Unreported Cases

INTRODUCTION

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

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

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ADVANCED MINING SYSTEMS, INC. v. FRICKE

No. 11,823

Court of Chancery of the State of Delaware, New Castle

August 4, 1992

Corporation brought this action against its former president alleging, *inter alia*, breach of fiduciary duty. Defendant filed a counterclaim against corporate directors, including a count for indemnification, and moved to compel plaintiff to advance expenses reasonably incurred by him in connection with the defense of the suit. The board of directors determined that the decision to advance the sums was within its discretion and concluded that it was not in the corporation's interest to extend credit to defendant. Defendant argued that the corporate bylaws, which state that the corporation shall indemnify its directors to the extent permitted by the General Corporation Law of Delaware, legally obligated corporation to advance the sums.

The court of chancery, per Chancellor Allen, held that a mandate to indemnify did not include an obligation to advance expenses prior to a determination whether indemnification is permitted or required, and denied the motion.

1. Costs ⟹57
   Corporations ⟹525
   Judgment ⟹181(14), 182, 183

Motion to compel plaintiff to advance expenses reasonably incurred by former director in connection with the defense of the corporation's lawsuit against him would be construed as motion for partial summary judgment on the indemnification count of defendant's counterclaim, although such treatment may be technically incorrect.

2. Costs ⟹106, 118, 119, 120, 268
   Corporations ⟹525

Expenses, including attorneys' fees, incurred by an officer or director defendant in any civil, criminal, administrative, or investigative action, suit, or proceeding may be paid by the corporation in advance of the final disposition of such action, suit, or proceeding

upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in section 145(e) of the Delaware General Corporation Law. DEL. CODE ANN. tit. 8, § 145(e) (1991).

3. Costs ⟹ 106, 118, 119, 120, 121, 268
   Corporations ⟹ 525

Section 145(e) of the Delaware General Corporation Law authorizes corporations to advance credit prior to the determination of whether a defendant is entitled to indemnification, but requires the receipt of an undertaking to repay if it shall ultimately be determined that the individual is not entitled to be indemnified. The undertaking required by section 145(e) of the Delaware General Corporation Law need not be secured. DEL. CODE ANN. tit. 8, § 145(e) (1991).

4. Costs ⟹ 120, 124
   Corporations ⟹ 310(1), 525

Section 145(e) of the Delaware General Corporation Law leaves to the business judgment of the board the task of determining whether the undertaking proffered in all of the circumstances is sufficient to protect the corporation's interest in repayment, and whether, ultimately, advancement of expenses would on balance be likely to promote the corporation's interests. DEL. CODE ANN. tit. 8, § 145(e) (1991).

5. Corporations ⟹ 54, 310(1), 525

Language of corporate bylaw which required corporation "to indemnify" was not intended to deprive board of its function under section 145(e) to evaluate the corporation's interest with respect to advancement of expenses. DEL. CODE ANN. tit. 8, § 145(e) (1991).

Lawrence A. Hamermesh, Esquire, and Jon E. Abramczyk, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff-counterclaim defendant Advanced Mining Systems, Inc., and for counterclaim defendants, Gary Lutin, Earl L. Romsberg, James B. Pitts, U.L. Uebelhoer, and Standard Industrial Systems, Inc.

Wayne N. Elliott, Esquire, Michael Hanrahan, Esquire, and Ronald A. Brown, Jr., Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for defendant-counterclaim plaintiff Richard A. Fricke.

Richard D. Kirk, Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware, for counterclaim defendant Bruce A. Cassidy.

ALLEN, *Chancellor*

[1] In this suit, Advanced Mining Systems, Inc., a Delaware corporation ("AMS"), charges Richard A. Fricke, its former President, with breaches of loyalty to the corporation while he was in office. Mr. Fricke has now moved to compel plaintiff to advance expenses reasonably incurred by him in connection with the defense of this suit. He claims a present right to the "interim advancement of indemnification payments" under Section 145 of the Delaware General Corporation Law and under AMS's bylaws. I put aside the procedural oddity of the motion[1] and turn to a recitation of background facts that appear to be undisputed.

Background

AMS manufactures and distributes roof-support systems for underground coal mines; fabricates related steel products and tools and dies; and operates a trucking business. It was formed in 1984 as a result of a leveraged buy-out of Republic Corporation's "Systems" division.

Richard Fricke was General Manager of one of the Republic plants that was to be spun-off in the creation of AMS. Fricke apparently was one of the promoters of the LBO. He was one of the principal shareholders of AMS, a member of its board and was

1. This "motion" seeks an award of money that would, in effect, constitute a final judgment on the legal claim that Mr. Fricke is entitled to on-going advancement of his reasonable expenses. While a fairly elaborate counterclaim has been pleaded—including a count alleging that he is entitled to indemnification—the counterclaim does not mention a claimed right to advancements. In order to try to advance the litigation both fairly and efficiently, I will construe the present motion as a motion for partial summary judgment on the indemnification count of the counterclaim although I entertain some doubts that such treatment is technically correct.

designated AMS's first President. His tenure as President and director, however, ended a little more than a year later in March 1986, following his six month leave of absence from those positions. After leaving AMS's management, Mr. Fricke continued to work for the corporation as a consultant for another year. Since March 1987, his sole connection with AMS apparently has been as a shareholder.

On November 16, 1990, AMS filed the present suit against Fricke, alleging that, while he was President of the company and a director, Fricke had violated fiduciary duties he owed to the company.[2] Fricke has since filed counterclaims alleging that one Gary Lutin,[3] together with other counterclaim defendants, primarily present or past AMS directors, attempted to force Fricke out of AMS and that, by such conduct, Lutin and the other counterclaim defendants: (1) violated fiduciary duties they owed to Fricke; (2) violated AMS's bylaws; and (3) breached a Stock Purchase Agreement among Fricke, Lutin, AMS and others.

* * *

Section 145 of the Delaware General Corporation Law states the mandatory and permissive scope of indemnification by a Delaware corporation of the losses or expenses of an officer, director, employee or agent of the corporation incurred by reason of holding any such position. While the permissive authority to indemnify its directors, officers, etc., may be exercised by a corporation's board of directors on a case-by-case basis, in fact most corporations and virtually all public corporations have by bylaw exercised the authority recognized by Section 145 so as to mandate the extension of indemnification rights in circumstances in which indemnification would be permissible under Section 145. Such provisions serve obvious corporate interests. *Merrit-Chapman & Scott Corp. v. Wolfson*, Del. Super., 321 A.2d 138 (1974).

This motion does not involve the question whether or under what circumstances Mr. Fricke will be entitled to indemnification

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2. Among other things, the complaint alleges that Fricke: (1) used AMS employees for his personal benefit; (2) improperly extended AMS credit for his personal benefit; (3) approved the sale of assets for inadequate consideration; (4) approved improper expenses; (5) wasted assets; (6) failed to exercise honest and reasonable business judgment; and (7) refused to account fully to AMS directors. AMS seeks damages and costs and expenses, including attorneys' fees.

3. Counterclaim defendant Gary Lutin, an investment banker and also one of the LBO's promoters, similarly became a director and a principal shareholder of AMS at the time of the leveraged buy-out. He continues as a director.

by AMS for his expenses in defending this suit or for the amount of any judgment entered against him. That matter will be governed by Section 145(b) and (c) of the Delaware General Corporation Law and must await a determination of the litigation.

What is involved here is the question *when* payment on account of a claim of indemnification must be made. Mr. Fricke seeks an order requiring the corporation to advance his reasonable litigation expenses now. He is willing to provide an unsecured undertaking to repay such amounts if it is ultimately found that he was not entitled to indemnification of such expenses, after the litigation is concluded. Not surprisingly, the corporation finds this an unappealing proposal. The board of directors has determined that it has discretion to decide whether such an advance should be made and that it is not in the corporation's interest to extend this credit to Mr. Fricke. Fricke contends that the corporation's bylaws legally obligate it to do so. Which view is correct is the legal issue that the motion presents.

* * *

[2] Advancement of indemnifiable expenses is a subject treated by subsection (e) of Section 145 of our General Corporation Law. It provides, in relevant part, as follows:

> §145. Indemnification of officers, directors, employees and agents; insurance.
>
> . . . .
>
> (e) Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding *may be paid by the corporation in advance* of the final disposition of such action, suit or proceeding *upon receipt of an undertaking* by or on behalf of such director or officer *to repay* such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in this Section. (emphasis added.)
>
> With respect to indemnification rights, AMS's certification of incorporation and bylaws provide in virtually identical language that "[t]he Corporation *shall indemnify* its directors, officers, employees and agents *to the extent permitted by the General Corporation Law of Delaware.*" Charter Article TWELFTH (emphasis added).[4]

4. Article 7, section 7 of the bylaws differs only in the order in which it sets forth the parties to be indemnified.

Thus, the question here may be restated to be whether a mandate to "indemnify" includes an obligation to advance expenses prior to a determination whether indemnification is permitted or required. In my opinion, it does not.

Whether it is in a corporation's interest to indemnify a director or officer for an expense, loss or liability covered by Section 145(a) or (b) is fundamentally different from the question whether it is in the corporation's interest to advance arguably indemnifiable litigation expenses before the proceeding in which expenses are incurred has terminated. The decision to advance litigation expenses is in some respects similar to the decision to extend indemnification rights—it also might act as an incentive to serve as a director—but it is also in some respects quite different. In making a decision to advance expenses to a director or officer, the corporation is not extending the amount by which it may be legally liable, as it does when it extends indemnification rights. The right to be indemnified for expenses will exist (or will not) depending upon factors quite independent of the decision to advance expenses. Thus, the decision to extend advancement rights should ultimately give rise to no net liability on the corporation's part. The corporation maintains the right to be repaid all sums advanced, if the individual is ultimately shown not to be entitled to indemnification. Thus, the advancement decision is essentially simply a decision to advance credit.

[3-4] Recognizing this fact, the statute authorizes such transactions, but requires "receipt of an undertaking . . . to repay . . . if it shall ultimately be determined that [the individual] is not entitled to be indemnified . . . ." This undertaking need not be secured. Section 145(e) leaves to the business judgment of the board the task of determining whether the undertaking proffered, in all of the circumstances, is sufficient to protect the corporation's interest in repayment and whether, ultimately, advancement of expenses would on balance be likely to promote the corporation's interests.

A bylaw mandating the advancement of funds on the receipt of an undertaking to repay deprives the board of an opportunity to evaluate the important credit aspects of a decision with respect to advancing expenses. While given the evolution of Section 145(e), I assume such a bylaw would be valid,[5] the better policy, more consistent with the provisions of Section 145(e), is to require any such

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5. *See, e.g.*, Drexler, Black & Sparks, *Delaware Corporation Law and Practice* § 16.04, at 16-14 (1992).

bylaw expressly to state its intention to mandate the advancement by the corporation of arguably indemnifiable expenses under subsection (e).

[5] Because I consider indemnification rights and rights to advancement of possibly indemnifiable expenses to be legally quite distinct types of legal rights, I cannot conclude that the language of this bylaw, which requires AMS "to indemnify," was intended to deprive the board of its function under Section 145(e) to evaluate the corporation's interest with respect to advancement of expenses. It is notable that when this bylaw was adopted and when Mr. Fricke served as President of AMS, Section 145(e) stated that advancement decisions were to be made "in the specific case." Thus, as a practical matter, it is extremely unlikely that a reasonable person could then have assumed that a right to advancement in every case had been created by the AMS bylaw. Moreover, even given the 1986 amendment deleting that language from the statute, I conclude that the reading that I give the words "to indemnify" in the AMS certificate and bylaws is more in keeping with the tenor of subsection (e) than the alternative interpretation would be.[6]

No case has been cited that decides the question here presented, except *TBG, Inc. v. Bendis*, C.A. No. 89-2423-01, 1992 W.L. 80,622 (D. Kan. Feb. 19, 1991). I cannot accept the reasoning of that case as correct, however. There the corporation's bylaws contained a provision permitting advancement "as authorized by the board of directors in the specific case . . . ." Notwithstanding that provision, the court held that a mandatory right of indemnification "to the full extent permitted [by the Delaware General Corporation Law]" included a mandatory right to advancement. Through this broad interpretation the court negated the effect of the "specific case" bylaw language. While the "specific case" requirement had been removed from the statute by the time of the TBG decision, I cannot agree that the corporation's bylaws were for that reason alone amended.

* * *

Should the board of directors or shareholders, for reasons they regard as sound, wish to create a right of the type here asserted that decision may be expressed easily enough in the company's bylaws. AMS, however, has not done so in my opinion.

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6. *Cf. Citadel Holding Corp. v. Roven*, Del. Supr., 603 A.2d 818, 822 (1992) (recognizing the distinction between rights to indemnification and rights to advancement).

Therefore, the pending motion will be denied.

AMERICAN GENERAL CORP. v. CONTINENTAL AIRLINES CORP.

No. 8390

Court of Chancery of the State of Delaware, New Castle

May 14, 1992

(Revised May 20, 1992)

In 1987 the court of chancery found that defendants had breached the warrant provisions of the 1983 loan agreement between plaintiff and one of the defendants. This proceeding was held to determine the damages that plaintiff suffered because of the defendants' failure to make provisions for plaintiff to receive the same option that the employees of one of the defendants had received, as part of the merger between that defendant and its majority stockholder, another defendant. At issue were the measure of damages, from what date they would be calculated, and the availability of prejudgment interest.

The court of chancery, per Vice-Chancellor Hartnett, held: (1) the damages would be measured from the date the employee option was approved because that was when the plaintiffs became entitled to the options according to the warrant provision of the loan agreement; (2) the appropriate measure of damages was the difference between the value of the warrants with the option attached and the value of the warrants without the option as of the day of approval; and (3) the plaintiff was entitled to prejudgment interest at a rate of five percent over the Federal Reserve discount rate applicable on the date of approval and measured from that date as well.

1. Contracts ⟹ 315
   Corporations ⟹ 584

Implicit in a holding that a party is entitled to receive an employee option as merger consideration is the holding that another

party who has not provided that merger consideration has breached a contractual right.

2. Contracts ⟹ 303(4)

Exercise of a contractual right is not necessary to put a party in breach when that party interferes with that performance by requiring release of a valuable contract right.

3. Contracts ⟹ 315
Corporations ⟹ 584

Warrant provision was breached when, upon completion of merger, there was failure to meet contractual provision for receipt of merger consideration.

4. Corporations ⟹ 584
Damages ⟹ 117

Date for measuring damages should be the date stockholders approved the option and when the party became absolutely entitled to the options.

5. Damages ⟹ 117

In breach of contract, damages are generally measured by what is necessary to put the non-breaching party in as good a position as it would have occupied had there been full performance of the contract.

6. Damages ⟹ 114

Because breach interfered with the alienability of the warrants, it is appropriate to apply the conversion measure of damages.

7. Corporations ⟹ 584
Damages ⟹ 114

Because ability of plaintiff to sell warrants and realize their full value was clearly undermined by defendants' breach, the issue of damages must be resolved without resort to an inquiry into the plaintiff's intent.

8. Trover and Conversion ⟹49

The injury that non-breaching party suffers is deprivation of the range of elective action, and by applying conversion measures of damages, a court endeavors to restore that range of elective action.

9. Corporations ⟹121(5)

Non-breaching party is not required to show that he would have sold his securities had he been able because this would require him to prove that he would have taken the steps that were precluded by the breach.

10. Corporations ⟹121(5)
Damages ⟹6

When defendants' acts prevent a court from determining with any degree of certainty what plaintiff would have done with his securities had they been freely alienable, justice requires that such uncertainty be resolved against the defendant.

11. Corporations ⟹584

Having deprived plaintiff of the ability to decide whether to hold or dispose of its warrants, defendant precluded an inquiry into plaintiff's intent and cannot claim that in order to recover plaintiff must prove it would have taken such action.

12. Damages ⟹62(4)

While there is a general duty to mitigate damages if it is feasible to do so, a plaintiff need not take unreasonable, speculative steps to meet that duty.

13. Damages ⟹114, 124(4)
Trover and Conversion ⟹49

The appropriate measure of damages for property of fluctuating value, i.e., warrants, is the difference between what the value of the warrants with the options attached would have been on the date the option was approved, or their highest intermediate value during a

reasonable period after that date, and the actual value of the warrants on that date in light of defendant's breach.

14. Damages ⟹6

An award of damages may not be based on speculation or on guesswork.

15. Corporations ⟹584
Damages ⟹117

The date from which to measure the value of warrants should be established by a determination of how long it would have taken the plaintiff to replace the securities in the open market.

16. Corporations ⟹584
Damages ⟹117

Because it would not be feasible to ascertain precisely how long it would have taken to purchase the large block of stock, the better replacement value to use in the computation would be the trading price on the day plaintiff became absolutely entitled to the options.

17. Interest ⟹39(2.5)

Prejudgment interest is available in Delaware as a matter of right.

18. Corporations ⟹584
Interest ⟹39(2.2)

Prejudgment interest is normally computed from day of breach but the court of chancery is empowered to grant such relief as the facts of the case may dictate.

19. Interest ⟹39(2.3)

Where underlying obligation to make payment arises *ex contractu*, the court looks to the contracts to determine when the right to prejudgment interest should begin to accrue.

20. Interest ⟹ 31

When claim for damages is legal, rather than equitable, in nature, the legal rate of interest, where there is no expressed contractual rate, shall be five percent over the Federal Reserve discount rate. DEL. CODE ANN. tit. 6, § 2301(a) (1991).

21. Contracts ⟹ 315
Corporations ⟹ 584

The breach of plaintiff's contractual right to receive the options occurred on the date of the merger because defendants failed to make plaintiff eligible for the same merger consideration as the employee stockholders were granted on that date.

22. Damages ⟹ 117

Plaintiff is entitled to a damage award measured from the date on which the employee options were approved, not from the date of the breach, because the rights were contractual and based on that which the employees were entitled to receive once the option was approved.

23. Damages ⟹ 114, 124(4)

The appropriate measure of damages is the difference between (1) the value of the warrants with the option attached, and (2) the value of the warrants without the option attached as of the date the employee option was approved.

24. Interest ⟹ 39(2.3)

Prejudgment interest is awarded at a rate of five percent over the Federal Reserve discount rate and is to be measured from the same date on which the damages are measured.

Jesse A. Finkelstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for plaintiffs.

Paul P. Welsh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants.

HARTNETT, *Vice-Chancellor*

[start - revised page - May 20, 1992]

In 1987 this Court found that the defendants, Continental Airlines Corporation ("Continental") and Texas Air Corporation ("Texas Air"), had breached a provision in an 1983 Loan Agreement between American General and Continental that provided that American General was entitled to receive the same stock option that was given to the employees of Continental as part of the 1987 merger between Continental and its majority stockholder Texas Air Corporation ("the Employee Option"). After trial on the issue of the amount of damages to be awarded because of the breach, the Court finds that plaintiffs are entitled to an award of $44,804,218 plus interest measured from May 20, 1987, at a rate of 5% over the Federal Reserve discount rate on that date.

I

The background of this litigation is set forth in detail in *American Gen. Corp. v. Texas Air Corp.*, Del. Ch., C.A. Nos. 8390, 8406, 8650 & 8805, Hartnett, V.C. (Feb. 5, 1987), and *American Gen. Corp. v. Continental Airlines Corp.*, Del. Ch., C.A. No. 8390, Hartnett, V.C. (Jan. 26, 1988), *aff'd*, 575 A.2d 1160 (1990).

American General Corporation and American General Life Insurance Company (collectively "American General") began their involvement in Continental Airlines Corporation ("Continental") on June 10, 1983, when they entered into a loan agreement ("Loan Agreement") with the then struggling airline. The Loan Agreement provided that American General would lend $40 million to a subsidiary of Continental in exchange for: (1) $40 million worth of 11% Senior Notes of the subsidiary due in 1998; (2) a separate written guaranty by Continental securing the debt; (3) an anti-dilution option provision that would allow American General to acquire 25% of any future stock issue of Continental occurring during the following ten years; and (4) warrants that would permit American General to acquire within five years approximately 5 million shares of Continental common stock at an exercise price of $8.50 per share. The exercise price and the expiration terms of the warrants were changed during the pendency of this litigation so that American General had until June 10, 1989, to buy the same number of pre-merger Continental shares at a warrant exercise price of $8.30.

On September 24, 1983, Continental sought Chapter 11 bankruptcy protection. When Continental emerged from the bankruptcy proceedings on September 7, 1986, it had so substantially reduced operating costs that it was considered to have the lowest operating costs of any domestic air carrier.

In July of 1985, while Continental was still in bankruptcy, Texas Air Corporation ("Texas Air"), which owned approximately 72% of Continental's stock, proposed to take Continental private. Although the terms of the merger changed throughout negotiations, each version of the transaction gave Continental employees the opportunity to purchase shares of Texas Air, through an option or a direct exchange.

The final terms of the merger were established by agreement of Continental and Texas Air in December of 1986. The basic terms of the Merger Agreement provided that Continental would be merged with a wholly owned subsidiary of Texas Air formed to facilitate the merger, and Continental's minority stockholders would be cashed out at a price of $16.50 per share. Texas Air publicly announced a related proposal, not contained in the Merger Agreement itself, that Continental employee stockholders would receive, in addition to the $16.50 per share merger consideration, the opportunity to exchange their shares of Continental common stock for Texas Air common stock at an exchange ratio of one pre-merger Continental share for .8 share of Texas Air. Significantly, the primary beneficiaries of this exchange would be Francisco A. Lorenzo, who at that time was the Chairman of the Board of Directors of both Continental and Texas Air, and a few other key insiders.

Apparently realizing the discriminatory effect of the proposed employee exchange offer, Texas Air withdrew that offer and granted to Continental's employee stockholders an option to buy Texas Air stock ("Employee Option"). The Employee Option was to be exercisable in August of 1988 and would allow the employee stockholders who continued to be employed by Texas Air to buy, for $16.50, .8 of a share of Texas Air for each share of pre-merger Continental stock that they owned between October 31, 1985, and February 6, 1987. This option was not set forth in the Merger Agreement, and it did not affect the $16.50 per share merger consideration that each employee stockholder would receive.

In December of 1986, American General filed suit in this Court seeking to enjoin the consummation of the merger on the grounds that the structure of the transaction discriminated among Continental's minority stockholders and that American General's contractual

warrant rights would thereby be impaired. Three other minority stockholders filed class actions, also seeking an injunction, but doing so on behalf of Continental's minority stockholders other than American General.

On February 5, 1987, this Court denied the motion for a preliminary injunction, holding that an adequate remedy other than injunctive relief existed because any claimed unfairness of the merger was reflected in the price to be paid and could be challenged in an action for an appraisal or for damages. *American Gen. Corp. v. Texas Air Corp.*, Del. Ch., C.A. Nos. 8390, 8406, 8650 & 8805, Hartnett, V.C. (Feb. 5, 1987). Texas Air completed the going-private merger the next day.

On March 13, 1987, the minority stockholders other than American General settled their class action suits in consideration of receiving an extra $3.75 per share. Pursuant to the settlement, the employee stockholders were precluded from receiving the additional $3.75 if they chose to exercise their employee option to purchase the .8 share of Texas Air stock. An employee stockholder was, therefore, given the right to choose to receive either: (1) the $16.50 cash per share merger consideration plus the employee option; or (2) the $16.50 cash per share merger consideration plus the $3.75 cash per share settlement consideration.

On March 3, 1987, American General moved for partial summary judgment on the issue of whether the following language in the warrant provision in the Loan Agreement entitled American General to receive the same option as the employees were entitled to receive under the Employee Option:

> 3.8 *Reorganization, Merger, etc.* If, after the date hereof, any capital reorganization or reclassification of the capital stock of the Company (except as provided in Section 3.5), or consolidation or merger of the Company with another corporation . . . or the sale or conveyance of all or substantially all of its assets to another corporation shall be effected, then, as a condition of such reorganization, reclassification, consolidation, merger, sale or conveyance, lawful and adequate provision shall be made whereby the holder hereof shall thereafter have the right to purchase and receive upon the same basis and upon the terms and conditions specified in this Warrant and in lieu of the shares of the Common Stock of the Company immediately theretofore purchasable and receivable upon the exercise of the rights represented

> hereby, such shares of stock, securities or property as may be issued or payable with respect to or in exchange for a number of outstanding shares of such Common Stock equal to the number of shares of such Common Stock purchasable and receivable upon the exercise of the rights represented hereby immediately prior to such reorganization, reclassification, consolidation, merger, sale or conveyance . . . .

American General argued that this language entitled it to receive the Employee Option with respect to the shares of pre-merger Continental stock that it could have purchased pursuant to its warrants.

Texas Air countered by moving for summary judgment that it had not violated any contractual provision contained in the warrants. Texas Air also asserted that the issue would become moot if the Court were to find that American General was entitled to the Employee Option because the Texas Air Board and stockholders had recently amended the Employee Option to include a self-destruct mechanism that would void the option upon such a judicial finding.

In response to the cross-motions for summary judgment, this Court held, *inter alia*, that American General was entitled to receive the Employee Option. *American Gen. Corp. v. Continental Airlines Corp.*, Del. Ch., C.A. No. 8390, Hartnett, V.C. (Jan. 26, 1988). This ruling was based on section 3.8 of the warrants, the language of which was interpreted to mean that American General had the right to receive the same consideration that *any* other stockholder received in a merger. *Id.* Despite the fact that Texas Air had gone to great lengths to restructure the Employee Option so that it appeared to be unrelated to the merger, this Court held that the option was clearly part of the merger consideration. *Id.*

The Delaware Supreme Court affirmed, *inter alia*, this Court's ruling that the Employee Option was merger consideration and that American General was, therefore, entitled to that option under section 3.8 of the warrants. *Continental Airlines Corp. v. American Gen. Corp.*, Del. Supr., 575 A.2d 1160 (1990). Because the Employee Option was merger consideration, the Supreme Court held that it could not be withdrawn via the self-destruct mechanism inserted by Texas Air. To allow such an attempt to succeed would be, according to the Supreme Court, to allow Texas Air to manipulate the Delaware courts and to render their decisions mere advisory opinions. The self-destruct mechanism was, therefore, held to be impermissible. *Id.* at 1169.

During the pendency of this litigation, the market price of Texas Air stock declined significantly. Shortly after the merger, in February of 1987, the price peaked at about $50 per share. Later that year, however, the price began to decline and the general market decline in October of 1987 depressed the price further. During the entire six month exercise period for the Employee Option (beginning on August 6, 1988), Texas Air stock traded below the $20.625 (per full Texas Air share) exercise price. Ultimately, Texas Air's financial condition worsened, and both Texas Air and post-merger Continental are now in the midst of bankruptcy proceedings.

While the appeal in the Supreme Court was pending on this Court's grant of summary judgment to American General, the warrants expired. The issue before this Court at trial, therefore, is limited to a determination of the damages that American General suffered (if any) because of defendants' failure to make provisions for American General to receive the same option that the employees received.

II

In their post-trial brief, defendants raise for the first time the argument that there has been no judicial finding that any breach of the terms of American General's warrants occurred. They contend that this Court's grant of summary judgment to American General and the Delaware Supreme Court's affirmance of that judgment amounted to nothing more than a declaration of American General's contractual rights. Because there was no express language in either of those opinions stating that defendants had breached American General's warrant rights, defendants assert that a finding that they were not in breach of the warrants would be entirely consistent with this Court's and the Supreme Court's prior holdings.

[1] Defendants exalt form over substance with their contention that this Court did not find that a breach of American General's contractual rights had occurred. Implicit in this Court's holding that American General was entitled to receive the Employee Option as merger consideration is the holding that defendants breached that contractual right by not providing American General with that merger consideration. Furthermore, the trial was limited to an ascertainment of American General's damages as provided in the Pre-Trial order. This would not have occurred if the Court had not already determined that a breach had occurred. There is no merit, therefore, to defendants' claim that there has been no ruling on the issue of their breach of the terms of American General's warrants.

III

Defendants next contend that if they have breached the terms of American General's warrant rights, the breach could not have occurred until American General first attempted to exercise its warrants in May of 1988. If American General had been able to exercise its warrants in May of 1988, it would have been entitled to over 5 million shares of pre-merger Continental. The number of options an employee stockholder could have obtained depended on the number of pre-merger Continental shares he owned. Defendants, therefore, reason that American General could not have become entitled to the same option as the employees received until it perfected its right to the pre-merger Continental shares through the exercise of its warrants. Because the price of Texas Air stock had declined below the option exercise price by the time American General tried to exercise its warrants in May of 1988, defendants conclude that American General suffered no damages because of the breach of the term of the warrants by defendants.

American General, however, was not required to actually exercise its warrants to establish defendants' breach. The exercise of the warrants was not a condition precedent to defendants' duty to grant American General the same option as it granted to its employees. As noted above, defendants breached section 3.8 of the warrants portion of the Loan Agreement by not performing their contractual duty to provide that American General would receive the same options as the employees received.

Even if American General had been required to exercise its warrants as a condition precedent under section 3.8 of the warrants portion of the Loan Agreement, American General's failure to do so would have been excused. Continental Airlines' General Counsel, by a letter dated May 10, 1988, informed American General that "[t]o exercise validly you must surrender the Warrants completely, including all ownership rights—such as, for instance, the right to enforce purported further claims under the Warrants." When American General attempted to exercise the warrants without releasing its claim to the Employee Option, defendants refused to honor the exercise. Indeed, defendants concede in their post-trial brief that they would have refused to acknowledge American General's right to the Employee Option regardless of when American General tried to exercise its warrants.

[2] Defendants, therefore, cannot claim that American General's exercise of the warrants was necessary to put defendants in breach of the 1983 Loan Agreement when the defendants interfered with that performance by requiring American General to simultaneously release a valuable contract right. *T. B. Cartmell Paint & Glass Co. v. Cartmell*, Del. Super., 186 A. 897 (1936). *See also Christophersen v. Blount*, Conn. Supr., 582 A.2d 460 (1990).

IV

The most difficult issue to determine is what date is to be used in assessing damages. Defendants contend that if the Court finds that damages are appropriate, they should be determined as of May 20, 1987, the day 90% of the voting Texas Air stockholders approved the Employee Option. Because the option could have been rejected by the stockholders up until the stockholder vote, defendants claim American General would not have had "even a future right" to the option before that date.

American General counters that the date to be used in computing damages should be February 6, 1987, the date of the merger, because the Employee Option, although subject to being later ratified, was merger consideration granted to the Continental employee stockholders as of that date. American General considers the necessary Texas Air stockholder approval to have been a mere "rubber stamp" process because of the overwhelming majority approval the plan actually received and the fact that management controlled over 50% of the voting stock. American General also points to the fact that one of the plan's primary beneficiaries, Francisco Lorenzo, had significant voting power in and influence over Texas Air. According to American General, it would be highly unlikely that he would vote against the option plan in light of the potential gains he would have received as a participant. All of this is mere speculation, however. [3] The breach of American General's contractual right to the options occurred on the date of the merger—February 6, 1987—not on the date of the Texas Air stockholder meeting, as argued by defendants. The language in the warrant provision of the Loan Agreement states that "as a condition of such . . . merger . . . lawful and adequate provision shall be made" for American General to receive the same merger consideration as any other stockholder. At the outset the employee stockholders were made eligible for the contingent option plan, but American General was not. Defendants, therefore, breached the warrant provision upon the completion of

the merger because they failed to meet the contractual provision that American General would receive the same merger consideration that the employee stockholders received—the Employee Option with its contingent nature.

Nevertheless, although defendants were in breach of American General's contractual rights as of the date of the merger, it would not be equitable to measure damages from that date. Defendants are correct in their contention that damages should be measured from the date on which the Texas Air stockholders approved the Employee Option and the contingent nature of the options was removed—May 20, 1987. As defendants point out, the approval of the Texas Air stockholders was necessary for the implementation of the option plan. Until it was actually approved, the Employee Option was contingent in nature and could have become a nullity. Without that approval, the employee stockholders would have received only the $16.50 cash-out merger consideration.

The language of the warrants provision of the Loan Agreement stated that "adequate provision shall be made whereby [American General] shall [after the merger] have the right to purchase . . . such . . . property that may be *issued or payable* with respect to . . . a number of outstanding shares." Section 3.8 of the warrant provision of the Loan Agreement. (emphasis added). The breach occurred when "adequate provision" was not made for American General to be eligible to be issued the Employee Option, but damages did not accrue at that time because the option was not "issued or payable" until it was actually approved by the stockholders on May 20, 1987. American General was entitled to receive only what the warrant provision of the Loan Agreement contractually provided that it was to receive: options when issued or payable.

American General's argument that it could have sold the right to receive the contingent options is too speculative to be given serious consideration.

American General's further argument that even on the date of the merger the stockholder approval was a virtual certainty, as borne out by the actual stockholder vote, is of little consequence in determining the date from which American General's damages should be measured. It is mere speculation to say that with all the benefits they stood to receive, Lorenzo and the other insiders would never defeat the Employee Option. If prior to the stockholder vote conditions had changed in such a way as to eliminate those benefits for the management beneficiaries, Lorenzo and the other insiders would

likely have used their significant influence to sway the vote against the plan.

[4] Although the defendants breached American General's contractual rights on the date of the merger by failing to make American General eligible to receive the Employee Option when and if approved by the stockholders, American General had no right to actually receive the options until they were issued or payable. The date for measuring damages should, therefore, be May 20, 1987, the date the stockholders approved the option plan and American General became absolutely entitled to be issued the options. American General's damages will, therefore, be measured from that date.

V

The facts in this matter are unique and, therefore, there is no clear precedent to measure the damages. At best, the existing precedents, by analogy, merely point the way to a fair measure of damages. Plaintiff has requested $91,759,037 in damages plus interest from February 6, 1987. Defendants claim no damages should be awarded.

[5] In a breach of contract action, a plaintiff's damages are generally measured by what is necessary to put it in as good a position as it would have occupied had there been full performance of the contract. *J. J. White, Inc. v. Metropolitan Merchandise Mart*, Del. Super., 107 A.2d 892 (1954).

American General asserts that there are two alternative measures of damages that would put it in the position it would have occupied if there had been full performance. The first measure of damage it advocates is a sum equal to the difference between the value of the warrants on the date of the breach and their value on the date of the trial. A more fact specific variation based on the same concept is that the damage is a sum equal to the difference between the value of the warrants on the date of the breach (or their highest value during a reasonable time after the breach), if the defendants had not breached the Agreement, and the actual value of the warrants on that date in light of defendants' breach.

The second measure of damages advocated by American General is a variation of the damage formula used in cases involving the conversion of securities of fluctuating value. Under that formula the damage would be based on the highest market price the stock reached within a reasonable time of plaintiff's discovery of the breach. American General, however, asserts a modified version of this damage

formula in order to reflect the difference in value of American General's warrants with and without the Employee Option, shortly after the breach.

While none of the formulas suggested are adequate to give a truly accurate measure of American General's damages, the better approach is a variation of the formula used in conversion cases. This approach, however, must reflect that the "highest intermediate value" should be determined from May 20, 1987, the date the contingency factor was removed from the options, not the date of the initial breach—February 6, 1987, the date of the merger.

VI

Defendants' objections to the use of the conversion formula of damages are without merit. First, defendants maintain that the "highest intermediate value" formula is not an appropriate measure of damages in this case because defendants did not interfere with American General's ability to sell its warrants. Secondly, defendants contend that American General failed to prove that it would have sold its warrants during the time period following May 20, 1987. Defendants also assert that American General should receive no damages because there was never a time when the employee stockholders could have exercised their options and received a financial gain. Finally, defendants claim that American General failed to mitigate its damages. None of these defenses have merit.

VII

Defendants first contend that American General has inappropriately advocated "the highest intermediate value" formula as the measure of damages despite that it is the most commonly employed measure of damages in conversion cases. Defendants cite *Loretto Literary & Benevolent Inst. v. Blue Diamond Coal Co.*, Del. Ch., 444 A.2d 256 (1982), as a basis of its claim that the conversion standard of damages should not be applied if the plaintiff was able to transfer the subject stock at all relevant times. Defendants also argue that *Loretto* imposes a burden on a plaintiff in a conversion case to show that he would have sold his stock during the time period on which he bases his damage calculation. Defendants argue that because American General was always able to sell its warrants, but apparently did not attempt a sale, it is precluded from claiming the "highest intermediate value" for its damages.

[6] In their application of the *Loretto* holding to the facts of this case, defendants have disregarded the effect of their denial to American General of its right to the Employee Option. While American General always had the legal ability to sell its warrants, defendants' breach certainly interfered with the salability of the warrants as a practical matter. With the legal right to the Employee Option in dispute, American General could not have realized the full value of the warrants—assuming it could have found a willing buyer at all. Because defendants' breach did interfere with the alienability of the warrants, the application of the conversion measure of damages to this case is consistent with the holding in *Loretto*.

[7] Moreover, *Loretto* cannot fairly be construed as imposing a burden on the plaintiff in a conversion case to prove that he would have sold his stock during the period for which he claims damages. This Court specifically held in that case that a theory of conversion was unavailable and the plaintiff was limited to its actual loss occasioned by the delay in the recordation of transfers of plaintiff's shares. The only reason the *Loretto* Court considered the issue of whether plaintiff intended to sell the stock during the period of delay was to ascertain whether plaintiff had been prevented from consummating such a sale. Because American General's ability to sell its warrants and realize their full value was clearly undermined by defendants' breach, the issue of damage must be resolved without resort to an inquiry into plaintiff's intent.

VIII

Defendants also argue that American General should not recover any damages because it would not have sold its warrants during the period when Texas Air was trading at prices that would make such a sale attractive. Defendants quote at length American General's statements at both the preliminary injunction and summary judgment stages of this litigation that it sought continuing equity participation in Texas Air. Defendants also place great emphasis on statements made at trial by American General's Chief Executive Officer, Mr. Hook, that although he did not attempt a sale of the contingent warrants during 1987, in hindsight, he would have recommended to American General that it should have liquidated its position in the defendant corporations if the existence of the option was not being challenged by defendants.

Defendants have essentially restated in a more factual context their contention that American General must prove that it would

have sold its warrants during the period for which it claims damages. As was stated above, American General does not have such a burden of proof.

[8-9] The hallmark of conversion cases is the interference with the plaintiff's ability to transfer securities he owns or to which he is entitled. The injury that the plaintiff suffers is the deprivation of his range of elective action, and by applying the conversion measure of damages a court endeavors to restore that range of elective action. *In re New York, N.H. & H.R. Co.*, D. Conn., 64 F. Supp. 487, 491 (1945). To require the plaintiff to show that he would have sold his securities, had he been able, is to require him to prove that he would have taken the "very steps" that defendant's "wrongful act . . . precluded him from taking . . . ." *Kaufman v. Diversified Indus., Inc.*, 2d Cir., 460 F.2d 1331, 1336 (1972).

[10] The defendant's acts prevent a court from determining with any degree of certainty what the plaintiff would have done with his securities had they been freely alienable. Because it is the defendant who creates this uncertainty, "fundamental justice requires that, as between [the plaintiff] and [the defendant], the perils of such uncertainty should be 'laid at defendant's door.'" *Madison Fund, Inc. v. Charter Co.*, S.D.N.Y., 427 F. Supp. 597 (1977) (quoting *Kaufman v. Diversified Indus., Inc.*, 2d Cir. 460 F.2d 1331, 1338 n.8 (1972)).

In the present case, the Court is faced with the same uncertainty that confronted the courts in the *Madison Fund* and *Kaufman* decisions. American General in 1986 did ask this Court to enjoin the merger in order to permit it to enjoy a continuing equity interest in Texas Air because it claimed the freeze-out merger was an attempt to keep it from realizing a profit on its investment in and relationship with pre-merger Continental. However, that request for continuing equity participation was reconcilable with the concept of having been able to sell the warrants with the option attached because through such a sale American General could have realized that profit.

Moreover, there is some credibility in American General's "hindsight" claim that it would have liquidated its warrant holdings if the entitlement to the Employee Option had not been under challenge. It is clear that by 1987 the relationship between American General and Continental had become strained. Mr. Hook testified that the structure of the merger, as well as Texas Air's planned acquisitions of three troubled airlines, caused him to doubt Mr. Lorenzo's commitment to a long-term relationship with American General. American General's confidence was also shaken when it learned that Texas Air insiders (most notably Francisco Lorenzo)

sold large blocks of Texas Air stock from October 1986 through March 1987. Finally, in August of 1986, American General had implemented a new investment management policy of diversification that was incompatible with a large investment in any single corporation.

[11] Having deprived American General of the ability to decide whether to hold or to dispose of its warrants with the Employee Option attached, defendants precluded an inquiry into American General's intent. Through their breach, the defendants assumed the risk that American General would have sold the warrants with the option attached when Texas Air stock was trading at relatively high prices if the right to the options was not disputed, and that they would have to compensate American General for the profits of any lost sale. They cannot, therefore, now claim that in order to recover damages American General must prove that it would have taken such action.

IX

Defendants also argue that American General should not recover any damages because the employee stockholders did not actually receive any financial benefit from the Employee Option. During the entire Employee Option exercise period (August 6, 1988, through February 6, 1989), Texas Air stock traded below the $20.625 (per full Texas Air share) option exercise price. Because the employee stockholders were apparently, therefore, unable to reap any financial gain from their options, defendants contend that awarding American General damages would put American General in a better position than it would have occupied had there been no breach.

Defendants are correct in their contention that American General was entitled to the Employee Option only upon the same terms as were given to the employee stockholders. That fact, however, does not lead to the assumption that American General was required to have followed the same course of action as the employee stockholders and would have held its options until the exercise period. As was noted above, the Court cannot ascertain precisely what American General would have done if it had been issued the options, but that uncertainty must be resolved against defendants.

Furthermore, if American General had been properly issued the Employee Option on May 20, 1987, it would have owned options for a significant block of Texas Air stock. Such a large holding would have permitted American General to sell its warrants with the options

attached well before the exercise period. The fact that the employee stockholders did not hold securities (such as the warrants that American General held) that would have allowed them to sell their rights to the otherwise inalienable Employee Options should not work to American General's detriment. Allowing American General to recover damages would, therefore, not constitute a windfall, despite the fact that the employee option holders were not actually able to receive any financial benefit from their options.

X

Defendants' final attack on American General's damage claim is that American General failed to mitigate its damages. Defendants have submitted elaborate schemes providing for the purchase of "put" and "call" options on Texas Air stock that they contend would have allowed American General to have "locked in" the profit it is now claiming as damages.

[12] The investment alternatives that defendants claim American General should have pursued in order to mitigate its damages are very high risk propositions. Indeed, they appear to be contrary to Texas regulations regarding the types of investments a Texas insurance company such as American General could have made. *See* TEX. INS. CODE ANN. art. 3.39-2 (Vernon Supp. 1991); *see also* TEX. ADMIN. CODE tit. 28, §71,103 (1988). While there is a general duty to mitigate damages if it is feasible to do so, a plaintiff need not take unreasonably speculative steps to meet that duty. *Edward M. Crough, Inc. v. Department of Gen. Servs. of D.C.*, D.C. App., 572 A.2d 457 (1990) (duty to mitigate damages with reasonable effort and without substantial risk of loss). American General was, therefore, not under a duty to engage in the put and call option scenarios set forth by defendants.

XI

[13] As was noted above, the appropriate measure of American General's damages is the difference between what the value of the warrants with the option attached would have been on the date of the stockholder meeting (May 20, 1987) or their highest intermediate value during a reasonable period after the meeting if the defendants had not breached the warrants, and the actual value of the warrants on that date in light of defendants' breach (that is, the value of the warrants without the option attached).

American General has put forth two alternative measures of the value of the warrants in May 1987 if the right to the option had been certain: (1) the "highest intermediate value"; and (2) the lost profits from a hypothetical short sale of Texas Air stock.

American General's second theory of valuing the warrants with the option attached, based on a "short sale" of Texas Air stock, is too speculative to support a damage award. "Short sales" are similar to "put" and "call" options in that they involve the risk that the market price of the stock could fluctuate enough to make the whole investment plan unprofitable. It seems very unlikely that a regulated insurance corporation such as American General would (or even could) engage in short sales of the magnitude suggested by the expert testimony presented at trial.

[14] An award of damages may not be based on "speculation or guesswork." *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946). Because the concept of American General's "short selling" of stock is mere speculation at best, it is an inappropriate valuation method to use in the computation of the damages suffered due to defendants' breach.

XII

As previously indicated, the Court finds that the critical date for determining the amount of damages is May 20, 1987, the date the options were approved by the stockholders, and not February 6, 1987, the date of the merger.

Based on this assumption, American General urges a valuation of the warrants with the option attached based on a $39.625 per Texas Air share trading price. It asserts that this figure is the "highest intermediate value" within a reasonable time after the May 20, 1987 stockholder vote. This trading price was reached on May 29, 1987. American General further asserts that the trading price must be reduced by the 15% discount that American General's expert (First Boston Corporation) claims it would have required had it been the purchaser of the warrants. Although the discount figure seems unusually low, no contrary evidence was presented. Plaintiff further asserts that the discounted trading price must be multiplied by the option ratio (the presumed return of the $16.50 consideration divided by the per full share exercise price of $20.625). The warrant exercise price ($8.30) then must be subtracted, and the resulting figure multiplied by the number of warrants (5,120,482) to which American General was entitled. Under this calculation, the value of the warrants

with the option attached on May 29, 1987, would be $95,471,387 as appears in Chart 1 as submitted by plaintiffs:

CHART 1

VALUE OF WARRANTS AT 15% DISCOUNT

$39.625	STOCK PRICE
x .85	15% DISCOUNT
= $33.68	
x .8	OPTION RATIO
= $26.95	
− $8.30	WARRANT EXERCISE PRICE
= $26.12	VALUE PER WARRANT
x 5,120,482	WARRANTS
= $95,471,387	VALUE OF WARRANTS WITH OPTION OF MAY 29, 1987

In order to reach the value of the warrants without the option attached, American General urges that the $16.50 merger consideration be the starting point. From that figure American General subtracts the warrant exercise price ($8.30). The resulting figure, $8.20, is then multiplied by the number of warrants held by American General, setting the value of the warrants without the option on May 29, 1987, at $41,987,952 as appears in Chart 2 as submitted by plaintiffs:

CHART 2

VALUE OF WARRANTS WITHOUT OPTION

$16.50	FREEZE-OUT CONSIDERATION
− $8.30	WARRANT EXERCISE PRICE
= $8.20	VALUE PER WARRANT
x 5,120,482	WARRANTS
= $41,987,952	VALUE OF WARRANTS WITHOUT OPTION ON MAY 29, 1987, AND VALUE TODAY

Finally, American General calculates the difference between the two values as $53,483,435 (see Chart 3 below). This is the damage award to which American General claims it is entitled if May 29, 1987, is used as the date for determining the amount of damages.

CHART 3

LOST VALUE OF WARRANTS

$95,471,387	1987 VALUE WITH OPTION
– $41,987,952	VALUE WITHOUT OPTION
= $53,483,435	LOST VALUE OF WARRANTS

XIII

[15] There is, however, a deficiency in American General's calculations. American General erroneously chose May 29, 1987, as the date from which to measure the value of the warrants with the option attached based on that date being the "highest intermediate value." The use of the "highest intermediate value" in the computation of damages is "a compromise attempt to value the chance that the plaintiff might at some time have profited by a rise in value." McCORMICK, *Damages* §48 (1971). This is not to say, however, that a plaintiff may pick and choose, with hindsight, a single date to set that value. Rather, the date should be established by resort to a "constructive replacement" purchase by the plaintiff, i.e., how long it would have taken the plaintiff to replace the securities on the open market. *Id. See also Madison Fund, Inc. v. Charter Co.*, S.D.N.Y., 427 F. Supp. 597, 609 (1977).

At first glance, nine days after the breach might seem to be a "reasonable time" for a "constructive replacement." American General knew before the stockholder meeting was held, however, that defendants had no intention of making American General eligible for the Employee Option. It also certainly knew that it was not made eligible to receive the options as of the day the vote took place. American General, therefore, would have been prepared to proceed to replace its shares immediately thereafter if it had desired to do so.

American General has not offered any evidence regarding how long it would have taken it to purchase "replacement" shares of Texas Air stock. It seems highly unlikely that a buyer with American General's resources and financial means would have needed nine days to purchase the stock, thereby making the choice of May 29, 1987, arbitrary. Not surprisingly, the $39.625 trading price on May 29,

1987, was the highest trading price Texas Air stock reached after May 20, 1987.

[16] Because it is not feasible to ascertain precisely how long it would have taken American General to purchase such a large block of Texas Air stock, the better "replacement" value to use in the computation would be the trading price on May 20, 1987. The appropriate stock price to begin the computation of the value of the warrants is, therefore, $37.125 per Texas Air share.

After substituting May 20, 1987's trading price of $37.125 for May 29, 1987's $39.625 trading price in American General's damage calculation, the Court finds that the damage award is $44,804,218.

XIV

American General also claims that it should be awarded prejudgment interest in its damages. It argues that such an award should be measured from the date of the breach—February 6, 1987.

[17-18] Prejudgment interest is available in Delaware as a matter of right. *Getty Oil Co. v. Catalytic, Inc.*, Del. Super., 509 A.2d 1123 (1986). Such interest is normally computed from the date of the breach, *Citadel Holding Corp. v. Roven*, Del. Supr., 603 A.2d 818 (1992), but the Court of Chancery "is empowered to grant such relief 'as the facts of a particular case may dictate.'" *Shell Petroleum, Inc. v. Smith*, Del. Supr., No. 350, 1991, Moore, J., (Apr. 23, 1991) (quoting *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701, 714 (1983)); *Rapid-American Corp. v. Harris*, Del. Supr., 603 A.2d 796 (1992).

[19] Where the underlying obligation upon which damages are based arises *ex contractu*, the Delaware Supreme Court has held that the court should look to the contract itself to determine when the right to prejudgment interest should begin to accrue. *Citadel Holding Corp.*, 603 A.2d at 826.

American General is, therefore, entitled to prejudgment interest measured from the date on which its damages began to accrue—May 20, 1987. The date of the breach, February 6, 1987, is not the appropriate starting point for the computation of interest because until the Texas Air stockholders made the Employee Option "issued or payable" as required by the language of the warrants provision in the Loan Agreement, American General was not entitled to be issued the options.

[20] American General's claim for damages is legal, rather than equitable, in nature and, therefore, the legal interest rate found in

6 *Del. C.* §2301 is the appropriate standard to be applied. 6 *Del. C.* §2301(a) provides that "[w]here there is no expressed contractual rate, the legal rate of interest shall be 5% over the Federal Reserve discount rate . . . ." The appropriate interest rate to be applied to American General's damage award is 5% over the Federal Reserve discount rate applicable on May 20, 1987—the date on which its damages and right to prejudgment interest began to accrue.

XV

[21-22] In summary, the breach of American General's contractual right to receive the contingent options occurred on February 6, 1987, the date of the merger, because defendants failed to make American General eligible for the same merger consideration that the employee stockholders were granted. American General's damages should not be measured from the date of the breach, however, because its rights are contractual and the contract upon which they are based provided that it would receive only that which the employees became entitled to receive. The Employee Option was not "issued or payable" until the Texas Air stockholders approved it. American General is, therefore, entitled to a damage award measured from the date on which the Texas Air stockholders approved the Employee Option and thereby made the option issuable or payable—May 20, 1987.

[23] The appropriate measure of American General's damages, therefore, is the difference between: (1) the value of the warrants with the option attached on May 20, 1987; and (2) the value of the warrants without the option on the same date. American General's damages calculated under this formula are $44,804,218.

[24] American General is also entitled to prejudgment interest at a rate of 5% over the Federal Reserve discount rate applicable on May 20, 1987. The prejudgment interest is to be measured from the date on which American General's damages are measured—May 20, 1987.

IT IS SO ORDERED.

AOC LIMITED PARTNERSHIP v. HORSHAM CORP.

No. 12,480

Court of Chancery of the State of Delaware, New Castle

June 17, 1992

Plaintiff, AOC Limited Partnership, on behalf of itself and derivatively on behalf of Clark Oil Refining Corporation alleged that defendants, including Horsham Corporation, a shareholder of Clark Oil, violated a shareholder agreement and breached their fiduciary duties to plaintiff. Specifically, plaintiff alleged that Clark Oil's initial public offering of Clark Oil's shares at fair market value violated a shareholder agreement and that defendants breached their fiduciary duties to plaintiff. Plaintiff claimed that the agreement did not allow defendants to issue Clark Oil shares at fair market value without a supermajority approval.

The court of chancery, per Vice-Chancellor Chandler, entered a judgment for defendants. The court held that the terms of the shareholder agreement clearly and unambiguously provided that Clark Oil may issue shares at fair market value without a supermajority approval, and that plaintiff was unable to rebut the presumption of the business judgment rule to show that defendants breached their fiduciary duties.

1. Corporations ⟹187

In determining the applicability of a provision in a shareholder agreement, the provision must be read in the context of the entire instrument rather than in isolation.

2. Contracts ⟹143.5

One should not interpret a contract so as to render any of its provisions meaningless.

3. Evidence ⟹450(1)

The court cannot consider parol evidence as to the meaning of a clear and unambiguous contract.

4. Reformation of Instruments ⟹45(1)

A contract may be reformed by the court when the contract does not represent the intent of the parties due to fraud, mutual

mistake or, in exceptional cases, a unilateral mistake coupled with the other party's knowing silence.

5. Reformation of Instruments ⟹ 45(1)

In order for the court to reform a contract, the plaintiff must demonstrate fraud, mutual mistake, or unilateral mistake coupled with knowing silence and clear and convincing evidence.

6. Corporations ⟹ 1.5(3)

Where a corporation does not possess another corporation or file a certificate of incorporation for another corporation, they have not acquired or organized a subsidiary which is wholly-owned.

7. Corporations ⟹ 314(1), 320(11)

Plaintiff bears the burden of demonstrating that a director has divided loyalties to the corporation in a breach of fiduciary duty claim under a duty of loyalty inquiry.

8. Corporations ⟹ 314(1), 320(11)

In order for a plaintiff in a breach of fiduciary duty claim under a duty of loyalty inquiry to demonstrate that a director has the necessary divided loyalties, the adverse interest in the transaction must be material; which means that the interest creates a reasonable probability that the independence of the judgment of a reasonable person in such circumstances could be affected to the detriment of the shareholders generally.

9. Corporations ⟹ 314(1), 320(11)

If plaintiff in a breach of fiduciary duty claim under a duty of loyalty inquiry is able to demonstrate divided loyalties, the burden of proof shifts to the director to demonstrate the entire fairness of the transaction.

10. Corporations ⟹ 310(1), 310(2)

In deciding a claim for breach of the fiduciary duty of care, the actions of directors of a corporation are entitled to the presumption

of the business judgment rule, i.e., that they acted on an informed basis, in good faith and in the honest belief that the actions taken were in the best interests of the company.

11. Corporations ⟹ 320(11)

The burden is on the party challenging the board of directors' actions to establish facts which rebut the presumption of the business judgment rule and demonstrate an abuse of discretion in a breach of fiduciary duty claim.

12. Corporations ⟹ 310(1)

Failure of directors to inform other directors adequately may result in a breach of fiduciary duty.

13. Corporations ⟹ 310(1)

Plaintiffs in a breach of fiduciary duty claim must show that director defendants lacked any rational business purpose for their acts.

14. Corporations ⟹ 70

A manipulation of corporate machinery is not present where the offering of shares is permitted by the operative instruments of the corporation and the offering is being undertaken for proper corporate purposes.

15. Corporations ⟹ 310(1)

Where acts related to an offering are in furtherance of proper corporate purposes and are permitted by the operative documents, the value of the work of professionals hired to complete the offering will be considered a waste of assets only if no person of ordinary, sound business judgment would deem it worth what the corporation has paid for those services.

Edward P. Welch, Esquire, Paul L. Regan, Esquire, and Karen L. Valihura, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and Susan Getzendanner, Esquire, Christina

M. Tchen, Esquire, and Hilary K. Krane, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Chicago, Illinois, for plaintiff.

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CHANDLER, *Vice-Chancellor*

Plaintiff, AOC Limited Partnership (the "AOC"), instituted this action on behalf of itself and derivatively on behalf of Clark Oil & Refining Corporation ("Clark Oil") alleging that, in connection with an initial public offering (the "Offering"), defendants had violated and will violate a shareholder agreement (the "Shareholder Agreement") and had breached and will breach their fiduciary duties to plaintiff. Plaintiff named the Horsham Corporation ("Horsham"), AOC Holdings, Inc. ("Holdings"), Clark Oil, Peter Munk, C. William D. Birchall and Jeremy Garbutt as defendants.

This is my decision on plaintiff's claims after an expedited trial on the merits. Part I of my decision provides a brief factual history. Part II analyzes plaintiff's allegations in Count I of its amended complaint. Part III analyzes plaintiff's allegations in Count II of its amended complaint. Finally, part IV contains my conclusions.

I. FACTUAL HISTORY

Holdings is a Delaware corporation. Its principal asset consists of its ownership of all the outstanding shares of common stock of Clark Oil, which is also a Delaware corporation. Clark Oil's principal business activities consist of crude oil refining, wholesale marketing of refined petroleum products and retail marketing of gasoline and other merchandise through gasoline stations and combination mini-mart/gasoline stations.

AOC owns 40% of the outstanding shares of Holdings' common stock. Paul A. Novelly, Samuel K. Goldstein and their children indirectly and wholly own AOC. Messrs. Novelly and Goldstein

serve as members of Holding's Board of Directors and Clark Oil's Board of Directors.

Horsham, a Quebec corporation, owns the remaining 60% of Holdings' outstanding shares. As of December 31, 1991, Peter Munk held approximately 83.1% voting control of Horsham. Mr. Munk is the Chairman of the Board of Horsham, Chairman of the Board and Chief Executive Officer of Clark Oil and Chairman of the Board and Chief Executive Officer of American Barrick Resources Corporation ("American Barrick"), a North American gold mining company in which Horsham owns a 20% interest.

Jeremy Garbutt has served as a member of Clark Oil's Board of Directors since April 1990 and was elected Vice Chairman of its Board on March 3, 1992. Mr. Garbutt previously served as President and Chief Operating Officer of Clark Oil and Horsham at various points in time. Mr. Garbutt also has served previously as Chief Financial Officer and Executive Vice President of Finance of American Barrick.

C. William D. Birchall is a member of the Board of Directors of Clark Oil, Horsham and American Barrick.

As of October 24, 1988, AOC, Horsham, Holdings and Clark Oil, which was formerly known as AOC Acquisition Corporation, entered into the Shareholder Agreement for Holdings. The Shareholder Agreement specifically provides that it remains in effect through October 21, 1998. (Am. Compl. Exh. A, § 8.10.) It also states that Delaware law should govern the Shareholder Agreement in all respects, including validity, interpretation and effect. (*Id.* § 8.6.)

The Shareholder Agreement provides that AOC and Horsham shall have the right to nominate a number of directors to Holdings' Board of Directors in proportion to the number of shares held by each. (*Id.* § 2.1.) The Shareholder Agreement further provides that, while AOC owns not less than 40% of Holdings, Holdings shall have five directors unless AOC agrees otherwise. (*Id.* § 2.2.) The Shareholder Agreement also grants similar rights to AOC and Horsham as to the election and composition of Clark Oil's Board of Directors. (*See id.* §§ 2.5-.6.)

The Shareholder Agreement importantly provides that:

> [t]he Certificate of Incorporation of [Holdings] and its subsidiaries shall be amended to require approval of the holders of ninety percent of each such corporation's shares for each such corporation to perform the following: (a) amend its Certificate of Incorporation, except to create or permit the issuance of additional Shares or other securities as permitted

> by Section 6.1(b); (b) authorize and/or issue additional Shares, any other equity instrument, any debt instrument which contains equity characteristics or any stock options or warrants, except for consideration at their then fair market value, but subject to the pre-emptive rights provided under Section 6.2; (c) liquidate, merge, consolidate, or combine other than a liquidation, merger, consolidation or combination of [Holdings'] subsidiaries into or with [Holdings] or another of [Holdings'] subsidiaries; (d) make a dividend distribution, whether in cash, property or [Holdings'] Shares other than a dividend from [Holdings'] subsidiaries to [Holdings]; (e) purchase a new line of business; (f) sell substantially all of its assets or the stock of any of its subsidiaries; or (g) acquire or organize a subsidiary that will not be wholly-owned. The holders of ninety percent of such subsidiaries' shares shall act at the direction of the holders of ninety percent of [Holdings'] shares.

(*Id.* § 6.1.) Finally, the Shareholder Agreement also provides that the parties will amend Holdings' certificate of incorporation so as to grant Holdings' shareholders preemptive rights to subscribe in any new or increased shares of Holdings' stock. (*Id.* § 6.2.)

As provided under the Shareholder Agreement, AOC thereafter acquired 40% and Horsham thereafter acquired 60% of the issued and outstanding shares of Holdings' common stock. (*Id.* § 1.1-.2.) As further provided under the Shareholder Agreement, Holdings acquired 100% of Clark Oil's shares. (*Id.* § 1.5.)

As of November 1988, the certificates of incorporation of Holdings and Clark Oil were amended purportedly so that they conformed with the Shareholder Agreement's requirements. Specifically, Holdings' charter was amended so as to require the approval of the holders of 90% of Holdings' shares for certain acts. (*Id.* Exh. B, § 11.) Also, Clark Oil's charter was amended so as to require the approval of the holders of 90% of Clark Oil's shares for certain acts. (*Id.* Exh. C, § 11.) Further, Holdings charter was amended so as to provide holders of Holdings' stock with preemptive rights. (*Id.* Exh. B, § 12.)

In early 1992, Clark Oil started planning the Offering. Mr. Novelly learned of the Offering as early as a February 13 lunch with Mr. Munk. In any case, Messrs. Novelly and Goldstein clearly were informed of the Offering on February 20 via a phone call from Mr. Birchall to Mr. Novelly. On the next day, Paul Melnuk, Clark Oil's

President and Chief Operating Officer, sent a memorandum (the "Melnuk Memorandum") to the members of Clark Oil's Board in which he referred to a proposed initial public offering and the "latest" term sheet from Goldman Sachs & Company ("Goldman Sachs"). (*Id.* Exh. D, at 1.) The Melnuk Memorandum also stated that the Board would be holding a meeting on February 24 to consider and approve various measures in conjunction with the Offering.

After Mr. Novelly's counsel, Mr. Ferrazzono, complained of the late notice of the meeting, it was postponed until February 27. Further, Mr. Melnuk met with Mr. Novelly on February 22 at which meeting Mr. Melnuk, for the first time, provided Mr. Novelly with a draft copy of the Form S-1 Registration Statement that the defendants proposed to file with the SEC in connection with the Offering and a copy of Goldman Sachs' presentation on the Offering.

On February 27, Clark Oil's Board held its meeting. During a recess, Messrs. Novelly and Goldstein for the first time received a copy of thirteen pages of proposed resolutions (the "Resolutions") that were designed to explore the implementation of the Offering. Messrs. Novelly and Goldstein thereafter furnished a written statement to the other directors which they requested be attached to the minutes of the meeting. The statement set forth their view as to why the $450 million valuation of Clark Oil by Goldman Sachs was inadequate. Therefore, Messrs. Novelly and Goldstein also noted that they were unwilling to authorize the Offering or to vote to amend Clark Oil's charter to allow the Offering.

On March 3, Clark Oil's Board met again. At this meeting, Mr. Novelly asserted that Clark Oil could not proceed with the Offering without AOC's approval. He also read a letter that he had sent the same day on behalf of AOC to Holdings in which AOC notified Holdings that AOC disapproved of the Offering and instructed Holdings not to vote any shares of Clark Oil owned by Holdings in favor of the Offering, purportedly pursuant to Section 6.1 of the Shareholder Agreement. Subsequently, Clark Oil's Board voted 3-2 in favor of having Clark Oil file its S-1 Registration Statement with the SEC, with Messrs. Munk, Birchall and Garbutt voting for and Messrs. Novelly and Goldstein voting against the resolution. Subsequently, on March 4, 1992, Clark Oil filed its S-1 Registration Statement with the SEC and issued a press release announcing the Offering.

At the Board meeting on March 10, a dispute arose as to what the Board had voted upon at previous meetings. Therefore, the Board voted on, and approved, the Offering, the adoption of the

Resolutions and all prior actions taken by Clark Oil and its representatives in furtherance of the Offering by a 3-2 margin, with Messrs. Munk, Birchall and Garbutt voting for and Messrs. Novelly and Goldstein voting against the items.

II. COUNT I

A. The Meaning of Section 6.1 of the Shareholder Agreement

The Clark Oil charter specifically provides that Clark Oil can issue shares at fair market value. (*Id.* Exh. C, § 11(b).) The parties dispute whether the charter conforms to the requirements of the Shareholder Agreement.

Defendants do not argue that a supermajority vote of Holdings' and Clark Oil's shareholders is necessary under the terms of the Shareholder Agreement in order to accomplish certain acts. Indeed, defendants do not dispute that an offering of Clark Oil's shares is one of those instances. However, defendants contend that the Shareholder Agreement specifically provides an exception for an offering of Clark Oil's shares at fair market value.

Plaintiff does not contend that the Offering of Clark Oil shares will not be at fair market value but, rather, argues that the parties intended the fair market value exception of section 6.1(b) to apply only to an issuance of shares by Holdings. In support of its argument, plaintiff relies on the language of the Shareholder Agreement, parol evidence as to the intent of the parties and the effect that the application of the fair market value exception would have on other facets of the Shareholder Agreement. Therefore, plaintiff argues that I should interpret the terms of the Shareholder Agreement and Clark Oil's charter so as to make the fair market value exception inapplicable to an issuance of shares by Clark Oil.

In analyzing plaintiff's claim, I first look to the explicit language of the Shareholder Agreement. The Shareholder Agreement contains supermajority voting requirements with which Clark Oil and Holdings must comply in order "for each such corporation [(i.e., Holdings and Clark Oil)] to perform the following . . . ." (*Id.* Exh. A, § 6.1.) Specifically, Holdings and Clark Oil must obtain supermajority approval for the issuance of "[Holdings'] Shares, any other equity instrument, any debt instrument which contains equity characteristics or any stock options or warrants." (*Id.* Exh. A, § 6.1(b).) However, the Shareholder Agreement also provides an exception to the requirement of obtaining supermajority approval for the issuance of

equity by stating "except for consideration at their then fair market value." (*Id.*)

The terms of section 6.1 clearly and unambiguously apply to the acts of both Clark Oil and Holdings. Moreover, the phrase "any other equity instrument" clearly includes the shares that Clark Oil wishes to sell in the Offering. Further, the terms of the fair market value exception clearly provide that it applies to all of the securities issued at fair market value for which supermajority approval may be necessary pursuant to section 6.1(b).

Besides the explicit terms of section 6.1(b), the applicability of section 6.1(b) to Clark Oil is logical. That is, as defendants argue, it would be nonsensical to require a two level vote (i.e., on Holdings' level and on Clark Oil's level) as section 6.1 appears to require if section 6.1(b) only applies to Holdings. Accordingly, because of the explicit terms of section 6.1(b), primarily, and the logic of the applicability of section 6.1(b) to Clark Oil, secondarily, I find that the terms of the Shareholder Agreement clearly and unambiguously provide for the applicability of section 6.1(b), including the fair market value exception, to an issuance of shares by Clark Oil.

[1] Although I find that section 6.1(b), including the fair market value exception, clearly and unambiguously apply to the shares to be issued pursuant to the Offering, I must read this provision in the context of the entire instrument, rather than in isolation. *See Wood v. Coastal States Gas Corp.*, Del. Supr., 401 A.2d 932, 937 (1979). As to the other facets of the Shareholder Agreement, my interpretation of section 6.1(b) will not affect section 6.1(a). That is, section 6.1(a) provides that supermajority approval is needed for Clark Oil or Holdings to amend their charters, except to permit the issuance "of [Holdings'] Shares or other securities as permitted by Section 6.1(b)." (Am. Compl. Exh. A, § 6.1(a).) The shares to be issued pursuant to the Offering clearly can fall within the meaning of "other securities as permitted by Section 6.1(b)." Therefore, my interpretation of section 6.1 is entirely consistent with section 6.1(a) and does not render it meaningless. Accordingly, I find that the effect of my interpretation of section 6.1(b) on section 6.1(a) does not persuade me that section 6.1(b) is ambiguous.

As to section 6.1(c), this provision requires supermajority approval of a business combination of Holdings and any of its subsidiaries. The ability of Clark Oil to issue shares to the public, pursuant to the fair market value exception, will cause neither Clark Oil nor any other entity to lose its status as distinct and separate legal entities. Accordingly, I find that the effect of my interpretation