of section 6.1(b) on section 6.1(c) does not persuade me that section 6.1(d) is ambiguous.

As to section 6.1(d), this provision requires that Holdings and Clark Oil cannot make a dividend distribution other than a dividend to Holdings from Clark Oil without complying with the supermajority vote requirement. Clark Oil's ability to issue shares under the fair market value exception does not affect this restriction in any way. That is, it is not necessary that an entity have an unfettered right to distribute dividends in order for the entity to issue shares.[1] Therefore, the effect of my interpretation of section 6.1(b) on section 6.1(d) does not persuade me that section 6.1(b) is ambiguous.

Section 6.1(f) prohibits Holdings and Clark Oil from selling the assets of their subsidiaries or the stock of the subsidiaries without supermajority approval.[2] In this case, Clark Oil is not selling its assets and is not selling the stock of its subsidiaries via the Offering. Holdings also is not selling its assets via the Offering since the amount of its investment in Clark Oil and the amount of Clark Oil's shares it owns will be the same as it is now after the Offering. Further, Holdings is not selling the stock of Clark Oil, its subsidiary. Rather, Clark Oil is issuing its own stock.

In my mind, the purpose of section 6.1(f) is to prevent Holdings from divesting itself of its ownership of Clark Oil. Assuming for the moment that an issuance of shares that represents a large portion of a subsidiary's equity will cause, in substance, a divesting of the parent's ownership of the subsidiary, this is not such a case since the Offering envisions the issuance of Clark Oil shares representing only 25% of its equity. That is, at best, the Offering only will *dilute* Holdings' ownership of Clark Oil by 25%. The Offering will not result in Holdings divesting itself of its ownership of Clark Oil. Accordingly, I find that the effect of my interpretation of section 6.1(b) on section 6.1(f) does not persuade me that section 6.1(b) is ambiguous since section 6.1(f) still has value, albeit the limited value for which the parties bargained, and is not rendered meaningless by my interpretation of section 6.1(b).

As to section 6.1(g), this provision requires Holdings not to acquire or organize a subsidiary that will not be wholly-owned. If

---

1. Indeed, defendants have agreed not to issue dividends on Clark Oil's shares without the consent of plaintiff or 90% of Holdings' shares. (Defs. Pretrial Br. Exh. A, at 1.)

2. I take no position as to whether the phrase "substantially all" applies only to the sale of assets.

Clark Oil is able to issue shares under the fair market value exception after Holdings acquired it as a wholly-owned subsidiary, section 6.1(g) still would afford AOC some rights because it ensures that all of AOC's protections in the Shareholder Agreement apply (e.g., sections 2.5 and 2.6), at least, until the entity is able to put together an issuance of shares pursuant to the fair market value exception. Obviously, the restriction that Holdings only must have subsidiaries that are wholly-owned when the subsidiary is organized or acquired is not as valuable as a requirement that all of Holdings' subsidiaries must be wholly-owned in perpetuity. However, it does have some limited value. Further, this is the value expressly granted to AOC in the Shareholder Agreement. That is, the section 6.1(g) restriction applies only to an act by which a subsidiary will be *acquired* or *organized*. I refuse to expand the protections of this provision just because the bargained for protections apply in very limited circumstances. Therefore, I find that the effect of my interpretation of section 6.1(b) on section 6.1(g) does not persuade me that section 6.1(b) is ambiguous since section 6.1(g) still has value, albeit the limited value for which the parties bargained, and is not rendered meaningless by my interpretation of section 6.1(b).

My interpretation of section 6.1(b) also does not render section 6.2 meaningless. That is, section 6.2 grants Holdings' shareholders a preemptive right to subscribe in any issuance of shares by Holdings. The ability of Clark Oil to issue shares pursuant to the fair market value exception does not render this provision meaningless because an issuance of shares by Clark Oil has a fundamentally different effect on the relevant power structure of AOC and Horsham than an issuance of shares by Holdings. For example, an issuance of shares by Holdings could cause AOC to fall below a 40% interest in Holdings and could cause the five director restrictions of sections 2.2 and 2.6 of the Shareholder Agreement to be deactivated. However, an issuance of shares by Clark Oil does not affect such rights. Thus, although my interpretation of section 6.1(b) causes section 6.2 to be less valuable, it does not render section 6.2 meaningless and, therefore, does not persuade me that section 6.1(b) is ambiguous.

As to the last sentence of section 6.1, I assume for the sake of argument that, as plaintiff argues, the sentence means that Clark Oil's shareholders only can act at the direction of 90% of Holdings' shareholders. The ability of Clark Oil to issue shares pursuant to the fair market value exception does not necessarily render this provision meaningless since Clark Oil could issue nonvoting stock, as is the case in the Offering. Likewise, the ability of Clark Oil to

issue shares pursuant to the fair market value exception does not necessarily affect the restrictions of section 2.5 as to the election of Clark Oil's Board since Clark Oil could issue nonvoting shares, as is the case in the Offering. Accordingly, I find that the effect of my interpretation of section 6.1(b) on section 2.5 and the last sentence of section 6.1 does not persuade me that section 6.1(b) is ambiguous.

I also find that my interpretation of section 6.1(b) will not render section 6.2 meaningless. That is, section 2.6 merely provides that, during the time period that AOC holds 40% of the issued and outstanding shares of Holdings, Clark Oil's Board shall be composed of five directors. Clark Oil's ability to issue shares pursuant to the fair market value exception will not affect this restriction. Indeed, the Offering envisions that the number of Board members will not change. (*See* Defs. Pretrial Br. Exh. A, at 1.) Therefore, I find that the effect of my interpretation of section 6.1(b) on section 2.6 does not persuade me that section 6.1(b) is ambiguous.

[2] In conclusion, it is true that one should not interpret a contract so as to render any of its provisions meaningless. 4 S. Williston, A Treatise on the Law of Contracts § 620, at 748 (3d ed. 1961). However, in this case, my interpretation of section 6.1(b), based on its clear and unambiguous language, may cause other facets of the Shareholder Agreement to be rendered less valuable to AOC, but will not cause them to be meaningless. Therefore, I find that section 6.1(b) is clear and unambiguous on its face and is not rendered ambiguous due to the effect of my interpretation of section 6.1(b) on other facets of the Shareholder Agreement.

[3] Besides plaintiff's arguments as to the meaning of the Shareholder Agreement from its explicit terms, plaintiff also has attempted to persuade me as to the proper interpretation of the Shareholder Agreement by relying on parol evidence. Although *Klair v. Reese*, Del. Supr., 531 A.2d 219 (1987), may appear to be authority for the argument that a decision maker always must consider parol evidence in determining the proper interpretation of a contract, subsequent case law has demonstrated that *Klair* is not so broad and that a decision maker cannot consider parol evidence as to the meaning of a clear and unambiguous contract. *See Pellaton v. Bank of N.Y.*, Del. Supr., 592 A.2d 473, 478 (1991); *City Investing Co. Liquidating Trust v. Continental Casualty Co.*, Del. Ch., C.A. No. 12,146, Chandler, V.C. (Mar. 30, 1992), mem. op. at 20-21. Moreover, even if I considered the parol evidence, it would not change my mind because the extrinsic evidence attempts to turn the clear language of the Shareholder Agreement on its head and I worry that

plaintiff is attempting to produce evidence in an effort to conform the terms of the Shareholder Agreement to its current wishes. *See id.*, mem. op. at 22-23.

B. Reformation

Plaintiff also implicitly requests that if I do not interpret the Shareholder Agreement so that the fair market value exception applies only to Holdings, I reform the Shareholder Agreement so that it limits the applicability of the fair market value exception to Holdings. [4-5] I may reform a contract only 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. *See Collins v. Burke*, Del. Supr., 418 A.2d 999, 1002 (1980). Furthermore, plaintiff must demonstrate this fraud, mutual mistake or unilateral mistake coupled with knowing silence with clear and convincing evidence. *Id.* Plaintiff has not alleged that the operative documents were procured by fraud or that Horsham also believed that the fair market value exception applied to only Holdings. Further, plaintiff has not demonstrated that Horsham knew that AOC had such an interpretation of the applicability of the fair market value exception. Therefore, I refuse to reform the Shareholder Agreement.

C. Other Alleged Violations of the Shareholder Agreement

[6] As should be obvious, I also find that the Offering will not violate other provisions of the Shareholder Agreement. Specifically, I find that the Offering will not violate section 6.1(f) since Clark Oil is issuing the shares rather than Holdings selling its shares. Further, I find that the Offering will not violate section 6.1(g). That is, Holdings will not be acquiring or organizing a subsidiary that is not wholly-owned because the Offering will cause Holdings neither to come into possession of Clark Oil, *see Huddleston v. United States*, 415 U.S. 814, 821 (1974), nor to incorporate a corporation by filing a certificate of incorporation, *see Walsh v. Search Exploration, Inc.*, Del. Ch., C.A. No. 11,673, Allen, C. (Aug. 31, 1990), mem. op. at 5. Therefore, I find that plaintiff is not entitled to relief based on other purported violations of the Shareholder Agreement by the Offering because the Offering will not violate the Shareholder Agreement as plaintiff argues.[3]

---

3. I note that plaintiff has alleged that the Offering would violate the res-

III. FIDUCIARY DUTY CLAIM

Plaintiff also asserts a breach of fiduciary duty claim. Plaintiff argues that, individually and collectively, a number of defendants' acts have constituted a breach of fiduciary duty. Specifically, plaintiff argues that the director defendants have committed a breach of their duty of loyalty. Plaintiff also contends that Messrs. Novelly and Goldstein have been given information in an extremely untimely manner when, in fact, they did get informed of Clark Oil's activities. Moreover, plaintiff contends that the defendants' acts in pursuit of the Offering have violated and will violate the Shareholder Agreement and that these violations constituted gross negligence. Further, plaintiff argues that the Offering is not for a valid corporate purpose. Also, plaintiffs complain that defendants have manipulated corporate machinery. Finally, plaintiff alleges that defendants have committed waste.

Defendants argue that Messrs. Novelly and Goldstein are improperly motivated (i.e., they are not in court because of the purported violation of the Shareholder Agreement but because the Offering could jeopardize their ability to sell their stake in Holdings to International Dunraine Limited at a price per share which is more than the price per share the Offering would yield) while defendants have no personal stake in the outcome. Further, they argue that Messrs. Novelly and Goldstein have been kept adequately informed. Finally, defendants argue that the disputed acts conform to the requirements of the Shareholder Agreement and Clark Oil's and Holdings' charters.

A. The Duty of Loyalty Claim

[7-9] I first analyze plaintiff's breach of fiduciary duties claim under a duty of loyalty inquiry. Under this inquiry, plaintiff bears the

---

trictions as to the number of Clark Oil's Directors (Am. Compl. Exh. A, § 2.6), as to the issuance of shares (*id.* § 6.1(b)), as to Clark Oil's ability to distribute dividends (*id.* § 6.1(d)) and as to the distribution of Clark Oil's shareholders voting power (*id.* § 2.5 and the last sentence of § 6.1). However, this argument is moot because defendants have agreed that, so long, as the Shareholder Agreement is in effect, Clark Oil will not, without the consent of plaintiff (or 90% or Holdings' shares), declare dividends on Clark Oil's shares. (Defs. Pretrial Br. at 1 n.1 and Exh. A.) Moreover, defendants also have represented that Clark Oil has no present intention to pursue the adoption of a management stock option plan or expansion of Clark Oil's Board. (*Id.*) Finally, Clark Oil also has represented that the shares to be issued via the Offering will be nonvoting. (*Id.*)

burden of demonstrating that a director has divided loyalties in a transaction adverse to the corporation. *Cinerama, Inc. v. Technicolor, Inc.*, Del. Ch., C.A. No. 8358, Allen, C. (June 24, 1991), mem. op. at 20-22. However, in order for the plaintiff 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 detrimental of the shareholders generally. *Id.*, memo. op. at 26. If plaintiff is able to demonstrate such divided loyalties, the burden of proof then switches to the director to demonstrate the entire fairness of the transaction. *Id.*, memo. op. at 21.

In this case, plaintiff relies on Horsham's option (the "Option") to purchase some of plaintiff's shares in Holdings[4] at 90% of their fair market value in making its duty of loyalty argument. That is, plaintiff argues that defendants are pursuing the Offering in order to establish a low market price for Clark Oil's shares so as to enable Horsham to buy plaintiff's shares on the cheap.

Plaintiff has failed to present any evidence that the Offering will not realize the fair market value for the shares. Moreover, I am not persuaded that defendants have a material adverse interest in the Offering because the Offering would be an incredibly expensive way (e.g., attorneys' and underwriters' fees are bound to be fairly substantial) of acquiring a portion of Holdings' shares owned by AOC cheaply and because it would be self defeating since Horsham would be diluting its investment in Clark Oil.[5] Therefore, I find that plaintiff has failed to convince me that the Option creates a reasonable probability that the independence of the judgment of a reasonable person could be affected to the detriment of AOC and, therefore, that the entire fairness analysis is applicable to this case.

B. The Duty of Care Claim

[10-11] Since I have found that the director defendants have not violated their duty of loyalty, I turn my analysis to the duty of care

---

4. The option grants Horsham the right to buy the amount of plaintiff's shares in Holdings which would reduce plaintiff's interest in Holdings to 25%.

5. Horsham would be diluting its investment because, under my *rough* calculations, it would be causing Clark Oil to sell 25% of its equity for less than fair market value while gaining the right to obtain only approximately 11.25% ([40% {AOC's ownership of Holdings}—25% {the base to which Horsham can exercise the Option on the Holdings' shares held by AOC}] x 75% [Holdings' ownership of Clark Oil if Clark Oil goes forward with the Offering]) of Clark Oil's equity on the cheap pursuant to the option.

allegations. In deciding a breach of the fiduciary duty of care claim, the actions of directors of a corporation are entitled to the presumption of the business judgment rule 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. *Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 812 (1984). The burden is on the party challenging the board's actions to establish facts which rebut the presumption and demonstrate an abuse of discretion. *Id.*

[12] While it is true that the failure of directors to inform other directors adequately may result in a breach of fiduciary duty, *see Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1283 (1989), plaintiff has failed to persuade me that such is the situation in this case. That is, as Mr. Melnuk testified, the Offering basically was his idea until approximately February 9, 1992, when he conveyed his thoughts regarding the Offering to the Horsham Board and the rest of Horsham's management. It appears from the testimony that Mr. Munk conveyed the possibility of the Offering to Mr. Novelly during a lunch in Paris on February 13 or during a phone call the following day. Further, Mr. Birchall specifically informed Mr. Novelly of the Offering via a phone call on February 20. As appears to be the case throughout the relationship, Mr. Munk's people adequately informed Mr. Novelly's people of the Offering and its terms in a timely manner (e.g., Mr. Munk's people gave Messrs. Novelly and Goldstein a copy of the S-1 Registration Statement prior to giving it to the other Board members and Mr. Melnuk spent three hours with Mr. Novelly on February 22 explaining the Offering). Indeed, the information given to Mr. Novelly was much more than adequate given the preliminary nature of the Board's actions.[6]

As to plaintiff's allegations as to the violations of the Shareholder Agreement, I have held, above, that the Offering, in fact, does not and will not violate this instrument. Therefore, allegations of a breach of fiduciary duty based on these purported violations do not demonstrate gross negligence.

[13] As to plaintiff's claim that the director defendants lacked a proper corporate purpose for the Offering, defendants have persuaded

---

6. That is, as stated by Mr. Munk, the Board was just taking the preliminary steps which were necessary to enable Clark Oil to test the waters of the equity market and determine the price Clark Oil would receive for its shares. Once the price to be received is determined, the Board will vote again to decide whether to actually go through with the Offering.

me via the tape of the February 27 Clark Oil Board meeting, the testimony of Mr. Munk and the testimony of Mr. Melnuk that the reasons for the Offering are that the initial public offering markets are incredibly favorable at this point in time, that the Offering would be very cost effective since Clark Oil has recently audited financial statements and a fairly recent SEC approved prospectus from a bond offering, that Clark Oil needs the extra capital[7] and that the Offering will provide Clark Oil with ready access to the capital markets in the future by rectifying its uneven debt/equity ratio and by establishing itself in the equity market. Therefore, plaintiff certainly has not demonstrated that the director defendants lacked *any* rational business purpose for their acts relating to the Offering. *Sinclair Oil Corp. v. Levien*, Del. Supr., 280 A.2d 717, 720 (1971).

[14] As to plaintiff's allegations regarding the manipulation of corporate machinery, the Offering, as stated above, is permitted by the operative instruments and is being undertaken for proper corporate purposes. Therefore, plaintiff has failed to persuade me that the actions of the director defendants are intended to perpetuate themselves in office and to disenfranchise plaintiff. *Schnell v. Chris-Craft Indus., Inc.*, Del. Supr., 285 A.2d 437 (1971).

[15] Plaintiff's allegations of waste are similarly deficient. Again, the acts related to the Offering are in furtherance of proper corporate purposes and are permitted by the operative documents. Therefore, I find that the work of the professionals hired by Clark Oil to aid in completing the Offering is not so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid. *See In re Rexene Corp. Shareholders Litig.*, Del. Ch., C.A. Nos. 10,897 & 11,300, Berger, V.C. (May 8, 1991), mem. op. at 8; *Grobow v. Perot*, Del. Ch., 526 A.2d 914, 928 (1987).

Ultimately, as to plaintiff's claim as to a breach of fiduciary duty of care, I find that, individually and collectively, plaintiff's allegations have not rebutted the applicability of the presumption of the business judgment rule. Therefore, I must respect the directors' actions with respect to the Offering.

---

7. The parties dispute whether Clark Oil actually needs the extra capital. However, I find that Clark Oil has a need for the extra capital because it can use it to retire its outstanding debt bearing 12 1/4% interest and to ensure that Clark Oil will be able to comply with the ever increasing costs of complying with various environmental regulations.

IV. CONCLUSIONS

I find that the terms of the Shareholder Agreement clearly and unambiguously provide that Clark Oil may issue shares at fair market value without a supermajority approval. Moreover, my conclusion would not change even if I considered parol evidence as to the meaning of the Shareholder Agreement. I also hold that an entire fairness standard does not apply to this case and that plaintiff has failed to rebut the presumption of the business judgment rule. Therefore, I am entering a judgment in favor of defendants as to both Counts of plaintiff's complaint.

IT IS SO ORDERED.

BBC ACQUISITION CORP. v. DURR-FILLAUER MEDICAL, INC.

No. 12,646

Court of Chancery of the State of Delaware, New Castle

August 10, 1992

Plaintiff brought this action to compel inspection of defendant's books, records, and documents pursuant to section 220 of the Delaware General Corporation Law. Defendant corporation entered into an agreement with Cardinal Distribution, Inc., in which Cardinal would acquire defendant. Upon learning of the proposed transaction, Bergen Brunswig Corporation formed plaintiff to act as the corporate vehicle with which Bergen could attempt to acquire defendant. Bergen caused plaintiff to acquire 100 shares of defendant and then, through plaintiff, made a cash offer that was superior to the offer that had been agreed to with Cardinal. After making their initial offer, plaintiff made a formal written demand pursuant to section 220 to inspect defendant's shareholder list and other books and records that had been furnished to Cardinal. Defendant refused to grant plaintiff permission to inspect certain books, records and documents. Further, defendant proceeded to negotiate an improved merger transaction with Cardinal. Plaintiff conceded that Cardinal's offer was superior

to its own, but did not increase its offer price. Plaintiff argued that it should be allowed access to the same nonpublic information that defendant had provided to Cardinal in order to decide whether to increase its offer price.

The court of chancery, per Vice-Chancellor Jacobs, held that plaintiff was not entitled to inspect defendant's corporate records because plaintiff had not established a proper purpose. The court found that plaintiff's purpose in inspecting the nonpublic information was to value the defendant corporation. Using this information, the plaintiff could decide whether or not to increase its offering price. The court held that such a purpose was not reasonably related to the plaintiff's interest as a stockholder of defendant corporation, and was therefore not a proper purpose under section 220.

1. Corporations ⟹ 181(1)

A stockholder is entitled to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder. DEL. CODE ANN. tit. 8, § 220(b) (1991).

2. Corporations ⟹ 181(5)

Where the stockholder seeks to inspect the corporation's books and records other than its stock ledger or stock list, he must first establish (1) that he has complied with provisions of section 220 respecting the form and manner of making demand for inspection of such documents; and (2) that the inspection he seeks is for a proper purpose. DEL. CODE ANN. tit. 8, § 220(c) (1991).

3. Corporations ⟹ 181(5)

In seeking to inspect a corporation's books and records, a shareholder may have more than one purpose; the requirement has been construed to mean that the shareholder's primary purpose must be proper; any secondary purpose, whether proper or not, is irrelevant.

4. Corporations ⟹ 181(2)

Inspection of a corporation's books and records is limited to those documents that are necessary, essential, and sufficient for the shareholder's purpose.

5. Evidence ⟹ 148

So long as other competent evidence is presented to establish that a statutorily proper demand was made, the testimony of the signatory is not a *sine qua non.*

6. Corporations ⟹ 181(1), 181(6)

The shareholder's right of inspection can only be taken away by statutory enactment, and it cannot be abridged or abrogated by an act of the corporation.

7. Corporations ⟹ 181(3)

The fact that a shareholder is a business competitor, without more, does not defeat the statutory right of inspection.

8. Corporations ⟹ 181(1)

Where a shareholder is making a tender offer and the primary purpose for inspecting nonpublic information, which was previously furnished to a competing bidder for the corporation, is to place a value on the corporation to determine if the shareholder should increase its offering price, the purpose is not proper and not reasonably related to the offeror's interest as a shareholder.

9. Corporations ⟹ 181(5)

Valuing the corporation for the sole purpose of acquiring it, unrelated and without regard to the acquiror's particular and preexisting investment in the corporation is not a proper purpose.

Steven J. Rothschild, Esquire, and David J. Margules, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware; and Robert E. Zimet, Esquire, of Skadden, Arps, Slate, Meagher & Flom, New York, New York, for plaintiff.

Jesse A. Finkelstein, Esquire, Anne C. Foster, Esquire, and Michael J. Feinstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; William C. Sterling, Jr., Esquire, Robert B. Mazur, Esquire, Marc Wolinsky, Esquire, and Lyon L. Roth, Esquire, of

Wachtell, Lipton, Rosen & Katz, New York, New York; and Rushton, Stakely, Johnston & Garrett, P.A., Montgomery, Alabama, for defendant.

JACOBS, *Vice-Chancellor*

This is the decision of the Court after trial in an action to compel inspection of corporate books and records pursuant to 8 *Del. C.* § 220. For the reasons discussed below, judgment will be entered in favor of the defendant.

I.

The facts are largely undisputed, but where disputed, they are as found herein. The plaintiff, BBC Acquisition Corporation ("BBC"), is a wholly-owned subsidiary of Bergen Brunswig Corporation ("Bergen"). BBC was formed as the corporate vehicle to implement Bergen's bid to acquire Durr-Fillauer Medical, Inc. ("Durr"), the defendant in this action. Durr had earlier entered into an agreement with another suitor, Cardinal Distribution, Inc. ("Cardinal"), for Cardinal to acquire Durr. The proposed Durr-Cardinal transaction contemplated a spinoff of certain of Durr's product divisions, and a sale of the remainder of Durr to Cardinal in a stock-for-stock merger.

Upon learning of the Cardinal transaction, Bergen, which is in the same business as Durr, decided to launch a competing bid to acquire Durr. Bergen took several steps in preparation. First, it formed BBC[1] and caused BBC to acquire 100 shares of Durr (and Cardinal) stock. Next, Bergen, through BBC, made a cash tender offer for all of Durr's outstanding shares (the "Tender Offer") at $26 per share—a price financially superior to the consideration then being offered by Cardinal. Third, Bergen (and BBC) brought a separate plenary action in this Court, claiming that Durr's board of directors had breached their fiduciary duty by dealing preferentially with Cardinal and by refusing to deal with Bergen, all to the detriment

1. BBC was originally formed under the name "MILN Corporation," which was later changed to "BBC Acquisition Corporation."

of Durr's stockholders.[2] Fourth, Bergen, through BBC, made a formal written demand on July 7, 1992, pursuant to section 220, to inspect Durr's shareholder list and certain of its books and records. Of relevance here is the final category of books and records enumerated in that demand, namely:

> All information pertaining to the Agreement and Plan of Reorganization, dated June 2, 1992 (the "CDI Reorganization Agreement"), between [Durr] and [Cardinal], including, but not limited to, the exhibits and schedules thereto; and all such other books, documents and records of [Durr] which have been furnished to [Cardinal] in connection with the CDI Reorganization Agreement.

BBC's demand letter recited the following purposes:

> to enable [BBC] to communicate with other holders of Common Stock on matters relevant to stockholders, including with respect to (a) the proposed transaction involving [Durr] and [Cardinal] (the "CDI Transaction") publicly announced by [Durr] on June 2, 1992 or alternatives thereto, (b) a possible solicitation of proxies or consents by [BBC] or any of its affiliates in connection with the proposed special meeting of [Durr's] stockholders for the purpose of voting with respect to the CDI Transaction or (c) the [Tender Offer], and [Durr's] response thereto. The purpose is also to enable [BBC] to evaluate its own shares, the Tender Offer and the CDI Transaction.

While it is out of chronological sequence, it is useful at this point to note that Durr never formally responded to BBC's books and records demand or to BBC's reiteration of that demand in subsequent correspondence. On July 16, 1992, nine days later, BBC filed this action. Ultimately, Durr did deliver its stock list and other related materials and certain other documents to BBC. However, Durr has refused to permit BBC to inspect the books, records, and other documents that Durr previously "furnished to [Cardinal] in connection with the CDI Reorganization Agreement," which include

---

2. That plenary action is captioned *Bergen Brunswig Corp. v. Durr-Fillauer Medical, Inc.*, C.A. No. 12,631. In that action, Bergen has requested, *inter alia*, a preliminary injunction and an order directing Durr to produce the same books, records, and other documents that are the subject of this summary proceeding under 8 *Del. C.* § 220.

documents of a highly confidential nature. It is those records that form the crux of this controversy.

After BBC submitted its section 220 demand, Bergen's chairman wrote letters to Durr, reiterating Bergen's desire to negotiate an acquisition and its need for access to the same information Durr had previously supplied to Cardinal. Durr rebuffed Bergen's overtures, and instead proceeded to negotiate an improved merger transaction with Cardinal after Cardinal had advised Durr (in response to BBC's Tender Offer) that it was willing to "sweeten" its proposed offering price.

On July 17, 1992, the day after BBC filed this action, Durr and Cardinal entered into, and publicly announced, a revised merger agreement wherein Durr's stockholders will receive increased consideration in the stock-for-stock merger (assuming they approve it). Although the value of that consideration is disputed, Durr claims that the revised transaction is worth $30.50 per share in Cardinal stock—$55 million more than what BBC is presently offering. BBC concedes that that transaction value, whatever it may be, is superior to its present $26 per share Tender Offer price.

To date, BBC has not increased its offering price. Rather, BBC has taken the position that, to decide whether to increase its bid, it must first be afforded access to the same nonpublic information that Durr earlier provided to Cardinal. That information, BBC claims, is essential to enable it to determine the target company's worth.[3] Since Durr would not voluntarily permit such access, BBC elected to prosecute this section 220 action. Thereafter, the parties engaged in expedited discovery and submitted pretrial briefs, and the matter was tried on August 6, 1992.

---

3. The revised Durr-Cardinal merger agreement contains a provision prohibiting Durr from negotiating with, or furnishing corporation books and records to, a competing bidder such as BBC, *unless* Durr receives a written proposal relating to a competing transaction which, in the written opinion of Durr's counsel, the Durr board is required by principles of fiduciary duty to consider. Durr argues that BBC, by refusing to raise its bid, has refused to take the steps necessary to obtain the requested documents by invoking this "fiduciary out" provision. BBC responds that it has a statutory right to that information that cannot be abridged by private actions or agreements of the corporation. BBC also contends that Durr's position bespeaks hypocrisy, since the original Durr-Cardinal agreement contained a similar provision, yet Durr never even requested its counsel to opine on whether the board had a fiduciary duty to furnish the requested information during the period in which BBC's tender offer price was over 15% higher than the original Durr-Cardinal merger price.

II.

[1] No one disputes the basic legal principles applicable in proceedings under 8 *Del. C.* § 220 to compel corporate books and records other than a corporate stock list or stock ledger. A stockholder is entitled to "inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder . . . ." 8 *Del. C.* § 220(b).

[2-3] Where the stockholder seeks to inspect the corporation's books and records other than its stock ledger or stock list, he must first establish "(1) that he has complied with the provisions of [section 220] respecting the form and manner of making demand for inspection of such documents; and (2) that the inspection he seeks is for a proper purpose." 8 *Del. C.* § 220(c). Thus, when seeking inspection of books and records other than the corporate stock ledger or stock list, a shareholder has the burden of proving that his purpose is proper. Since such a shareholder will often have more than one purpose, that requirement has been construed to mean that the shareholder's *primary* purpose must be proper; any *secondary* purpose, whether proper or not, is irrelevant. *CM & M Group, Inc. v. Carroll*, Del. Supr., 453 A.2d 788, 792 (1982); *Helmsman Management Servs., Inc. v. A & S Consultants, Inc.*, Del. Ch., 525 A.2d 160, 164 (1987).

[4] A petitioning stockholder who has complied with the statute's procedural requirements and who has satisfactorily proved a proper purpose for the requested inspection will have demonstrated his entitlement to inspection. However, that entitlement is not open-ended; it is restricted to inspection of the books and records needed to perform the task. Accordingly, inspection is limited to those documents that are necessary, essential, and sufficient for the shareholders' purpose. *Petition of B & F Towing & Salvage Co.*, Del. Supr., 551 A.2d 45, 51 (1988); *Helmsman Management Servs., Inc.*, 525 A.2d at 167. That limitation on the scope of inspection is a corollary to a broader policy which recognizes that the Court is "empowered to protect the corporation's legitimate interests and to prevent possible abuse of the shareholder's right of inspection by placing such reasonable restrictions and limitations as it deems proper on the exercise of the right." *CM & M Group, Inc.*, 453 A.2d at 793-94, *quoted in B & F Towing*, 551 A.2d at 51 n.7.

This recitation of legal principles sets the stage for the array of defenses that Durr has interposed in support of its denial to BBC

of access to its documents. Durr contends that BBC is not entitled to inspect those documents because: (i) BBC has not established that it has made a proper demand under oath, since it did not produce the signatory of the demand as a deposition or trial witness to testify that he signed the demand in the presence of a notary; (ii) BBC did not establish its status as a stockholder of record, since the certificate for 100 Durr shares was issued to "MILN Corporation," and BBC failed to prove that MILN and BBC are one and the same entity; (iii) BBC has not established a proper stockholder purpose, since BBC's true (and primary) purpose is to determine whether to reprice or restructure the Tender Offer, which purpose is not cognizable under section 220; (iv) insofar as it is claimed that the requested inspection is needed to value BBC's shares, the documents enumerated in the demand are unnecessary for that purpose, since Durr is a public company and publicly-filed information is sufficient; (v) even if BBC were otherwise entitled to inspect those documents, relief should be denied to BBC because it is a direct competitor of Durr, and to permit BBC to inspect highly confidential Durr documents would strategically disadvantage Durr and disserve Durr's best interests; and (vi) in any event, no inspection should be ordered unless and until BBC increases its offering price to a level such as would impose upon Durr's board of directors a fiduciary duty to permit inspection, as the "fiduciary out" clause in the Durr-Cardinal agreement contemplates. (*See supra* note 3, pp. 3-4).

III.

To resolve this controversy, the Court need not address any of Durr's defenses other than its third defense (relating to the propriety of BBC's purpose for seeking inspection). Nonetheless, it addresses those other defenses here both for completeness and to provide such future guidance as might be thought useful. The single defense that is pivotal—the "purpose" defense—is treated in Part IV, *infra*, of this Opinion.

[5] For the following reasons, Durr's first and second defenses are without merit. First, Durr is correct in arguing that in cases where the corporation insists upon strict proof of the petitioning stockholder's compliance with the statutory formalities, it has been customary for the plaintiff shareholder to establish the demand's authenticity by calling as a trial witness the person who executed the demand. However, what may be customary, or even preferable, is not necessarily legally mandated. So long as other competent

evidence is presented to establish that a statutorily proper demand was made, the testimony of the signatory is not a *sine qua non*. In this case, BBC's witness was a BBC corporate officer whose testimony I find credible. That witness testified that he was familiar with and recognized the signature of another BBC officer whose signature appears on the demand. Moreover, insofar as Durr seriously disputes the genuineness of the notarization, BBC's demand is, in this respect, self-authenticating. *See* Rules 901(b)(1) and 902(8) of the Delaware Uniform Rules of Evidence. In addition, after Durr's counsel advanced the argument (apparently for the first time) at trial that BBC was not a stockholder of record, BBC introduced into evidence an officially-filed certificate which established that MILN Corporation had changed its name to BBC Acquisition Corporation.

Equally unpersuasive as bases for barring relief under section 220 are Durr's fourth and sixth defenses. Without question the sought-after documents were needed by Cardinal to determine Durr's value and, as a consequence, the price Cardinal was willing to pay to acquire Durr. At the trial, Durr's president and chief operating officer conceded that Cardinal needed those documents—all non-public—for that purpose. That being the case, Durr cannot credibly argue that those same documents are not necessary for a competitive bidder that is identically situated (BBC), or that BBC must be relegated to inspecting publicly-filed documents when Cardinal was not so limited. Thus, if BBC were found to be otherwise entitled to inspect the requested documents, that defense would pose no obstacle.

[6] Nor, in such event, would Durr fare any better in its argument that inspection should be conditioned upon BBC's compliance with the "fiduciary out" clause of the Durr-Cardinal agreement. The shareholders' right of inspection can only be taken away by statutory enactment. *Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc.*, Del. Supr., 535 A.2d 1357, 1359 (1987). It, therefore, cannot be abridged or abrogated by an act of the corporation. *Id.* (citing *State ex rel. Cochran v. Penn-Beaver Oil Co.*, Del. Supr., 143 A. 257 (1926)). Accordingly, whatever relevance the Durr-Cardinal agreement might have in determining BBC's right to discover that information in the companion plenary action, in this summary proceeding under section 220 (again assuming that BBC were found to have otherwise established its statutory entitlement to inspection) Durr could not be permitted to interpose its agreement with Cardinal to abridge BBC's entitlement.

[7] As for Durr's defense that inspection relief should be denied because BBC is a business competitor, that fact alone, without more,

does not defeat the statutory right of inspection. *E.L. Bruce Co. v. State*, Del. Supr., 144 A.2d 533, 534 (1958); *SafeCard Servs., Inc. v. Credit Card Serv. Corp.*, Del. Ch., C.A. No. 6426, Walsh, V.C., ltr. op. at 7 (Sept. 5, 1984). Moreover, BBC is willing to inspect the documents subject to executing a confidentiality agreement comparable to (and, according to BBC, in some respects more restrictive than) the confidentiality agreement executed by Cardinal, which is also a competitor of Durr in certain markets. Durr asserts, but has not persuasively demonstrated, that a confidentiality agreement will not afford it sufficient protection.

It is not necessary, however, to resolve that dispute at this time, because it relates only to the *scope* of inspection. That issue arises only if the shareholder is first found to be *entitled* to inspection. Because I conclude, for the reasons discussed below, that BBC has not established its entitlement to inspect the Durr documents, and because the confidentiality issue will most likely have to be resolved in the plenary action wherein BBC seeks discovery of those same documents on the basis of fiduciary principles, prudence dictates deferring any ruling on that question until such a ruling becomes appropriate (if at all) in that separate (and quite distinct) proceeding.

IV.

The pivotal question in this case is whether BBC has established a proper purpose. I conclude that it has not.

[8] Although BBC's demand states several purposes, BBC places heaviest (if not exclusive) emphasis upon two of those purposes: (i) to value its own shares of Durr, and (ii) to communicate with other Durr shareholders concerning BBC's Tender Offer or a "possible solicitation of proxies or consents" in connection with a Durr shareholders' meeting proposed to approve the Durr-Cardinal transaction. The evidence overwhelmingly establishes, and I find as fact, that despite the several purposes recited in its demand, BBC has one primary purpose for inspecting the nonpublic information previously furnished to Cardinal: to place a value on Durr so that BBC can consider whether to increase its offering price and, if so, by how much. BBC's other stated purposes, to the extent they have independent reality, are clearly secondary and subordinate. I further conclude, as a matter of law, that in these particular circumstances, BBC's primary purpose is not one "reasonably related to [BBC's] interest as a shareholder" and is, therefore, not a "proper purpose" within the meaning of section 220.

The relevant correspondence introduced at trial, as well as the testimony of BBC's trial witness, made it indisputably clear that BBC needs the requested nonpublic documents to determine what Durr is worth, at least to BBC. Armed with that information, BBC will then be in a position to decide what course of action to take; e.g., increase its Tender Offer; solicit proxies either in conjunction with, or as an alternative to, a revised offer; or abandon the takeover effort altogether.

BBC does not deny these facts. Rather, it attempts to build two arguments around them. BBC's first argument is that each of the purposes enumerated in its demand is an independent, proper purpose of stature equal to the others. BBC's second argument (made in the alternative) is that even if valuing Durr is found to be BBC's primary purpose, it is still "proper" under section 220. That is because (BBC claims) its purpose is to value *BBC's stock interest* in Durr which, as Delaware courts have held, relates to an investor's interest as a shareholder. *See, e.g.*, *CM & M Group, Inc.*, 453 A.2d at 792; *Helmsman Management Servs., Inc.*, 525 A.2d at 165; *Radwick Pty. Ltd. v. Medical Inc.*, Del. Ch., C.A. No. 7610, Berger, V.C., slip op. at 6 (Nov. 7, 1984).

Neither argument, in my view, is meritorious. As earlier noted, the primary purpose of the sought-after inspection is to value Durr. The remaining purposes are simply consequences of that valuation purpose, that is, they relate to possible courses of action that BBC might or might not follow, depending upon the results of that valuation. Those other purposes do not, therefore, stand on the same independent and equal footing as the valuation purpose; they are secondary to it.

Nor does the Court find persuasive BBC's effort to shoehorn its "valuation-of-shares" purpose into a legally-recognized category into which it simply does not fit. BBC owns only 100 shares, for which it paid approximately $2,250. The purpose of BBC's proposed inspection is *not* to place a value on those 100 shares, whose cost is trifling in relation to the cost of this litigation (or to the over $300 million cost of acquiring Durr, at $26 per share). Rather, BBC's purpose is to place a value on Durr itself, and BBC's 100 share interest is irrelevant to that quest except insofar as it provides a legal vehicle which enables BBC to embark upon it.

BBC's nominal stock interest is not what this inspection dispute is about. This is not a case where an investor in a nonpublicly-held corporation needs to inspect corporate books and records to value his investment in order to determine how to protect or preserve it,

viz., whether to sell his shares, buy more shares (or possibly seek control), or take some other course of action. In that circumstance there is reality to a petitioning shareholder's contention that he needs to value his stock interest in the corporation because that interest (however large or small it might be) and its preservation are of real significance to him. In that situation, and in others where that reality drives the valuation purpose, section 220 relief is available to aid shareholders who demonstrate their entitlement to it.

[9] That is not this case. BBC's characterization of its purpose as being one of valuing its interest in Durr obscures what truly is going on here. To repeat, BBC is not seeking to value its 100 shares of Durr, but Durr as a whole. For purposes of section 220, the chasm between those two purposes is fatally unbridgeable: valuing a stockholder's interest in the corporation is a proper purpose. Valuing the corporation for the sole purpose of acquiring it, unrelated and without regard to the acquiror's particular and pre-existing investment in the corporation, is not. In terms of the present case, that latter purpose relates only to BBC's status as a bidder for Durr, not to its status as a Durr stockholder. Section 220 is intended to serve shareholders whose need for inspection is truly related to their stock interest. BBC is not such a stockholder.

* * *

That is not to suggest that given a proper showing, BBC might not be found entitled to inspection relief in its companion plenary action.[4] All I hold is that BBC is not entitled to that relief in a proceeding under 8 *Del. C.* § 220. For these reasons, judgment shall be entered in favor of the defendant and the complaint shall be dismissed. IT IS SO ORDERED.

---

4. Nor should this ruling be read to imply that BBC would not be entitled to inspect Durr's stock list, had that been the issue. BBC's purpose for seeking inspection of the stock list, namely, to communicate with other shareholders concerning its Tender Offer, was quite distinct from its purpose in seeking inspection of Durr's books and records. Clearly that former purpose was a proper one, which presumably was why Durr ultimately supplied the stock list-related information to BBC.

CANAL CAPITAL CORP. v. FRENCH

No. 11,764

Court of Chancery of the State of Delaware, New Castle

July 2, 1992

Plaintiff brought this derivative action charging the defendant directors with various breaches of fiduciary duty. Edelman, one of the defendant directors, and the other defendants entered into, and later failed to cancel, an investment advisory contract with two companies controlled by Edelman. The plaintiff alleged that through these actions the defendants breached their duties of care and loyalty. Defendants moved to dismiss for failure to state a claim and, in the alternative, failure to satisfy the demand requirements of Chancery Court Rule 23.1.

The court of chancery, per Vice-Chancellor Berger, granted defendants' motion. The court found that the corporation could delegate the task of managing the company's investments without relinquishing managerial control and that plaintiff failed to state sufficient facts to substantiate a claim of waste. Further, plaintiff did not allege with particularity why failure to make a pre-suit demand would be excused under Chancery Court Rule 23.1. Considering these factors, the court held that the plaintiff had failed to state a claim for breach of fiduciary duty and dismissed the complaint.

1. Corporations ⟹ 310(1)

A board of directors, which exercises due care, may delegate the task of managing the company's investments without abdicating its managerial responsibilities and fiduciary duties.

2. Corporations ⟹ 312(7)

In order to state a claim for waste, the plaintiff must allege facts, which, if true, indicate that what the corporation received had such little value that a reasonable person of sound business judgement would find it to be worth substantially less than what the corporation paid.

3. Corporations ⟹ 314(2)

A director who is entitled to receive a personal financial gain from the transaction at issue is an interested director for purposes

of the demand analysis if the stockholders will not share equally in the benefit.

4. Corporations ⟹ 314(2)

The fact that one director is interested does not taint the entire board; there must be a reasonable doubt as to the interest or disinterest of a majority of the board. The business judgment rule will protect the board's decision unless a majority of the board was interested or disabled by a lack of independence.

Pamela S. Tikellis, Esquire, James C. Strum, Esquire, and Edward Seglias, Esquire, of Greenfield & Chimicles, Wilmington, Delaware, for plaintiff.

Lawrence C. Ashby, Esquire, and Keith R. Sattesahn, Esquire, of Ashby & Geddes, Wilmington, Delaware; Irwin J. Sugarman, Esquire, Chaye Zuckerman Shapot, Esquire, Howard O. Godnick, Esquire, and Glenn E. Butash, Esquire, of Schulte Roth & Zabel, New York, New York, of counsel, for defendants.

BERGER, *Vice-Chancellor*

Plaintiff, a stockholder of Canal Capital Corporation ("Canal"), brought this derivative action charging the directors of Canal with breach of fiduciary duty. Defendants, in addition to Canal, are the company's eight directors: Raymond French ("French"), Asher B. Edelman ("Edelman"), Gerald N. Agranoff ("Agranoff"), Daniel R. Kail ("Kail"), Burton Lehman ("Lehman"), Clark R. Mandigo ("Mandigo"), Michael E. Schultz ("Schultz") and Dwight D. Sutherland ("Sutherland"). The complaint alleges that Edelman, the beneficial owner of 52% of Canal's stock, and his fellow directors breached their duties of care and loyalty by entering into, and later failing to cancel, investment advisory contracts with two companies controlled by Edelman. This is the decision on defendants' motion to dismiss for failure to state a claim and/or failure to satisfy the demand requirements of Chancery Court Rule 23.1. For the reasons that follow, defendants' motion will be granted.

The facts, as alleged in the complaint, may be summarized as follows: Canal is a Delaware corporation engaged in real estate leasing, securities trading and arbitrage, and antiquities dealing. Edelman, in addition to being Canal's majority stockholder, is Vice

Chairman of the Board. French is Canal's President and Chief Executive Officer, and Kail is the Executive Vice President. All of the remaining directors have ties to Edelman through other businesses and companies he controls. Agranoff is a general partner of Asco Partners and Plaza Securities Company. Edelman is the controlling general partner of both businesses. Lehman, Schultz and Sutherland are directors of Intelogic Trace, Inc. ("Intelogic") and Mandigo, in addition to being a director, is the President and Chief Executive Officer of Intelogic. Edelman controls that company as well. Finally, Mandigo and Sutherland are directors of another corporation controlled by Edelman, Datapoint Corporation ("Datapoint").

As noted at the outset, Edelman controls A. B. Edelman Management Co., Inc. ("Edelman Management") and Arbitrage Securities Company ("Arbitrage"), the two companies retained by Canal to perform investment services. Under the terms of the investment contract between Canal and Edelman Management,[1] complete authority over Canal's investment portfolio is assumed by Edelman Management while the risk of loss remains with Canal. Edelman Management receives 25% of the gains realized on Canal's investments. Canal reserves the right, at its option, to cancel the contract upon notice.

Canal's investment portfolio includes many high risk securities because its trading activities focus on takeover ventures. As a result of Canal's high risk portfolio, the company has suffered significant losses on its investments. For example, in 1989 Canal suffered a net loss of over $2 million on securities transactions. In addition, defendants allegedly attempted to cover up other losses from securities trading by improperly designating the transactions as long-term investments, which are not updated to reflect current market value.

From these facts, plaintiff charges that director defendants breached their fiduciary duties of loyalty and due care. First, the complaint alleges that Edelman benefitted from the investment advisory contract at the expense of Canal's other stockholders. His company, Edelman Management, received excessive advisory fees and, through Edelman Management's control over Canal's investment choices, Edelman was able to advance his personal takeover

1. The current contract is held by Edelman Management. Prior to October 24, 1988, Canal contracted for the same services with Arbitrage. For simplicity, I will refer to only Edelman Management, as the terms of the contracts apparently are the same.

strategy with the help of Canal's funds. Second, defendant directors permitted Canal to invest in high risk securities and failed to cancel the contract with Edelman Management after those risky investments resulted in losses. In so doing, plaintiff claims that defendants breached their duty of care. Finally, without any elaboration or explanation, the complaint alleges that defendant directors mismanaged the company's affairs and wasted its assets.

The duty of care claims, as explained in plaintiff's brief, are based on the general principle of non-delegation. That principle begins with the premise that directors are responsible for managing the business and affairs of the corporation. *Paramount Communications, Inc. v. Time, Inc.*, Del. Supr., 571 A.2d 1140, 1150 (1990) (citing 8 *Del. C.* §141(a)). Here, plaintiff charges that director defendants breached their duty of due care by failing to manage Canal's investment portfolio and, instead, contracting out that responsibility to Edelman Management. Since securities trading composes a substantial part of Canal's business, plaintiff argues that defendant directors must retain control over investment decisions and are liable for their failure to do so.

I find this claim to be without merit. It is settled law that directors may not delegate to others those duties that are "at the heart of the management of the corporation." *Chapin v. Benwood Found., Inc.*, Del. Ch., 402 A.2d 1205, 1210 (1979), *aff'd*, Del. Supr., 415 A.2d 1068 (1980). *See also* Fletcher Cyc. Corp. §496, at 588-89 (perm. ed. 1990); 8 *Del. C.* §141(a). The so-called duty of non-delegation has been addressed under several different factual scenarios. *See, e.g.*, *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 943 (1985) (holding that the duty was not breached where oil company had petroleum engineering firm prepare economic valuations of the company's reserves that would be binding on the company in future merger negotiations and stating that "it is important to note why the delegation was made, and what task was actually delegated"); *Clarke Memorial College v. Monaghan Land Co.*, Del. Ch., 257 A.2d 234 (1969) (finding the duty breached where directors authorized two officers to determine whether sale of substantially all of the corporation's assets should proceed and, if so, upon what terms); *Lehrman v. Cohen*, Del. Supr., 222 A.2d 800 (1966) (delegation of directors' managerial duties, when effected by stockholder action instead of board action, is valid); *Adams v. Clearance Corp.*, Del. Supr., 121 A.2d 302 (1956) (finding no per se breach where board deposited into a voting trust shares of a controlled subsidiary corporation

notwithstanding the fact that the shares were the sole substantial asset of the corporation).

The general principle upon which the rule is based has been stated as follows: "[T]his Court cannot give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on *management matters*." *Chapin*, 402 A.2d at 1211 (quoting *Abercrombie v. Davies*, Del. Ch., 123 A.2d 893, 899 (1956), *rev'd on other grounds*, Del. Supr., 130 A.2d 338 (1957)) (emphasis added). *Abercrombie* involved an "agents' agreement" by which certain stockholder defendants of American Independent Oil Company agreed to relinquish to director defendants the sole and exclusive voting power of the stock covered by the agreement. The votes were always to be exercised as a unit by the agents. If any agent voted against the rest of the group, the agreement provided that the parties would have him removed and replaced. If seven of the eight agents could not agree how to vote the stock, the binding decision of a disinterested arbitrator would determine how the votes were to be cast. The agreement was irrevocable unless at least seven of the agents agreed otherwise.

The Court found that the agreement constituted an illegal restraint on the directors' action in violation of 8 *Del. C.* §141:

> Because it tends to limit in a substantial way the freedom of director decisions on matters of management policy it violates the duty of each director to exercise his own best judgments on matters coming before the board . . . . [A] director-agent might here feel bound to honor a decision rendered under the agreement even though it was contrary to his own best judgment.

Id. at 899. Such an arrangement would "substantially encroach on the duty of directors to exercise independent judgment." *Abercrombie*, 123 A.2d at 900.

[1] Thus, a director breaches his fiduciary duty of due care if he abdicates his managerial duties. The term "management," as used in this context, "relate[s] to supervision, direction and control. [T]he details of the business [may be] delegated to inferior officers, agents and employees." *Cahall v. Lofland*, Del. Ch., 114 A. 224, 229 (1921). In *Rosenblatt*, 493 A.2d at 943, the Delaware Supreme Court recognized that directors' decisions to delegate responsibility are valid exercises of business judgment:

> An informed decision to delegate a task is as much an exercise of business judgment as any other. The realities

> of modern corporate life are such that directors cannot be expected to manage the day-to-day activities of a company. This is recognized by the provisions of 8 *Del. C.* §141(a) that the business and affairs of a Delaware corporation are managed "by or under the direction" of its board. In setting its agenda as to the matters in which it will be directly involved, and those it will delegate, a board's decisions in those areas are entitled to equal consideration as exercises of business judgment. [Citations omitted].

Here, Canal's directors decided that Edelman Management should handle the task of managing the company's investments. They retained ultimate control over Edelman Management in that they were free to cancel the contract at any time. Under these circumstances, assuming that the Canal Board exercised due care in making its decision to enter into the Edelman Management contract, there is no basis for a claim that defendant directors abdicated their managerial responsibilities in violation of their fiduciary duty of due care.

The other due care claim is based upon the failure to cancel the investment advisory contract after Canal incurred losses on its investment portfolio. Plaintiff apparently believes that defendant directors were required to cancel the contract as soon as the company suffered a loss. That is not the law. Directors' business judgment will not be second-guessed by the Court or stockholders who may hold different views as to the appropriateness of continuing an investment advisory contract under the facts alleged here. A loss in one year may be more than offset by gains in other years, and the decision to continue with Edelman Management's investment strategy is appropriately left to Canal's directors.

[2] Plaintiff's waste claim fares no better than his duty of care claim. In order to state a claim for waste, plaintiff must allege facts which, if true, indicate that "what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid." *Saxe v. Brady*, Del. Ch., 184 A.2d 602, 610 (1962). Plaintiff attacks the investment advisory contract as constituting a waste of corporate assets because the 25% fee is excessive and because the benefits of the contract are illusory.

The complaint contains no factual support for the conclusory allegation that the fee is excessive. Moreover, even if a 25% fee is higher than that charged by other firms, it does not necessarily follow that the investment advisory contract constitutes a waste of assets.

The Edelman Management fee would have to be so high relative to fees charged by others that it could not be justified by a rational person. There is simply nothing in this complaint to suggest that such a discrepancy exists.

Plaintiff's theory that the investment advisory contract is illusory is based upon his contention that Canal employees could be performing the same services provided by Edelman Management. To the extent that plaintiff is complaining about Canal's failure to provide these services "in-house," he is merely restating the non-delegation claim already found to be deficient. On the other hand, plaintiff may be arguing that Canal employees are being paid but are performing no services because Edelman Management is doing their job. If this is plaintiff's theory, his complaint contains no facts to support it. Accordingly, the waste claim must be dismissed for failure to state a claim.

The remaining claim, for breach of the duty of loyalty, must be dismissed for failure to comply with the demand requirements of Chancery Court Rule 23.1. Plaintiff alleges that Edelman breached his duty of loyalty by entering into the investment advisory contract in order to benefit himself as the controlling owner of Edelman Management. The contract allegedly benefits Edelman in at least two ways: (1) Edelman's company receives excessive fees for its investment services; and (2) Edelman is able to use Canal's funds to advance his own interest in various takeover ventures. Four other Canal directors—Agranoff, French, Schultz and Sutherland—allegedly breached their duty of loyalty by directly or indirectly participating in or benefitting from Edelman's investment strategies.

While it is not at all clear that the complaint adequately states a claim for breach of the duty of loyalty, if it does, the complaint must also allege with particularity why the failure to make a presuit demand is excused. Chancery Court Rule 23.1; *Levine*, Del. Supr., 591 A.2d 194 (1991). In testing the sufficiency of a complaint for purposes of Rule 23.1, the Court must determine, "(1) whether threshold presumptions of director disinterest or independence are rebutted by well-pleaded facts; and, if not, (2) whether the complaint pleads particularized facts sufficient to create a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment." *Levine*, 591 A.2d at 205. Plaintiff argues that his complaint satisfies either prong of the demand futility test. I disagree.

[3] A director is interested, for purposes of the demand analysis, "whenever divided loyalties are present, or a director either has

received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders." *Pogostin v. Rice*, Del. Supr., 480 A.2d 619, 624 (1984). If the allegations in the complaint are true, there can be little question but that Edelman fits this description. Through Edelman Management he will either receive or be entitled to receive a portion of the 25% fee being paid by Canal.

[4] The fact that one director is interested, however, does not taint the entire board.[2] There must be a reasonable doubt as to the disinterest or independence of a majority of the board. *Aronson v. Lewis*, Del. Supr., 473 A.2d 805 (1984). Plaintiff argues that defendants Mandigo, Kail and French, as employees of Edelman controlled companies, are beholden to Edelman and, therefore, lack independence. According to plaintiff, the same is true for defendants Lehman, Schultz and Sutherland, who are directors of Edelman controlled companies, although not employees of those companies.

Plaintiff relies on *In re NVF Co. Litig.*, Del. Ch., C.A. No. 9050, Chandler, V.C. (Nov. 21, 1989), in arguing that these various relationships establish Edelman's domination and control over a majority of the Canal Board. *NVF* involved the sale of a major corporate asset to Victor Posner, who was the beneficial owner of 38% of NVF stock and was the company's President, CEO and Chairman of the Board. Posner allegedly had a substantial interest in at least fifteen other public corporations and there was a significant overlap in the board membership of NVF and these other businesses. Six board members voted on the challenged transaction. Three were related to Posner and were officers of as many as twelve other Posner companies. A fourth NVF director was an officer of the company and a director of two other Posner companies, and a fifth NVF board member was a director of fourteen other Posner companies. From these facts, the Court concluded that five of the six directors were, in effect, full-time Posner employees and found that their relationships with Posner created a reasonable doubt as to their lack of interest in a transaction benefitting Posner.

The facts in *NVF* are distinguishable from those presented in plaintiff's complaint. Of the eight directors on Canal's Board, only

---

2. The allegation that Agranoff, French, Schultz and Sutherland somehow benefitted from the investment advisory contract is not supported by any particularized facts and, therefore, will not be considered in evaluating the possible interest of board members.

three are employees of the company. The complaint contains conclusory allegations that the remaining five directors have business relationships with other Edelman companies. However, no factual support is provided. For example, Mandigo and three other Canal directors allegedly are directors of Intelogic. The only information provided about Intelogic is that it is a company "controlled by Edelman." Compl., ¶4(j). Such a conclusory statement does not meet the pleading requirements of Chancery Court Rule 23.1. *Heineman v. Datapoint Corp.*, Del. Ch., C.A. No. 8873, Hartnett, V.C. (July 29, 1991), memo. op. at 13. Thus, whereas five of the six directors in *NVF* were found to be full-time Posner employees, here, only three (including Edelman) of eight could be said to be similarly situated.

The next test, under *Levine*, is whether the pleaded facts create a reasonable doubt that the transaction was a valid exercise of business judgment. Since the due care and waste claims have been dismissed, the only question is whether the duty of loyalty claim raises such a reasonable doubt. Based upon the foregoing analysis, I find that it does not. The business judgment rule will protect the board's decision unless a majority of the board was interested or disabled by a lack of independence. Having found that the complaint fails to adequately allege such a taint, it follows that the applicability of the business judgment rule is not in doubt.

Defendants' motions to dismiss are granted. IT IS SO ORDERED.

IN RE CHRYSLER CORP. SHAREHOLDERS LITIGATION

No. 11,873 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

July 27, 1992

A shareholder rights plan was adopted by the board of directors of Chrysler Corporation. The plan allowed shareholders, excluding the acquiror, to purchase Chrysler common stock at a reduced rate once an individual or group of persons acquired thirty percent of

the company's common stock. After the plan's adoption, the board reduced the trigger threshold from thirty percent to twenty percent. Later, the board again amended the plan and further reduced the trigger threshold from twenty percent to ten percent. This action was brought as a class action by shareholders of Chrysler who challenged the final amendment to the rights plan claiming that it was not the product of a valid exercise of business judgment and was taken to entrench the directors in office. The defendants moved to dismiss the amended complaint pursuant to Chancery Court Rules 12(b)(6) and 23.1.

The court of chancery, per Vice-Chancellor Jacobs, held that the plaintiffs' claim for money damages must fail as plaintiffs' failed to plead facts indicating that they had suffered specific economic harm. The court further held that plaintiffs' complaint created reasonable doubt that the directors were motivated solely or primarily by entrenchment concerns therefore ruling they had satisfied the reasonable doubt pleading standard of Rule 23.1 and the less stringent notice pleading standard of Rule 12(b)(6). The court determined that the proper standard to be applied in determining whether due care averments would survive a motion to dismiss was one of gross negligence. In applying this standard the court concluded that the directors' actions were deliberate and amounted to, at best, simple negligence.

1. Corporations ⟹320(12)
   Pleading ⟹16

To recover money damages a plaintiff's allegation must include a showing of specific financial harm. Absent a showing that plaintiff was precluded from entering into a specific transaction, or was denied a tangible opportunity to enter into a specific transaction that would have yielded a financial benefit to him, plaintiff's claim, whether individual or derivative will not be deemed ripe for adjudication and will be dismissed.

2. Corporations ⟹320(2), 320(5)

To excuse the demand requirement for derivative actions, the inquiry is whether the particularized factual allegations of the complaint, taken as true, create a reasonable doubt either that (1) the directors are disinterested and independent, or (2) the challenged transaction was otherwise the product of a valid exercise of business

judgment. If either prong of this test is satisfied, demand is excused and a Rule 23.1 dismissal motion will be denied. DEL. CH. CT. R. 23.1.

3. Corporations ⟹320(2), 320(5)
Pleading ⟹16

Allegations that a shareholder rights plan deters all hostile takeover attempts by limiting the exercise of proxy rights creates reasonable doubts as to entrenchment motivations and satisfies the reasonable doubt pleading standard of Rule 23.1 and the notice pleading standard of Rule 12(b)(6). DEL. CH. CT. R. 23.1, 12(b)(6).

4. Corporations ⟹310(2)
Pleading ⟹9

Legal conclusions without pleaded factual support alleging violations of due care are not sufficient to establish the applicable due care standard of gross negligence and will be dismissed.

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

R. Franklin Balotti, Esquire, Gregory V. Varallo, Esquire, Helen M. Richards, Esquire, and Chris J. Pietrafitta, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendants.

JACOBS, *Vice-Chancellor*

The plaintiffs, who are shareholders of Chrysler Corporation, ("Chrysler"), commenced these class actions against Chrysler and its directors beginning on December 14, 1990. After the actions were consolidated on January 9, 1991, the plaintiffs amended their complaint on March 11, 1991, to include a derivative claim on behalf of Chrysler. On July 25, 1991, the defendants moved to dismiss the amended complaint pursuant to Chancery Court Rules 12(b)(6) and 23.1. The parties briefed that motion and orally argued it on March 17, 1992. This is the Opinion of the Court on the defendants' motion to dismiss the amended complaint.

I.

The following facts, all derived from the amended complaint, are assumed to be true for purposes of this motion. *Grobow v. Perot*, Del. Supr., 529 A.2d 180, 187 (1988).

In February 1988, Chrysler's Board of Directors adopted a Shareholder Rights Plan (the "Rights Plan"). As originally adopted, the Rights Plan provided for the distribution of a dividend of one preferred stock purchase right (a "right") per share of common stock. If any person, or combination of persons, acquired 30% of Chrysler's common stock, the rights would be "triggered," thereby entitling Chrysler's shareholders (excluding the acquiror) to purchase $240 worth of Chrysler common stock for $120.[1] Thus, the rights, if triggered, would cause an immediate and substantial dilution of the acquiror's investment in Chrysler. On September 8, 1989, the board of directors amended the Rights Plan to reduce that trigger threshold from 30% to 20% of Chrysler's outstanding common stock.

Between October 11 and December 7, 1990, Kirk Kerkorian ("Kerkorian"), through Tracinda Corporation, his wholly-owned company, purchased approximately 5% of Chrysler's outstanding common stock. After becoming aware of Kerkorian's stock purchases, defendant Lee Iacocca ("Iacocca"), Chrysler's President and Chairman, met with Kerkorian on December 7, 1990. During that meeting, Iacocca asked Kerkorian to enter into a standstill agreement that would have limited his investment to 5% of Chrysler's outstanding stock, but Kerkorian refused. Instead, between December 7 and December 12, 1990, Kerkorian increased his Chrysler holdings to approximately 9.8% of its outstanding common stock.

In response to Kerkorian's Chrysler stock purchases, Chrysler's Board of Directors held an "emergency session" on December 14, 1990. At that meeting the board adopted several amendments to the Rights Plan, including a second reduction of the trigger threshold, this time from 20% to 10% of Chrysler's outstanding common stock.

Thereafter, Kerkorian took no steps to mount a hostile takeover of Chrysler. Rather, on December 17, 1990, Kerkorian reiterated his position that he was a "passive investor" in Chrysler. He also filed a Schedule 13D with the Securities and Exchange Commission, publicly disclosing his purchase of Chrysler shares, and stating that:

> [t]he acquisition by Tracinda of the Shares is solely for the purpose of investment. The shares were acquired, in part, as a result of the high regard held by Mr. Kerkorian and

1. There is also a "flip-over" provision that permits Chrysler shareholders to purchase shares of an acquiring company at a discount, but that provision is not at issue.

> Tracinda for the Company's Chairman of the Board and Chief Executive Officer Lee A. Iacocca.
>
> . . . .
>
> Except to the extent indicated above, Mr. Kerkorian and Tracinda . . . presently have no plans or proposals which relate to or would result in: (a) the acquisition by any person of additional securities of the Company or the disposition of securities of the Company; (b) an extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the Company or any of its subsidiaries; (c) a sale or transfer of a material amount of assets of the Company or any of its subsidiaries; (d) any change in the present Board of Directors or management of the Company, including any plans or proposals to change the number or term of Directors or to fill any existing vacancies on the Board of Directors; (e) any material change in the present capitalization or dividend policy of the Company; (f) any other material change in the Company's business or corporate structure . . . .

(Am. Comp., ¶24.)

This litigation followed.

II.

The amended complaint contains two counts: (i) individual and class claims and (ii) derivative claims. In both counts the plaintiffs challenge the December 14, 1990 amendments to the Rights Plan (including the reduction of the trigger threshold from 20% to 10%), and claim that those actions were taken to entrench the directors in office, and were not the product of a valid exercise of business judgment. For relief, the plaintiffs seek court-ordered rescission of those December 14, 1990 amendments, as well as money damages.

In support of their entrenchment claims, the plaintiffs argue that the reduction of the Rights Plan trigger impairs a third party's ability to effect a successful tender offer for Chrysler, and the Chrysler shareholders' ability to associate freely with one another to oppose management or influence corporate policy through the proxy process. According to the plaintiffs, the Rights Plan effectively deters Chrysler shareholders, individually or in concert, from increasing their ownership level above 10% of Chrysler's common stock, and thereby severely limits their ability to wage proxy contests. (*See* Am. Comp.,

¶40(a).) In support of their due care claims, the plaintiffs argue that the directors' decision to reduce the Rights Plan trigger was not the product of a valid exercise of business judgment because that decision was unreasonable, hasty, and uninformed.

The defendants argue that the Court should dismiss this action for the following reasons: (i) the individual and class claims cannot stand because the alleged injury is solely derivative in nature; (ii) the plaintiffs lack standing to pursue a derivative claim because they have not excused their failure to make a pre-litigation demand upon the board of directors; (iii) even if the plaintiffs' claim is not solely derivative, their individual and class allegations present no claim upon which relief can be granted; and (iv) in all events, the plaintiffs' individual and class claims are not ripe for adjudication.

For the reasons that follow, I conclude that the motion to dismiss must be granted as to (a) the plaintiffs' claims for money damages, (b) their due care claim, and (c) defendant Greenwald.[2] In all other respects the motion will be denied.

III.

The defendants argue that the individual and class claims must be dismissed because they are not ripe for adjudication. The defendants point out that the plaintiffs do not allege that Kerkorian or anyone else is presently engaged in a proxy contest, or that anyone would have engaged in a proxy contest but for the reduction of the trigger threshold to 10%. Therefore, the defendants argue, any claim that the reduction in the Rights Plan trigger threshold caused individual harm to Chrysler's shareholders is entirely speculative.

[1] Insofar as the defendants equate "individual harm" with monetary damages, I agree. The plaintiffs have pled no facts indicating that the plaintiffs have suffered specific economic harm. Moreover, even if there were a cognizable damage claim, it is not ripe. To cause financial harm to the plaintiffs, the trigger threshold reduction must have precluded a specific transaction, or tangible opportunity for a specific transaction, that would have yielded a financial benefit

2. In their opeining brief, the defendants argue (based upon a supporting affidavit) that this action should be dismissed as to defendant Gerald Greenwald because he resigned from Chrysler's Board before the directors adopted the complained-of amendments to the Rights Plan. (*See* Def. Op. Br. at 2 n.2; Micale Aff., ¶ 2.) The plaintiffs have not challenged this contention in their briefs or at oral argument, nor have they offered any reason why Mr. Greenwald should remain in the case as a defendant. Accordingly, Mr. Greenwald will be dismissed from this action.

to them. As the complaint alleges no such transaction, the plaintiffs' money damage claim (*see* Am. Comp. at 26, ¶(D)), whether individual or derivative, is not ripe for adjudication and must be dismissed. *See Stroud v. Milliken Enterprises, Inc.*, Del. Supr., 552 A.2d 476 (1989); *Schick Inc. v. ACTWU*, Del. Ch., 533 A.2d 1235, 1239 (1987).

By so ruling, I do not intend to suggest that there is no ripe claim for *non-monetary* relief. Clearly ripe is the complaint's claim for rescission of the board's December 14, 1990 amendments to the Rights Plan (including the trigger reduction), even absent an actual or threatened proxy contest. (*See* Am. Comp. at 26, ¶(C).) The plaintiffs may be viewed as complaining of "the [Rights] Plan's *present effect* on their entitlement to receive and consider takeover proposals and to engage in a proxy fight for control of [Chrysler]." *Moran v. Household Int'l, Inc.*, Del. Ch., 490 A.2d 1059, 1072, *aff'd*, Del. Supr., 500 A.2d 1346 (1985) (emphasis added). Thus, the complaint fairly alleges an injury from the December 14, 1990 amendments that has a present and continuing adverse effect upon the shareholders' interests and makes their claim for rescission of those amendments ripe for adjudication.

Consequently, what remains in this case are the plaintiffs' claims for rescission, and what remains to be decided is whether those claims have been pleaded sufficiently to survive a dismissal motion under Rules 12(b)(6) and 23.1. That question is addressed in Part IV, *infra*, of this Opinion (which treats the plaintiffs' entrenchment claims) and Part V, *infra* (which considers the plaintiffs' due care claims).

IV.

The defendants also contend that the plaintiffs' claims are solely derivative in nature (for which reason the individual and class claims must be dismissed), and that the plaintiffs have not excused their failure to make a pre-litigation demand upon the board of directors (for which reason the derivative claims must be dismissed under Rule 23.1).

In response the plaintiffs argue that: (i) the complaint states cognizable individual and class claims; (ii) their derivative claims should not be dismissed because the reduction of the trigger threshold to 10% was a defensive measure requiring the application of the *Unocal* standard, and the defendants have failed to meet the burden imposed on them by that standard;[3] and (iii) even if *Unocal* is not

3. Under the standard set forth in *Unocal Corp. v. Mesa Petroleum Co.*, Del.

the applicable standard, the complaint pleads facts that are sufficient in all events to excuse demand under the traditional, and more rigorous, pleading standards of *Aronson v. Lewis*, Del. Supr., 473 A.2d 805 (1984), and *Pogostin v. Rice*, Del. Supr., 480 A.2d 619 (1984).

The Court need not (and therefore does not) decide whether the plaintiffs' rescission claims are solely derivative,[4] or whether the *Unocal* standard is applicable on a Rule 23.1 dismissal motion. For even if the rescission claims were wholly derivative, I am satisfied that the present complaint meets the more stringent demand excusal pleading requirements established by *Aronson* and *Pogostin*. Therefore, for purposes of deciding the present motion, the Court will assume (but not decide) that the plaintiffs' claims are completely derivative. [2] The Rule 23.1 standard for demand futility is well-settled. The inquiry is whether the particularized factual allegations of the complaint, taken as true, create a reasonable doubt either that: (i) the directors are disinterested and independent; or (ii) the challenged transaction was otherwise the product of a valid exercise of business judgment. *Levine v. Smith*, Del. Supr., 591 A.2d 194, 205 (1991); *Grobow v. Perot*, 539 A.2d 180, 186 (1988); *Pogostin*, 480 A.2d at 624; *Aronson*, 473 A.2d at 814. If the plaintiffs satisfy either prong of that test, demand is excused and the Rule 23.1 dismissal motion will be denied. *Levine*, 591 A.2d at 206. To establish a reasonable doubt as to the first prong of the *Aronson* test, the plaintiffs here must plead particularized facts demonstrating that the directors had either a financial interest or an entrenchment motive in reducing the Rights Plan trigger threshold. *Grobow*, 539 A.2d at 188.

Supr., 493 A.2d 946 (1985), the defendants have the burden of establishing the reasonableness of their response to a threat to corporate policy and effectiveness posed by Kerkorian before they can be cloaked with the presumptions of the business judgment rule. Although the *Unocal* burden is *evidentiary*, the plaintiffs are arguing that it imposes the *pleading* burden on this Rule 23.1 motion to dismiss upon the defendants, contrary to the dictates of *Aronson v. Lewis*, Del. Supr., 473 A.2d 805 (1984), which imposes the pleading burden upon the plaintiffs.

4. "[C]laims of entrenchment may be either individual or derivative or both depending on the circumstances. An entrenchment claim will be an individual claim when the shareholder alleges that the entrenching activity directly impairs some right she possesses as a shareholder, such as the right to vote her shares." *Avacus Partners, L.P. v. Brian*, Del. Ch., C.A. No. 11,001, Allen, C., mem. op. at 13 (Oct. 24, 1990) (footnote omitted) (citing *Lipton v. News Int'l, PLC*, Del. Supr., 514 A.2d 1075, 1078-79 (1986), and *Williams v. Geier*, Del. Ch., C.A. No. 8456, Berger, V.C. (May 20, 1987)).

The plaintiffs maintain that the factual allegations of their complaint create a reasonable doubt that the directors, in deciding to reduce the Rights Plan trigger, were motivated to entrench themselves in office. The appropriate analysis for claims of that kind is articulated in *Pogostin* as follows: "Where . . . allegations detail the manipulation of corporate machinery by directors for the sole or primary purpose of perpetuating themselves in office, the test of *Aronson* is met and demand is excused." 480 A.2d at 627. Because the complaint must create a reasonable doubt that entrenchment was the directors' "sole or primary purpose," demand is not excused if from the complaint it appears that the challenged action "could, at least as easily, serve a valid corporate purpose as an improper purpose, such as entrenchment." *Cottle v. Standard Brands Paint Co.*, Del. Ch., C.A. No. 9342, Berger, V.C., mem. op. at 20 (Mar. 22, 1990).

I am persuaded that the present complaint creates a reasonable doubt that the directors were motivated solely or primarily by entrenchment concerns. (*See* Am. Comp., ¶4.) In *Moran v. Household Int'l, Inc.*, Del. Ch., 490 A.2d 1059, *aff'd*, Del. Supr., 500 A.2d 1346 (1985), then-Vice Chancellor (now Justice) Walsh held that the following pleaded facts created a reasonable doubt as to entrenchment motivation:

> [T]he plaintiffs' complaints, which set forth particularized facts alleging that the Rights Plan deter *all* hostile takeover attempts through its limitation on alienability of shares and the exercise of proxy rights, sufficiently pleads a primary purpose to retain control, and thus casts a reasonable doubt as to the disinterestedness and independence of the board at this stage of the proceedings.

Id. at 1071.

This case is analogous to *Moran*, in that the complaint here similarly alleges that the Rights Plan deters all hostile takeover attempts by limiting the exercise of proxy rights. Specifically, the plaintiffs allege that:

> [a]mong other things, the amendments *significantly impair and hinder a third party's ability to effectuate a successful tender offer for the Company* by substantially reducing the number of shares which can be acquired prior to triggering the Rights. The amendments further impair the ability of Chrysler shareholders to oppose management or otherwise influence corporate policy by preventing shareholders from

> owning individually or collectively more than 10% of Chrysler's common stock *thereby limiting concerted action through proxy contests or contests for control.*

(Am. Comp., ¶40(a) (emphasis added).)[5]

The allegation that the trigger threshold reduction limits the exercise of proxy rights is enhanced by the pleaded fact that the Rights Plan will be triggered even if a group or combination of shareholders (as distinguished from a single shareholder) collectively crossed the 10% threshold. (*See id.*) These pleaded facts, when combined with the allegations that (i) the board reduced the Rights Plan trigger in direct response to Kerkorian's purchase of Chrysler shares, and that (ii) Kerkorian was a "passive investor" who constituted no threat to Chrysler or its shareholders[6] (*see id.* ¶¶3, 20; Def. Rep. Br. at 7), create, in my view, a reasonable doubt that the board took this action solely or primarily for entrenchment purposes. Those pleaded facts also rebut the defendants' assertion that the directors' defensive response is as easily explained by a valid corporate purpose (to protect shareholders from the perceived deleterious threat of a takeover by Kerkorian) as by an improper motive (entrenchment). [3] I hasten to add that I have not concluded, and intimate any view, that the Chrysler directors were, in fact, so motivated or that the plaintiffs will be able to prove their entrenchment claims. The Court concludes only that the complaint pleads particularized facts

---

5. This case differs from *Moran* in that there the plaintiffs claimed that the rights plan deterred all hostile takeover attempts by reason of two mechanisms: the limitation on the exercise of proxy rights *and* the limitation on the alienability of shares. Here, the plaintiffs also allege that the Rights Plan deters all hostile takeover attempts, but only through the mechanism of limiting the exercise of proxy rights. Conceptually speaking, I do not regard this distinction as critical, because as I read *Moran*, what was important was not the specific quantity of deterrent mechanisms employed, but that the plaintiffs alleged with particularity that the Rights Plan deterred all hostile takeovers.

6. Kerkorian's Schedule 13D statement disclosing his "passive" investment in Chrysler was admittedly filed after the board adopted the December 14, 1990 Rights Plan amendments. However, it is inferable from the complaint that Kerkorian had made his intentions known beforehand: the complaint alleges that "[i]n connection with [his] purchases [of Chrysler shares], Kerkorian described himself as a 'passive investor' [and] despite [his] stated passivity [the board adopted the December 14, 1990 amendments]." (Am. Comp., ¶¶ 2, 3.) The plaintiffs also allege that "[i]n conjunction with the 13D filing, Kerkorian *reiterated* that he intended to be a 'passive investor' in Chrysler . . . ." (*Id.* ¶ 25 (emphasis added).) If Kerkorian was "reiterating" that position, it is inferable that he made his intentions known before the board decided to act. Whether that inference can be established by persuasive evidence is a separate issue that must await a later stage and another day.

that create a reasonable doubt as to whether the directors were disinterested when they adopted the December 14, 1990 Rights Plan amendments. Finally, because the Court has found that the plaintiffs' entrenchment claims satisfy the more stringent Rule 23.1 (reasonable doubt) pleading standard, those claims are, *a fortiori*, also sufficient under the more liberal Rule 12(b)(6) (notice pleading) standard. *Chrysogelos v. London*, Del. Ch., C.A. No. 11,910, Jacobs, V.C., memo. op. at 15-16 (Mar. 25, 1992).

V.

Although the plaintiffs' entrenchment allegations are found sufficient to survive the pending dismissal motion, their due care averments are not. Those latter allegations appear in the following single paragraph of the 26-page complaint:

> In addition to being self-interested, the Individual Defendants—in taking the actions described above—fundamentally failed to exercise sound and proper business judgment. These defendants, *inter alia*, acted unreasonably and improperly in precipitously adopting the Challenged Amendments given that Chrysler already possesses an entire panapoly [sic] of standard anti-takeover defenses which are more than sufficient to repel any viable threat to the corporation and its constituencies, and further given that Kerkorian poses no genuine threat to the Company or its shareholders. The Individual Defendants further acted with undue haste and were uninformed in connection with their implementation of the Challenged Amendments.

(Am. Comp., ¶40(d).)

[4] These averments fail to state a claim upon which relief can be granted, for several reasons. Essentially, the allegations are legal conclusions without pleaded factual support. *Weinberger v. UOP, Inc.*, Del. Ch., 409 A.2d 1262, 1264 (1979) ("[A] motion [to dismiss] does not concede pleaded conclusions of law or fact where there are no allegations of specific fact that would support such conclusions."). Here, the facts that are pleaded would tend to establish that the directors' actions were deliberate, not the product of gross negligence. Moreover, those legal conclusions are insufficient on their face: they amount at best to simple negligence, but do not state a claim for

gross negligence, which is the applicable due care standard.[7] *Aronson*, 473 A.2d at 812.

* * *

For the above reasons, the amended complaint shall be dismissed (a) insofar as it alleges claims for relief other than rescission, (b) insofar as it alleges claims that the directors acted without appropriate due care, and (c) in its entirety as to defendant Greenwald. In all other respects the motion to dismiss is denied. Counsel for the parties shall submit an appropriate form of order implementing the rulings herein.

FELDBAUM v. McCRORY CORP.

No. 11,866

UNITED APPLE SALES INC. PROFIT SHARING TRUST v. E-II HOLDINGS INC.

No. 11,920

IN RE McCRORY PARENT CORP.

No. 12,006 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

June 1, 1992

Plaintiffs, holders of public debt instruments, filed suit against the defendants for breach of the indentures' implied covenants of

---

7. Since the due care claim is legally insufficient under Rule 12(b)(6), it faiils, *a fortiori*, to satisfy the more stringent reasonable doubt pleading standard applicable to Rule 23.1 dismissal motions. The due care allegations, apart from being legally insufficient on their face, are contradicted by the plaintiffs' inconsistent allegations that the directors were purposefully acting to perpetuate themselves in office. The true thrust of the complaint is that the directors acted deliberately and with an improper motive, as opposed to acting negligently and without adequate information as to the consequences of their actions. That inconsistency is fatal, becaue the due care allegations are not pleaded as an alternative claim, but, rather, are "[i]n addition to" the entrenchment claims. (Am. Comp., ¶ 40(d).)

good faith and fair dealing, for fraudulent conveyances, and for common law fraud. This action arose out of a three step corporate restructuring transaction, in which the defendants allegedly increased the risk of defaults on their outstanding bonds and caused default on certain principal and interest payments. The defendants, in turn, filed motions seeking dismissal on the grounds of lack of subject matter jurisdiction, *forum non conveniens*, and failure to state claims on which relief could be granted.

The court of chancery, per Chancellor Allen, denied the defendants' motions to dismiss for lack of subject matter jurisdiction and *forum non conveniens*, but dismissed all but two of the claims on the grounds of failure to state claims on which relief could be granted. The court held that the inclusion of the no-action clause within the plaintiffs' indentures effectively barred the plaintiffs' fraudulent conveyance, implied warranty, and common law fraud claims. The court further held that the plaintiffs' claims based on explicit breaches were stayed by the ongoing bankruptcy proceedings.

1. Equity ⟹ 43

The court of chancery has subject matter jurisdiction whenever the remedies at law would not be fully adequate.

2. Courts ⟹ 28

A defendant seeking a dismissal or stay on *forum non conveniens* grounds must accordingly meet a high burden which shows both hardship and inconvenience.

3. Corporations ⟹ 554

Absent an allegation of fraud in the inducement of the purchase, no-action clauses generally foreclose bondholder suits under the indenture, where plaintiff has not complied.

4. Corporations ⟹ 554

If the trustee is capable of satisfying its obligations, then any claim other than a one which seeks recovery for past due interest is subject to the terms of a no-action clause.

5. Corporations ⟹473

Courts will not apply the no-action clauses in cases where the trustee is guilty of misconduct.

6. Corporations ⟹473

Bondholder waivers apply equally to claims against non-issuing defendants.

7. Corporations ⟹473

No-action clauses bar plaintiffs' fraudulent conveyance claims, as the clause in question bars all action with respect to the indenture of securities.

8. Corporations ⟹473

No-action clauses bar plaintiffs' claims of breaches of implied covenants of good faith and fair dealing, as the trustee can and should enforce these covenants.

9. Fraud ⟹120

No-action clauses do not bar a plaintiff who alleges that she was fraudulently induced to purchase bonds.

10. Fraud ⟹41

As the fraud alleged in the case at bar has nothing to do with the purchase or sale of the bonds by the defendant, the no-action clause bars the plaintiffs' right to sue.

11. Fraud ⟹41

In order to transmute a breach of contract claim into a claim of fraud, a plaintiff must allege and prove that false statements were made with an intention that plaintiff rely on them.

12. Corporations ⟹473

Claims for anticipatory repudiation and past due interest and principal are stayed if they arise before the commencement of bank-

ruptcy proceedings and are asserted against the bankrupt debtor. 11 U.S.C. § 362(a)(1) (1992).

Pamela Tikellis, Esquire, Carolyn D. Mack, Esquire, and James C. Strum, Esquire, of Greenfield & Chimicles, Wilmington, Delaware; Melvyn I. Weiss, Esquire, Steven G. Schulman, Esquire, and Lee S. Shalor, Esquire, of Milberg Weiss Bershad Specthrie & Lerach, New York, New York, of counsel; Joseph A. Rosenthal, Esquire, of Rosenthal, Monhait & Gross, P.A., Wilmington, Delaware; and Christopher Lovell, Esquire, New York, New York, for plaintiffs in C.A. No. 11,920.

Wayne N. Elliott, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; Stuart Savett, Esquire, of Kohn, Savett, Klein & Graf, P.C., Philadelphia, Pennsylvania, of counsel; Mordecai Rosenfeld, Esquire, New York, New York; Heiman, Aber & Goldlust, Wilmington, Delaware; Meredith & Cohen, Philadelphia, Pennsylvania; and Levin, Fishbein, Sedran & Berman, Philadelphia, Pennsylvania, for plaintiffs in C.A. No. 12,006.

Thomas G. Hughes, Esquire, and Brian P. Glancy, Esquire, of Schlusser, Reiver, Hughes & Sisk, Wilmington, Delaware; and Gary K. Feldbaum, Esquire, Philadelphia, Pennsylvania, for plaintiff in C.A. No. 11,866.

Charles F. Richards, Jr., Esquire, William F. Mongan, Esquire, and Ann C. Foster, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Joseph T. Baio, Esquire, and William J. Borner, Esquire, of Willkie Farr & Gallagher, New York, New York, of counsel, for defendants E-II Holdings, Inc. and McGregor Acquisition Corporation.

Martin P. Tully, Esquire, and Jon E. Abramczyk, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; Gerald Harris, Esquire, Martin J. Schwartz, Esquire, Paul H. Aloe, Esquire, and Jennifer Rothschild, Esquire, of Rubin Baum Levin Constant & Friedman, New York, New York, of counsel, for defendants McCrory Parent Corporation, McCrory Corporation, Meshulam Riklis, Riklis Family Corporation, McGregor Holding Corporation, World Wide Financial Partnership L.P., and Riklis Holding Corporation.

ALLEN, *Chancellor*

This opinion disposes of pending motions in three consolidated class action suits.

I. The Parties

Each suit is brought by a different plaintiff, and each plaintiff purports to represent holders of different debtor defendant's public debt instruments. There are three such debtor defendants: E-II Holdings Inc. ("E-II"), McCrory Parent Corporation ("MPC"), and McCrory Corporation ("McCrory"). This opinion refers to E-II, MPC, and McCrory collectively as the "debtor defendants" and to the plaintiffs in each suit respectively as the "E-II plaintiffs," the "MPC plaintiffs," and the "McCrory plaintiffs."

The financier Meshulam Riklis owns and controls each of the debtor defendants and is named as a defendant. Also named as defendants are other Riklis-controlled entities.

Prior to the corporate restructuring that is most centrally involved in this litigation, the relationship among the debtor defendants was as follows: E-II was a holding company, an important asset of which was its 100% ownership of MPC. MPC was, in turn, a holding company owning 100% of the voting stock of McCrory. McCrory was (and is) an operating company that owns a nationwide chain of retail variety stores.

According to plaintiffs, these corporate relationships came about as follows: In 1989, E-II acquired MPC and, with its, MPC's subsidiary, McCrory, from Riklis Family Holding Company, E-II's own indirect parent. As part of this transaction, E-II committed itself to finance McCrory's capital requirements until January 1, 1991. Specifically, it agreed to lend McCrory up to $60 million per year. Although the plaintiff classes disagree as to the extent of McCrory's resulting debt to E-II, they do not dispute that McCrory was later substantially indebted to E-II.[1]

II. The Challenged Transactions

Although the wrongs complained of differ, in some respects, among the three suits, and, in at least one instance, are inconsistent

1. E-II plaintiffs allege that, on December 6, 1990, following an earlier restructuring, E-II's financial support for McCrory totalled $372 million. This included some preferred stock.

with each other, each suit challenges the same series of transactions. That is, each suit challenges a three-step, December 1990 corporate structuring which, plaintiffs say, Riklis instigated for the sole purpose of distancing various bondholders from McCrory so that its cash flow and assets could be preserved rather than used to repay the various debtor defendants' notes and debentures.

The challenged restructuring involved (1) E-II's transferring its interest in MPC and, with it, McCrory and (2) MPC's transferring its interest in McCrory. According to plaintiffs, it happened in the following manner: First, at Riklis's direction, MPC authorized amendment of the McCrory certificate of incorporation to permit the issuance of a new series of McCrory common shares. Second, in exchange for forgiveness of E-II's outstanding advances (*see supra* note 1) and cancellation of preferred stock with a face value of $204 million, McCrory issued to E-II 10,000 shares of common stock, including the newly authorized ones, carrying 90% of the voting power of the company. McCrory also issued to E-II 1,000 shares of newly-created McCrory subordinated junior preference shares with an aggregate liquidation preference of $100 million and a senior, non-interest bearing, allegedly secured promissory note in the amount of $22.35 million. Finally, upon receipt of the 90% interest in McCrory, E-II immediately resold it to a new Nevada corporation set up by Riklis solely for this transaction and referred to as Riklis Holding Corporation ("Riklis Holding"). In exchange, Riklis Holding gave E-II a $250 million, non-interest bearing, non-recourse, unsecured promissory note, payable upon certain conditions allegedly in the control of Riklis Holding. At the same time the McCrory sale took place, E-II also sold to Riklis Holding for nominal consideration its 100% interest in MPC.

When the dust had settled, the restructuring transactions had had the following impacts:

(1) McCrory had issued a controlling interest in new stock and $22.35 million in new "senior" debt, in exchange for the cancellation of existing debts and had replaced its existing preferred stock with another issue having a reduced liquidation preference;

(2) MPC had given up control of, and thus access to, McCrory's cash flow and assets (although it retained a 10% interest), in consideration of its 10% share of whatever benefit McCrory may have reaped in its debt-for-equity swap with E-II; and

(3) E-II had given up (a) its interest in MPC, (b) its indirect control of—and access to—McCrory's cash flow and assets (i.e., through MPC) and (c) its direct loans to McCrory, all in exchange for unsecured, non-recourse loans to a newly formed holding company, over which it has no control.

Plaintiffs allege that the December 1990 transactions increased the risk of default on the outstanding bonds of each of the debtor defendants and constituted fraudulent conveyances. The MPC plaintiffs also allege that MPC, in fact, has defaulted on certain principal and interest payments. Both E-II and MPC are now in bankruptcy proceedings; thus suits against those issuers of the bonds have been automatically stayed.

III. The Plaintiffs' Claims

A. *Contract Claims*

The plaintiffs challenge the December 1990 transactions with an array of theories. First, they assert contract claims, i.e., that the debtor defendants—with the help, or at the direction, of other defendants—breached each of the indentures.

Specifically, the E-II bondholders allege that E-II violated its indentures' implied covenants of good faith and fair dealing (1) by extending loans to McCrory in the amounts that it lent; (2) by selling MPC and McCrory to Riklis Holding for inadequate consideration; and (3) by engaging in a number of other unrelated transactions with Riklis companies and third parties which involved E-II's receipt of inadequate consideration or assumption of unwarranted risk.

The MPC bondholders allege that MPC (1) breached explicit indenture provisions by failing to make certain interest and principal payments and (2) repudiated the indentures by announcing a suspension of future interest payments. They also allege (3) that MPC breached implied covenants of good faith and fair dealing by, *inter alia*, facilitating the December 1990 transactions, while knowing that the transactions would result in its defaulting on its own obligations and would accomplish surreptitiously an end prohibited by its own indentures, namely the transfer of an asset, ownership of McCrory, to its parent, E-II.

The McCrory plaintiffs assert only one contract claim: a breach of the implied covenant of good faith and fair dealing. Specifically, plaintiffs contend that McCrory breached that covenant by issuing a controlling, 90% interest in itself to E-II, while knowing that E-

II would sell that interest to Riklis Holding. According to plaintiffs, in knowingly permitting such a sale, McCrory knowingly allowed itself to be delivered up to an entity (Riklis Holding) that can be expected to plunder it. Plaintiffs, however, allege no transfers from McCrory to Riklis Holding or another affiliate, since the date of that transaction, that would render McCrory less able to pay the principal and interest on its bonds.

B. *Fraudulent Conveyance Claims*

In addition to the contract claims, plaintiffs in two of the suits assert fraudulent conveyance claims which, in my opinion, are governed by New York law. *See New York Debtor and Creditor Law* § 270 *et seq.* (McKinney 1990). The E-II plaintiffs assert that the following constituted fraudulent conveyances: (1) the December 1990 exchange with McCrory of McCrory loans for McCrory equity; (2) E-II's sale of MPC and McCrory to Riklis Holding; and (3) a series of transactions pre-dating the December 1990 transactions.

The MPC plaintiffs assert that MPC fraudulently conveyed its controlling stake in McCrory to E-II, when it authorized new McCrory shares, thereby allowing McCrory to give E-II 90% ownership.

The McCrory defendants assert no fraudulent conveyance claims.

C. *Common Law Fraud Claims*

Finally, plaintiffs in two of the suits assert common law fraud claims. The MPC bondholders allege that MPC materially misled its public debt holders when it stated (long after the completed underwriting of plaintiffs' bonds) that the December restructuring did not violate any of its indentures and when it failed to state that the restructuring would increase the riskiness of the debentures, result in a lowering of their credit rating and lead to MPC's failure to repay them.

The McCrory plaintiffs allege generally that McCrory had a common law duty to, but did not, disclose material information that would have allowed them to evaluate realistically the risks presented by the transaction. It is not alleged that any bondholders had a right to vote on any aspect of the transaction.

IV. Disposition of Defendants' Motions

Defendants in each of the suits have filed motions to dismiss.[2] These motions are premised on a variety of grounds: (1) lack of

2. On motion of defendants in each action discovery in these cases has been stayed pending resolution of their motions to dismiss.

subject matter jurisdiction as to all the claims; (2) *forum non conveniens*; (3) lack of personal jurisdiction as to Meshulam Riklis and Riklis Holding; and (4) failure to state claims upon which relief can be granted. Defendants also have filed motions to stay all claims in each of the three suits because of the pending bankruptcy proceedings against MPC and McCrory.

For the reasons provided below, I conclude that this court has subject matter jurisdiction over all the claims and that this case need not be dismissed on *forum non conveniens* grounds. I nonetheless do dismiss, with respect to all defendants, each of plaintiffs' claims except two. The two that are not dismissed are, however, stayed because of MPC's pending bankruptcy proceeding.

Each of the claims dismissed at this time is dismissed either because it is barred by no-action clauses[3] appearing in the indentures or because, although it escapes the barring effect of such clauses, it nonetheless fails to state a legal wrong.[4]

As all the claims are either dismissed or stayed, I need not address the question whether the court has personal jurisdiction over Riklis and Riklis Holding. Nor, of course, need I address the question whether the claims that are dismissed might otherwise have been stayed by the pending bankruptcy proceedings against MPC and McCrory. *Compare Hart Holding Co. v. Drexel Burnham Lambert, Inc.*, Del. Ch., C.A. No. 11,514, Allen, C. (Nov. 7, 1991).

A. *Subject Matter Jurisdiction*

[1] Defendants contend that this court has no subject matter jurisdiction to adjudicate these consolidated suits.[5] I cannot agree. The Court of Chancery has subject matter jurisdiction whenever the remedies available at law would not be fully adequate. *International Business Mach. Corp. v. Comdisco, Inc.*, Del. Ch., 602 A.2d 74, 78

---

3. As explained below, four claims escape the barring effect of the no-action clauses. They are two fraud claims, one in the MPC action and one in the McCrory action, and two contract claims, both in the PC action, one for principal and interest and the other for anticipatory repudiation.

4. The claims that both escape the barring effect of the no-action clauses and do state claims upon which relief may be granted, but which are nevertheless stayed are the two common law fraud claims: one in the MPC action and the other in the McCrory action.

5. All defendants make this point with respect to the E-II action. E-II is the only defendant to make the point with respect to the MPC action. And only E-II and McGregor Acquisition Corporation make it in the McCrory action.

(1991). Such is the case here. Plaintiffs seek rescission of the December 1990 restructuring and other transactions and a return of the parties to the *status quo ante*. This would involve, among other things, cancellation of instruments in order to reverse the issuance of stock and debt. Such relief is unavailable in a court of law.

B. *Forum Non Conveniens*

[2] Defendants in all three suits argue that the claims pending against them here should be dismissed on *forum non conveniens* grounds. They say the better forum is provided by New York.[6]

Under our law, suits must ordinarily proceed in the court in which they are first commenced, notwithstanding the existence of an arguably more convenient forum elsewhere. This approach reflects the view that the inefficiency inherent in any change in forum is warranted only when (1) litigating in the existing forum would impose hardship upon defendant and (2) an alternative forum would be substantially more convenient. A defendant seeking a dismissal or stay on *forum non conveniens* grounds must accordingly meet a high burden which incorporates each of these two criteria.

As articulated by the Supreme Court, in the cases *ANR Pipeline Co. v Shell Oil Co.*, Del. Supr., 525 A.2d 991 (1987) and *Texas City Refining, Inc. v. Grand Bahama Petroleum Co.*, Del. Supr., 347 A.2d 657 (1975), a pending suit will never be dismissed on *forum non conveniens* grounds unless the defendant shows "inconvenience and hardship." Simply put, a Delaware court need not—and, indeed, should not—consider the merits of alternative forums until it first has determined that litigation here would impose an unjustifiable burden upon defendant.

If litigation here would not be particularly burdensome to defendant, the *forum non conveniens* analysis would accordingly come to an end. *See, e.g.*, *St. Joe Minerals Corp. v. Horsehead Indus., Inc.*, Del. Ch., C.A. No. 10,522, Allen, C. (Apr. 7, 1989), slip op. at 2. If, however, litigation in Delaware would indeed work a hardship on defendant or substantially inconvenience it, the analysis proceeds to the second step. The court then should ask, not merely whether

---

6. At the time that defendants originally made this argument in their motions to dismiss, a later-filed, allegedly parallel action was pending in the federal district court for the Southern District of New York. Plaintiffs had based a portion of their *forum non conveniens* argument on the pendency of that suit. However, it has since been dismissed. *See Victor v. Riklis*, No. 91 Civ. 2897 (S.D.N.Y. May 15, 1992).

another forum would be better, but whether that alternative forum would be so much better as to justify dismissal of the case. *See id.* This second step entails a weighing of both the benefits and the costs of litigating the dispute in the other jurisdiction.

I need not focus on the second stage analysis with its concern for comparative analysis of fora, as I conclude that this jurisdiction does not present an inconvenient forum for this litigation.

Defendants make just one colorable allegation of inconvenience. They allege that the location, in New York, of documents responsive to plaintiffs' interrogatories would impose on defendants, their counsel and witnesses the inconvenience and expense of travelling from New York to Delaware.[7] This argument has been made and rejected before.[8] And, as before, *see St. Joe Minerals*, C.A. No. 10,522, slip op. at 9, I am unable to conclude that the two-hour train ride to Delaware for trial at the tail end of the long litigation process works any significant hardship or substantial inconvenience on defendants. Indeed, Delaware courts regularly decide complex cases in which parties travel from, and conduct discovery in, places much further from Delaware than New York without incurring any inconvenience greater than that which they routinely incur as executives operating in a modern, international economy.

I accordingly deny their motion to dismiss the present proceedings on *forum non conveniens* grounds.

C. *Failure to State Claims*

On the merits, I turn first to the question of the effect on these actions of clauses in the indentures limiting the ability of bondholders

---

7. Plaintiffs had alleged that continued Delaware proceedings impose on them the burden of defending similar suits simultaneously in two jurisdictions, New York and Delaware. I need no longer consider this allegation because of the recent dismissal of the New York action, discussed *infra* p. 19. However, the result would not have been different had the New York case continued to pend. The pendency of a similar suit in an alternative jurisdiction may be relevant, on the second step of *forum non conveniens* analysis, in measuring the benefits of dismissing or staying suits here in favor of proceedings in an alternative forum. But, it would have had no bearing on the immediate question whether the location of litigation in Delaware constitutes a hardship or substantial inconvenience to defendants.

8. *See, e.g.*, *Texas City Refining*, 347 A.2d at 658; *St. Joe Minerals*, C.A. No. 10,522, slip op. at 2 (denying motion to dismiss on *forum non conveniens* grounds and holding that two-hour train ride from New York caused no hardship or substantial inconvenience); *see also ANR Pipeline Co. v. Shell Oil Co.*, Del. Supr., 525 A.2d 991 (1987).

to prosecute claims that they purportedly hold in their capacities as bondholders. For the reasons that follow, I conclude that the "no-action" clauses in the indentures constitute waivers by plaintiffs of any right to bring the following claims against any defendants, without first satisfying the procedural requirements of those clauses: (1) the fraudulent conveyance claims; (2) the claims for breaches of implied covenants of good faith and fair dealing; and (3) those common law fraud claims that are based on injuries allegedly arising from a missed opportunity for plaintiffs to enjoin the December 1990 transactions.

* * *

The no-action clause in the E-II indentures is representative. It reads as follows:

> A Securityholder may not pursue *any remedy with respect to this Indenture or the Securities* unless:
>
> (1) the Holder gives to the Trustee written notice of a continuing event of default;
>
> (2) the Holders of at least a majority in principal amount of outstanding Securities make a written request to the Trustee to pursue the remedy;
>
> (3) such Holder or Holders offer to the Trustee indemnity satisfactory to the Trustee against any loss, liability or expense;
>
> (4) the Trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity; and
>
> (5) during the 60-day period the Holders of a majority in principal amount of the outstanding Securities do not give the Trustee a direction which is inconsistent with the request.

(E-II Indenture § 6.06) (emphasis added).

[3] Absent an allegation of fraud in the inducement of the purchase, clauses of this sort are generally applied to foreclose bondholder suits under the indenture, where plaintiff has not complied. *See Elliott Assocs., L.P. v. Bio-Response, Inc.*, Del. Ch., C.A. No. 10,624, Berger, V.C. (May 23, 1989); *Friedman v. Chesapeake & Ohio Ry.*, 395 F.2d 663 (2d Cir. 1968); *Ernst v. Film Prod. Co.*, N.Y. Supr., 264 N.Y.S. 227 (1933). Such clauses are bargained-for contractual provisions which inure, not only to the benefit of issuers, but also to the benefit of the investors in bonds. Such clauses need not prevent the pros-

ecution of meritorious suits.[9] They do, however, make it difficult for individual bondholders to bring suits that are unpopular with their fellow bondholders. This, in fact, is their primary purpose. As the American Bar Foundation's *Commentaries on Indentures* § 5.7, at 232 (1971), notes, regarding the Foundation's proposed model no-action clause:

> The major purpose of this Section is to deter individual debentureholders from bringing independent law suits for unworthy or unjustifiable reasons, causing expense to the Company and diminishing its assets. The theory is that if the suit is worthwhile, [a significant percent[10]] of the debentureholders would be willing to join in sponsoring it. . . . An additional purpose is the expression of the principle of law that would otherwise be implied that all rights and remedies of the indenture are for the equal and ratable benefit of all holders.

The primary purpose of a no-action clause is thus to protect issuers from the expense involved in defending lawsuits that are either frivolous or otherwise not in the economic interest of the corporation and its creditors. In protecting the issuer such clauses protect bondholders. They protect against the exercise of poor judgment by a single bondholder or a small group of bondholders, who might otherwise bring a suit against the issuer that most bondholders would consider not to be in their collective economic interest. In addition to providing protection against improvident litigation decisions, a no-action clause also protects against the risk of strike suits. Obviously the class features of any such suits make that prospect

---

9. This, as a practical matter, is especially true of bonds of failing or bankrupt companies whose bonds tend to move into the hands of specialists, so-called vulture funds, for whom, given their small numbers and significant holdings, collective action problems do not present the obstacle to collective action that frequently accompanies wide-spread distribution of financial interests. *See, e.g.*, Marcel Kahan & Bruce Tuckman, *Do Bondholders Lose From Junk Bond Covenant Changes?* (Feb. 1992) (unpublished study on file with authors) (exit consent solicitation of bondholders of failing companies appear not to have a "coercive" effect).

10. The no-action clause proposed by the American Bar Foundation requires that an investor seeking to bring a suit get at least 25% of securityholders (including itself) to ask the Trustee to bring suit before the bondholders—upon the Trustee's refusal to take up the action—may bring suit individually. The no-action clauses at issue in the present case require a would-be plaintiff to join, not 25%, but a majority of debentureholders in asking the trustee to bring suit. I attach no legal importance to this higher threshold.

somewhat more likely and somewhat more risky to the issuer than it would otherwise be.

No-action clauses address these twin problems by delegating the right to bring a suit enforcing rights of bondholders to the trustee, or to the holders of a substantial amount of bonds, and by delegating to the trustee the right to prosecute such a suit in the first instance. These clauses also ensure that the proceeds of any litigation actually prosecuted will be shared ratably by all bondholders.[11]

[4] In this case, plaintiffs argue that no-action clauses apply only to claims for breaches of express indenture provisions. They assert that their claims, predicated upon breaches of implied obligations of fair dealing, for fraudulent conveyance and for fraud, are not affected by the no-action clauses. Given the purposes for which no-action clauses are designed, I cannot accept plaintiffs' position. No principled reason or factual particularity of this case is advanced that would justify this view. In my opinion, no matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for the recovery of past due interest or principal, is subject to the terms of a no-action clause of this type. *See, e.g.*, *Ernst v. Film Prod. Corp.*, N.Y. Supr., 264 N.Y.S. 227, 228 (1933) (fraudulent conveyance claim); *Elliott Assocs., L.P. v. Bio-Response, Inc.*, Del. Ch., C.A. No. 10,624, Berger, V.C. (May 23, 1989) (receivership claim and claim for breach of implied covenant of good faith and fair dealing); *Friedman*, 395 F.2d at 664 (contract claim for breach of indenture provisions requiring sinking fund payments, payment of back interest upon any distribution of dividends and payment of principal upon breach of indenture); *Feder v. Union Carbide Corp.*, N.Y. App. Div., 530 N.Y.S.2d 165 (1988) (contract claim for breach of indenture provision requiring the adjustment of terms for conversion to common stock); *Sutter v. Hudson Coal Co.*, N.Y. App. Div., 21 N.Y.S.2d 40 (1940) (contract claim for breach of sinking fund obligations created by indenture); *Relmar Holding Co. v. Paramount Publix Corp.*, N.Y. Supr., 263 N.Y.S. 776

---

11. "No-action" clauses are thus consistent with, if not central to, the indentures in which they are found, for the primary purpose of such indentures is to centralize enforcement powers by vesting legal title to the securities in one trustee. *See* George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 250, at 280 (rev. 2d ed. 1992) ("In the case of debenture bonds, . . . the issue is often made payable to a trustee in order that the powers of enforcement may be centralized.").