (HBO) and Coca Cola, and challenging the validity of certain amendments to Tri-Star's certificate of incorporation. The court of chancery had, in an earlier decision, dismissed HBO as a defendant for failure to state a valid claim and dismissed plaintiff's challenge of Articles Fifth and Seventh of Tri-Star's certificate of incorporation. Plaintiff moved for entry of final judgment in order to take an immediate appeal from the court of chancery's decision.

The chancery court, per Vice-Chancellor Jacobs, denied the plaintiff's motion for final judgment pursuant to Delaware Chancery Court Rule 54(b). The court concluded that the plaintiff did not show the requisite hardship or injustice to justify a final judgment on the two claims.

1. Appeal and Error ⇐ 80(6)

For the court to grant a motion for final judgment, it must find that: (1) the action involves multiple claims or parties, (2) at least one claim or the rights and liabilities of at least one party has been finally decided, and (3) there is no just reason for delaying an appeal.

2. Federal Courts ⇐ 811

A determination of whether there is just reason for delaying an appeal is addressed to the sound discretion of the court.

3. Federal Civil Procedure ⇐ 2575, 2578

Federal Courts ⇐ 571, 811

The long established policy against piecemeal appeals requires that a court sparingly exercise the discretion in determining whether a just reason exists to delay an appeal.

4. Federal Civil Procedure ⇐ 2575

Federal Courts ⇐ 811

The Delaware Chancery Court Rule 54(b) exists to create a discretionary power to afford a remedy in the infrequent harsh case. DEL. CH. CT. R. 54(b).

5. Federal Courts ⇨ 599, 811

In deciding whether there is just reason to delay an appeal of an individual final judgment in a multi-claim action, the court may consider any factor relevant to judicial administrative interests or the equities of the case.

6. Federal Courts ⇨ 660

Federal decisions applying Rule 54(b) caution that excessive resort to Rule 54(b) will increase the already sizeable burden of appellate dockets and that, therefore, a Rule 54(b) order should not be entered unless the moving party can show some danger of hardship or injustice through delay which would be alleviated by immediate appeal. FED. R. CIV. P. 54(b); DEL. CH. CT. R. 54(b).

7. Federal Civil Procedure ⇨ 24, 35, 38

Because Delaware Chancery Court Rule 54(b) and Federal Rule of Civil Procedure 54(b) are substantially identical, cases decided under the Federal Rule afford helpful guidance in cases arising under the counterpart Delaware Chancery Court Rule. FED. R. CIV. P. 54(b); DEL. CH. CT. R. 54(b).

8. Federal Civil Procedure ⇨ 2575, 2579

Sound judicial administration favors not fostering the piecemeal appeal of closely related causes of actions, where declining Delaware Chancery Court Rule 54(b) relief will cause no substantial hardship to the plaintiff. DEL. CH. CT. R. 54(b).

William Prickett, Esquire, Michael Hanrahan, Esquire, Elizabeth M. McGeever, Esquire, and Joseph Grey, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiffs.

Lawrence A. Hamermesh, Esquire, Thomas C. Grimm, Esquire, and Leone L. Ciporin, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Coca-Cola.

James F. Burnett, Esquire, and Donald J. Wolfe, Jr., Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendant Columbia Pictures.

Allen M. Terrell, Jr., Esquire, and Michael J. Feinstein, Esquire, of Richards, Layton & Finger, for defendant HBO.

Lawrence C. Ashby, Esquire, and Stephen E. Jenkins, Esquire, of Ashby, McKelvie & Geddes, Wilmington, Delaware, for four individual defendant directors of Tri-Star.

JACOBS, *Vice-Chancellor*

The plaintiff has moved for the entry of final judgment pursuant to Court of Chancery Rule 54(b). Plaintiff's purpose in seeking this relief is to take an immediate appeal from this Court's decision granting, in part, the defendants' motions to dismiss plaintiff's complaint pursuant to Chancery Court Rule 12(b)(6). Those rulings and their basis are set forth in *Siegman v. Tri-Star Pictures, Inc.*, Del. Ch., C.A. No. 9477, Jacobs, V.C. (May 5, 1989).

Plaintiff filed this action on behalf of a class of public shareholders of Tri-Star, Inc. ("Tri-Star") and derivatively on behalf of Tri-Star. The amended complaint alleges seven counts. Counts I, II and VII alleged that Home Box Office, Inc. ("HBO"), acting in concert with Coca-Cola and other defendants, violated certain fiduciary duties owed to Tri-Star and to the shareholder class. Count III challenged the validity of certain amendments to Articles Fifth, Sixth and Seventh of Tri-Star's Certificate of Incorporation. In its May 5, 1989 decision, this Court dismissed HBO as a defendant for failure to state a valid claim against HBO, and dismissed Count III insofar that it challenged Articles Fifth and Seventh of HBO's Certificate of Incorporation. Plaintiff now asks the Court, under Rule 54(b), to enter final judgment with respect to its dismissal of both the Article Seventh claim and the claims against HBO. This is the Court's decision on that motion.

I.

Chancery Court Rule 54(b) pertinently provides that:

> When more than 1 claim for relief is presented in an action, whether as a claim, counterclaim, cross-claim, or third-party claim, the Court may direct the entry of a final

> judgment upon 1 or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment.

[1] Thus, for the Court to grant the plaintiff's motion, it must find that: (1) the action involves multiple claims or parties, (2) at least one claim or the rights and liabilities of at least one party has been finally decided, and (3) that there is no just reason for delaying an appeal. The parties do not dispute that the first two of the above-mentioned criteria have been satisfied. At issue is the third.

[2-4] A determination of whether there is just reason for delaying an appeal is addressed to the sound discretion of the Court. *Curtis-Wright Corp. v. General Elec. Co.*, 446 U.S. 1, 9, 100 S. Ct. 1460, 1465 (1980). The long established policy against piecemeal appeals requires that this Court exercise that discretion sparingly. Indeed, Rule 54(b) exists to create "a discretionary power to afford a remedy in the infrequent harsh case . . . ." *Panichella v. Penn. R.R. Co*, 252 F.2d 452, 455 (3rd Cir. 1958).

[5-7] In exercising its discretion, this Court may consider any factor relevant to judicial administrative interests or the equities of the case. *See Curtis-Wright*, 446 U.S. at 9, 100 S. Ct. at 1465. However, the federal decisions applying Rule 54(b)[1] caution that excessive resort to that Rule will increase the already sizeable burden of appellate dockets, and that, therefore, a Rule 54(b) order should not be entered unless the moving party can show "some danger of hardship or injustice through delay which would be alleviated by immediate appeal." *Ansam Assoc., Inc. v. Cola Petroleum, Ltd.*, 760 F.2d 442, 445 (2d Cir. 1985) quoting *Campbell v. Westmorland Farm Inc.*, 403 F.2d 939, 942 (2d Cir. 1968). Because the plaintiff has not made that showing either as to the Article Seventh claim or as to his claims against HBO, I decline to enter final judgment under Rule 54(b).

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1. Because Chancery Court Rule 54(b) and Federal Rule of Civil Procedure 54(b) are substantially identical, cases decided under the Federal Rule afford helpful guidance in cases arising under the counterpart Chancery Court Rule. *See Shellburne, Inc. v. Roberts*, Del. Supr., 238 A.2d 331, 335 (1968) (relying on federal cases in a Rule 54(b) decision); *Gilbert v. El Paso Co.*, Del. Ch., C.A. Nos. 7075 & 7079, Jacobs, V.C. (June 17, 1986).

II.

First, plaintiff has not shown that his inability to appeal his Article Seventh claim now would visit upon Tri-Star or the class sufficient hardship to justify a departure from the normal procedure in which all issues are first resolved before an appeal is taken. Article Seventh, by its terms, automatically incorporates any future amendments to the Delaware General Corporation Law limiting director liability. Plaintiff argues that directors of Delaware corporations would continue to enjoy the protection afforded by Article Seventh until all issues in this case are finally resolved. Thus, for some considerable period the shareholders would remain subject to the risk that the General Assembly might enact a provision that would further broaden director immunity from liability. That risk, however, is highly speculative, and I am not persuaded that it poses "hardship" of the kind that has prompted other courts to enter Rule 54(b) judgments in other decided cases.[2]

Plaintiff argues, quite correctly, that his Article Seventh claim can be resolved solely on the basis of the language of Article Seventh and the pertinent Delaware law. Therefore, that claim can be severed from the other claims without delaying or otherwise affecting this Court's adjudication of the remaining claims. Plaintiff also contends that the power of stockholders to exempt directors from liability based on legislative enactments that may be adopted in the future is a matter of great concern to other Delaware corporations that might adopt similar charter provisions. While the severability of the Article Seventh claim is a factor that tends to favor the plaintiff's position,

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2. Examples of fact patterns found to justify Rule 54(b) orders are edifying: *Bank of Lincolnwood v. Federal Leasing, Inc.*, 622 F.2d 944, 951 (7th Cir. 1980) (delay in the entry of final judgment would prevent execution on that judgment), *United Bank of Pueblo v. Hartford Acc. & Indem. Co.*, 529 F.2d 490, 492-93 (10th Cir. 1976) delay pending defendant's third-party claim would deprive plaintiff of difference between statutory pre-judgment interest rate and the prime rate); *T.S.I. 27, Inc. v. Berman Enter., Inc.*, 115 F.R.D. 252, 256 (S.D.N.Y. 1987) (granting Rule 54(b) motion because delay in payment of judgment would jeopardize ability of plaintiff corporation to survive); *Prudential Ins. Co. v. Curt Bullock Builders, Inc.*, 626 F. Supp. 159, 169 (N.D. Ill. 1985) (granting Rule 54(b) motion because defendant's precarious financial condition might jeopardize plaintiff's ability to collect if judgment were not entered); *Republic Nat'l Bank of New York v. Sabet*, 512 F. Supp. 416, 430 (S.D.N.Y. 1980) (granting Rule 54(b) motion where delay deprived plaintiff of difference between market rate of interest and rate set in note on which it sued), *aff'd without op.*, 681 F.2d 802 (2d Cir.), *cert. denied*, 456 U.S. 976, 102 S. Ct. 2241 (1982).

it does not, of itself, carry the day.[3] Moreover, even if there is some public interest in having this matter decided promptly, the plaintiff has failed to persuade me that that concern is of such weight as to warrant a piecemeal appeal of that issue. More specifically, the plaintiff's inability to demonstrate that any hardship to the corporation or the class would result from denying Rule 54(b) relief counsels against carving out an exception to the procedure normally followed even in multiparty, multi-issue cases.

III.

The plaintiff has also failed to make the necessary showing with respect to its claims against HBO. Plaintiff argues that if this Court's dismissal of HBO is reversed on appeal, a second trial (involving the HBO-related issues) would be necessary. That may be correct, but there are several offsetting factors. First, even if plaintiff were allowed to appeal immediately, and the dismissal of HBO were reversed, and the claims against HBO were then tried together with the other claims, a second trial might still be required. That could occur if the Supreme Court were to reverse any final judgment and remand the case for a new trial. Thus, there is no guarantee that an immediate appeal would obviate or even reduce the risk of a second trial.

[8] Second, the claims against HBO involve issues common to the remaining claims against the remaining defendants. Therefore, a trial on those remaining claims, if decided in defendants' favor, could moot the claims, against HBO. That result would make completely unnecessary, if not advisory, any earlier Supreme Court decision in a Rule 54(b) appeal. Sound judicial administration favors not fostering the piecemeal appeal of closely related causes of action, where declining Rule 54(b) relief will cause no substantial hardship to the plaintiff. *Panichella*, 252 F.2d at 455. Accordingly, the motion must be also denied as to plaintiff's claims against HBO.

The plaintiff's motion for entry of final judgment pursuant to Rule 54(b) is therefore denied. IT IS SO ORDERED.

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3. Inexplicably, the plaintiff also insists that the Article Seventh claim is closely tied, in a legal sense, to his Articles Fifth and Sixth claims. However, the plaintiff has not demonstrated how or why that is so, and in any event that assertion contradicts plaintiff's argument that the Article Seventh claim is severable from his other certificate claims.