(1932), *aff'd mem.*, N.Y. App. Div., 237 A.D. 870 (1933) (contract claim for breach of indenture provision prohibiting the creation of liens not shared ratably by the bondholders).

[5] I do not mean to imply that courts will apply no-action clauses to bar claims where misconduct by the trustee is alleged. For the same reason that equity has long recognized that, in some circumstances, corporate shareholders will be excused from making a demand to sue upon corporate directors, but will be permitted to sue in the corporation's name themselves, bondholders will be excused from compliance with a no-action provision where they allege specific facts which if true establish that the trustee itself has breached its duty under the indenture or is capable of disinterestedly performing that duty. *See Cruden v. Bank of N.Y.*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,466, at 97,413 (S.D.N.Y. Sept. 4, 1990).[12]

I rather conclude only that, absent circumstances making application of a no-action clause inappropriate, such as those described above, courts systematically conclude that, in consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all bondholders, and thus can be prosecuted by the trustee, unless they first comply with the procedures set forth in the clause or their claims are for the payment of past-due amounts.

[6] Courts have implicitly concluded that this waiver by a bondholder applies equally to claims against non-issuer defendants as to claims against issuers. *See Norte & Co. v. Manor Healthcare Corp.*, Del. Ch., C.A. Nos. 6827 & 6831, Berger, V.C. (Nov. 21, 1985) (dismissing for failure to comply with a no-action clause breach of

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12. In *Victor v. Riklis*, No. 91 Civ. 2897 (S.D.N.Y. May 15, 1992), discussed *infra* pp. 18-19, the federal district court for the Southern District of New York addressed *Cruden*, *supra*, an earlier case in which that court had permitted fraud and RICO claims brought by individual bondholders to proceed in the face of a no-action clause. It concluded that the facts with which it was then presented (which I conclude below are substantively identical to those alleged here) differed from those of the *Cruden* case in that the clause with which it was then presented was broader than that addressed by the court in *Cruden*. It accordingly declared that the *Cruden* holding did not control its determination and declared that the no-action clause with which it was presented barred plaintiffs' claims.

I note that, even if there had been no difference between the no-action clauses addressed in the two cases, i.e., the no-action clause interpreted in *Cruden* had been as broad as that considered in *Victor*, the cases likely would still have come out differently. Application of the no-action clause in *Cruden* still may well have not been appropriate because the trustee in *Cruden* was accused of impropriety. In *Victor*, as here, no such conflict was alleged.

indenture claims against issuer and codefendants); *Levy v. Paramount Publix Corp.*, N.Y. Supr., 266 N.Y.S. 271, *aff'd*, N.Y. App. Div., 269 N.Y.S.2d 997 (1934) (dismissing for failure to comply with no-action clause breach of fiduciary duty claims against issuer's directors in connection with issuer's alleged fraudulent conveyance); *Relmar Holding Co. v. Paramount Publix Corp.*, N.Y. Supr., 263 N.Y.S. 776 (1932) (dismissing for failure to comply with no-action clause fraudulent conveyance claim against recipient of transferred assets).

The policy favoring the channeling of bondholder suits through trustees mandates the dismissal of individual-bondholder actions no matter whom the bondholders sue. So long as the suits to be dismissed seek to enforce rights shared ratably by all bondholders, they should be prosecuted by the trustee. Moreover, like other no-action clauses, the clauses at issue here explicitly make their scope depend on the nature of the claims brought, not on the identity of the defendant. For example, the E-II clauses quoted earlier begin: "A Securityholder may not pursue *any* remedy *with respect to this Indenture or the Securities* unless . . . ."

1. *The No-Action Clauses Bar Plaintiffs' Fraudulent Conveyance Claims.*

[7] Plaintiffs assert that the fraudulent conveyance action is a statutory action that does not arise under the "Indenture or the Securities." Thus, they say it is not covered by the no-action clause. I cannot agree. The clause in question bars all action "with respect to" the indenture or the securities. A fraudulent conveyance action is such an action. On May 15 of this year, in an action parallel to this one but brought by a different plaintiff, the federal district court for the Southern District of New York addressed the question whether the no-action clause in the E-II indenture barred plaintiff's claim that E-II and the other Riklis companies, all of which are also joined as defendants here, fraudulently conveyed E-II's interest in MPC and McCrory to Riklis Holding. *See Victor v. Riklis*, No. 91 Civ. 2897 (S.D.N.Y. May 15, 1992). It held that the no-action clause did bar the claim.

I concur. The fraudulent conveyance claims brought here, which are substantively identical to the claim addressed by the district court, plainly do fall within the scope of the no-action clauses. The claims allegedly arise from transactions by issuers of their bonds and assert injuries arising from the bondholder status of plaintiffs. If plaintiffs have been legally injured by the transactions complained of, they are hurt derivatively. They can allege no harm different

from that suffered by their fellow bondholders and thus should share any remedy they receive on a *pari passu* basis with other bondholders.

Given the derivative character of these claims, it is clear that they can be prosecuted by the trustees representing the bondholders as a group, provided the trustees are in a position in which they can represent plaintiffs fairly. *See Continental Ill. Nat'l Bank & Trust Co. v. Hunt Int'l Resources Corp.*, Del. Ch., C.A. Nos. 7888 & 7844, Jacobs, V.C. (Feb. 27, 1987) (denying motion to dismiss suit by trustee on fraudulent conveyance theory against non-issuer defendants). Plaintiffs have not alleged that the trustees have engaged in any impropriety or are otherwise incapable of performing their duties. I thus find that plaintiffs' claims arising under the fraudulent conveyance statute are subject to the no-action clauses. Since plaintiffs have not complied with the procedures for bringing suit set forth in those clauses, I further conclude that they as individual holders of bonds may not maintain their fraudulent conveyance claims. *See* cases cited *supra* pp. 15-16.

2. *The No-Action Clauses Bar Plaintiffs' Claims for Breaches of Implied Covenants of Good Faith and Fair Dealing.*

[8] With respect to plaintiffs' claims for beaches of covenants of good faith and fair dealing which, plaintiffs say, are implied in the indentures, I conclude that they too are barred by the no-action clauses. Any conduct by the issuer that violates an indenture covenant, implied or otherwise, necessarily harms all bondholders in the same manner, to wit, through an increased risk of default and a corresponding reduction in the market value of the bonds. Such conduct thus gives rise to claims that bondholders share ratably and therefore can be, and should be, enforced by the trustee. *Elliott Assocs., L.P. v. Bio-Response, Inc.*, Del. Ch., C.A. No. 10,624, Berger, V.C. (May 23, 1989) (barring for failure to comply with no-action clause receivership claim and claim for breach of implied covenant of good faith and fair dealing).

3. *Common Law Fraud Claims*

a. *The No-Action Clauses Bar Plaintiffs' Claims for Common Law Fraud to the Extent that They Allege Injury Based on a Missed Opportunity for Plaintiffs to Attempt to Prevent the December 1990 Transactions.*

[9] The rule stated above (p. 17) applies to certain claims of fraud but not others. No-action clauses of this type will not bar a plaintiff

who alleges that she was fraudulently induced to *purchase* bonds. *See Kusner v. First Pa. Corp.*, 531 F.2d 1234, 1239 (3d Cir. 1976); *Slater Trust Co. v. Randolph-Macon Coal Co.*, 166 F. 172, 173, 177 (S.D.N.Y. 1908). In such cases, the fraud alleged is in the inducement of the relationship and thus goes to the question whether the bondholder effectively consented to the transaction, including the no-action clause itself. If the bondholder did not implicitly consent to the no-action clause, she cannot be bound by it. Nor do these clauses bar claims in which a bondholder alleges that she was induced to *sell* her bonds by her issuer's fraud. *See Mann v. Oppenheimer & Co.*, Del. Ch., C.A. No. 7275, Walsh, V.C. (Apr. 4, 1985). Once she sells her bonds, her status as a bondholder ends, and her continuing relationship with the trustee concludes. The trustee can no longer represent her interests, whatever they may be. It represents the holders of bonds. It thus makes no sense to require a former holder to request the trustee to bring suit. Put differently, one in those circumstances is not bound by a no-action clause because she does not necessarily share her claim ratably with the other bondholders.

[10] The common-law fraud claims in this case, however, have nothing to do with the purchase or sale of the bonds by defendant. Generally, the essence of any alleged fraud is a misrepresentation (or failure to disclose under circumstances where a duty to do so existed) made to the plaintiff with knowledge of its falsity and an intention to mislead plaintiff, upon which the plaintiff reasonably relied to his detriment. *See Simons v. Cogan*, Del. Ch., 542 A.2d 785, 791 (1987), *aff'd*, Del. Supr., 549 A.2d 300 (1988); *Harmon v. Masoneilan Int'l, Inc.*, Del. Supr., 163 A.2d 278 (1960); N. Page Keeton et al., *Prosser and Keeton on the Law of Torts* § 105, at 728 (5th ed. 1984). The common law fraud claims asserted here are unusual in that they do not allege that defendants sought to deceive plaintiffs into making any transfer, casting a vote, giving a consent, or otherwise performing any act necessary to effectuate a transfer. How then can the bondholders plausibly assert a theory of common law fraud arising out of "untrue" public statements or omissions?

Plaintiffs' theory is as follows: through a 10Q filing, defendants made false public statements with respect to the restructuring transactions' compliance with the indentures and neglected to state the true purpose and effect of the transactions (*see supra* pp. 6-7); plaintiffs reasonably relied on these misstatements and omissions by (a) not suing to enjoin the allegedly harmful transactions and (b) not selling their bonds; and, as a result of their inaction, the transactions were completed to their (prospective) injury.

These claims are difficult to analyze in terms of the no-action clause. The first claim of injury—that defendants' misstatements and omissions precluded a suit to enjoin the December 1990 transactions—reflects injury that, if suffered at all, was suffered, not by the bondholders individually, but derivatively. Only the trustee could have brought suits to enjoin the transactions, unless the holders of more than half of the bonds concurred. It would seem that a claim that someone was wrongfully deprivated (by false statements) of an opportunity to bring suit could be held only by the person with a right to bring suit. In this case, such a person was only the trustee or holders of more than half of the bonds. Thus, insofar as the complaints purport to allege damages based on a missed opportunity to enjoin the December 1990 transactions, plaintiffs' common law fraud theory is inconsistent with legal effect of the no-action clause and therefore fails to state a claim.

b. *To the Extent that Plaintiffs' Common Law Fraud Claims Allege Injury Based on a Missed Opportunity for Plaintiffs to Sell their Bonds, They Fail to State Claims Upon Which Relief Could Be Granted.*

[11] Insofar as plaintiffs' common law fraud claims allege damages from the bondholders being wrongfully induced *to hold* their bonds to their injury, they are not claims that the trustee could litigate. These claims are not necessarily held ratably by all bondholders (some might not have been fooled for example). The trustee is concerned only about the bonds. It has no interest in whether one holder gets to unload bonds into the hands of others or holds onto the bonds. Thus, an individual holder's claim that he has been injured by holding bonds falls outside the reach of the no-action clauses.

This aspect of plaintiffs' common law fraud theory, however, is simply an attempt to convert a breach of contract claim into a fraud claim. The gist of the alleged misstatements were that these transactions were in breach of the indentures,[13] and were a prelude to a prospective looting of McCrory. If the transactions *were* in

13. Plaintiffs allege that MPC stated falsely in its December 14, 1990 10Q that the December 1990 restructuring was not prohibited by the company's indentures. Plaintiffs further allege that MPC should have, but did not, disclose that the restructuring (1) would increase the riskiness of plaintiffs' MPC bonds; (2) would result in a lowering of the bonds' credit rating; and (3) would lead to MPC's eventual default on the bonds. Finally, they allege that McCrory should have, but did not, disclose that the transactions would increase the riskiness of their bonds.

violation of the indentures, the indenture trustee or, upon compliance with the no-action provision, the bond holders can achieve a remedy. But, of course, defendants deny that the substantive violation of the indentures has occurred. Thus, in order to litigate the purported misstatement theory that plaintiffs wish to press, they will have to litigate the breach of the indenture claim. If their common law fraud theory were sound, therefore, it would defeat the purpose of the indentures' no-action clause. Plaintiffs would have found a way to transmute a contract claim litigable only by the indenture trustee into an individual fraud claim.

This effort has occurred in other contexts. Shareholder class action plaintiffs have regularly attempted to transmute an alleged breach of fiduciary duty by corporate directors into a claim for breach of a disclosure obligation by the expedient of alleging that the board failed to state that the transaction in question constituted a wrong. This stratagem has been regularly, if not uniformly, rejected under both state and federal disclosure law. *See, e.g.*, *Fischer v. United Technologies Corp.*, Del. Ch., C.A. No. 5847, Hartnett, V.C. (May 12, 1981), slip op. at 7; *Columbia Pictures Indus., Inc. v. Kerkorian*, Del. Ch., C.A. No. 6394, Marvel, C. (Dec. 16, 1980); *Michelson v. Duncan*, Del. Ch., 386 A.2d 1144, 1154-55 (1978), *aff'd*, Del. Supr., 407 A.2d 211 (1979); *Goldberger v. Baker*, 442 F. Supp. 659, 664-65 (S.D.N.Y. 1977); *Markewich v. Adickes*, 422 F. Supp. 1144, 1147 (E.D.N.Y. 1976); *see generally Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

There is even less reason to credit this stratagem in the bondholder context than in the shareholder context. In the shareholder setting the defendants are inevitably proposing a transaction that requires shareholder assent through vote or tendering of stock. Thus, there is some surface plausibility to the notion that the directors could be misleading them about the *bona fides* of the transaction. Nevertheless, the courts have rejected the conversion technique. Here, the defendants had (1) no need to get the consent of the bondholders to the transactions and (2) no economic (or other) interest in whether these particular bondholders held or sold their bonds. This lack of substantial interest in misleading the bondholders (even if one assumes that the transactions do constitute a breach of the indentures) is reflected in plaintiffs' pleadings, by an absence of specification with respect to the element of a fraud claim that requires that plaintiff alleges and proves that false statements were made with an intention that plaintiff rely upon them. *Prosser & Keeton*, *supra*, § 105, at 728.

I, thus, conclude that plaintiffs have not succeeded in their effort to transmute a breach of contract claim into a litigable claim for fraud. This claim too must, therefore, be dismissed.[14]

D. Plaintiffs' Claims Based on Explicit Breaches of the Indentures Are Stayed Automatically Because of MPC's Pending Bankruptcy

[12] Like plaintiffs' fraud claims that allege injury from a missed opportunity to sell bonds, the claims for past due principal and interest escape the barring effect of the no-action clauses. The Indentures themselves make this clear. For example, Section 8.04 of the MPC 14 1/2% Indenture contains a provision making the right of a bondholder to sue for past due principal and interest absolute and unconditional. Such provisions, in fact, are a requirement of the Trust Indenture Act § 313(b). 15 U.S.C. § 77 (1981). *See also General Inv. Co. v. Interborough Rapid Transit Co.*, 200 N.Y. App. Div. 794, 193 N.Y.S. 903 (1st Dept. 1922); *Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, Del. Ch., C.A. No. 8578, Berger, V.C. (Jan. 27, 1988); *Feder*, 530 N.Y.S.2d at 167. Additionally, I assume, although without deciding, that the anticipatory repudiation claims likewise would not be subject to the effect of the no-action clauses.

On November 25, 1991, three MPC bondholders filed an involuntary bankruptcy petition against MPC. Section 362(a)(1) of the federal bankruptcy law stays all "claim[s] against the debtor that arose before the commencement" of bankruptcy proceedings. Thus, since plaintiffs' claims for anticipatory repudiation and past due interest and principal arose before the commencement of bankruptcy proceedings and are asserted against the bankrupt debtor (MPC), they are automatically stayed under 11 U.S.C. § 362(a)(1). Moreover, since these claims of breach of contract may only be asserted against the issuer, *see Simons*, 542 A.2d at 792, the stay of action

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14. Although this reasoning applies to the misstatement and omission allegations alike, I focus it on the misstatement allegations because there is an alternative ground for dismissing the omission allegations. Neither MPC nor McCrory had a duty to disclose the information that plaintiffs say they should have disclosed. Indeed, absent a need to clarify a misimpression left by an earlier statement or to comply with a contractual disclosure provision, a defendant will have a duty to disclose information to its bondholders only in rare situations. No such duty will arise unless bondholders have some role in approving the transaction. *See Glinert v. Wickes Co.*, Del. Ch., C.A. No. 10,407, Allen, C. (Mar. 27, 1990); *see generally Chiarella v. United States*, 445 U.S. 222 (1980). Absent such duty, no fraud action will lie.

against the issuer is dispositive of these claims for present purposes in all respects.

* * *

The complaints allege serious charges of misconduct. Whether those charges are based, in fact, or not is not yet determined. But it is plain that the issuers, the underwriters and the trustees created at the outset of this commercial relationship a legal structure to permit and to govern the resolution of claims relating to the bonds. No fact has been alleged (such as the conspiracy of the trustee or other circumstance causing the original structure to lose its effectiveness) that might justify a court of equity in entertaining these suits at this time. Defendants may submit on notice a form of implementing order consistent with the foregoing.

FOOD & ALLIED SERVICE TRADES DEPARTMENT, AFL-CIO v. WAL-MART STORES, INC.

No. 12,551

Court of Chancery of the State of Delaware, New Castle

May 19, 1992

Plaintiff, a shareholder owning twenty-three shares of defendant's stock sought to compel defendant corporation to permit inspection of the shareholder list and related materials as permitted under section 220 of the Delaware General Corporation Law for the purpose of soliciting proxies to be voted at an upcoming annual meeting. Plaintiff alleges that it complied with the requirements of section 229 and also that the defendant corporation improperly withheld the shareholder information. The defendant contended that the plaintiff was not entitled to examine the information because the plaintiff's purpose in obtaining the list was not related to its economic interests in owning the stock.

The court of chancery, per Chancellor Allen, ordered the defendant to produce the shareholder list. The court held that plaintiff had complied with all the requirements of the Delaware statute; and that while the plaintiff's purpose was primarily non-economic, it was

consistent with management's conception of the corporation's long-term interests.

1. Corporations ⟹181(1)

Under section 220, addressing a shareholder's right to examine a shareholder list and related information, the burden of proof is on the corporation to show that a shareholder's purpose in seeking the information is improper. DEL. CODE ANN. tit. 8, § 220 (1991).

2. Corporations ⟹181(8)

A shareholder's willingness to agree to restrictions on the use of the shareholder list and a limitation of the names to be disclosed can serve to rebut a corporation's claim of improper purpose.

3. Corporations ⟹181(1)

A defendant corporation must permit inspection of its stockholder list by a stockholder whose purpose in seeking the list was to solicit proxies with the ultimate aim of inducing the corporation to deal more generously with its suppliers of which the stockholder was one.

4. Corporations ⟹181(1)

A shareholder seeking to ensure that the corporation complies with its legal obligations in the interest of forced laborers in China, while principally directed toward non-economic interests, is consistent with management's conception of the corporation's long-term interest and is, therefore, proper.

Allen M. Terrell, Esquire, and Gregory P. Williams, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Eric Seiler, Esquire, of Friedman & Kaplan, New York, New York, of counsel, for plaintiff.

Lawrence C. Ashby, Esquire, Stephen E. Jenkins, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Joseph M. Hassett, Esquire, George H. Mernick, III, Esquire, and Gregory A. Kalscheur, Esquire, of Hogan & Hartson, Washington, D.C., of counsel, for defendant.

ALLEN, *Chancellor*

This is an action under Section 220 of the Delaware General Corporation Law for an order compelling defendant to permit plaintiff to inspect defendant's stockholder list and related materials.

Plaintiff Food and Allied Service Trades Department, AFL-CIO ("FAST") is an unincorporated labor organization. It was established as a department of the AFL-CIO[1] by that organization's sixteen, affiliated labor unions for the purpose of addressing the affiliates' common concerns by means of research, public relations and, apparently, litigation. Significantly, it also is the owner of twenty-three shares of the defendant's common stock.

Defendant Wal-Mart Stores, Inc. ("Wal-Mart"), a Delaware corporation, is the largest retailer in the United States.

* * *

Section 220 provides:

> any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's . . . list of stockholders . . . and to make copies or extracts therefrom.

On April 24 of this year, FAST delivered to Wal-Mart a written demand[2] under oath for a list of the corporation's shareholder and other related documents customarily demanded in connection with such inspection requests. That demand stated the purpose of the inspection request to be:

> to permit the undersigned to communicate with other stockholders of the Company on matters relating to their interest as stockholders, including communicating with such stockholders regarding a solicitation of proxies to be conducted by the undersigned in connection with the Company's 1992 Annual Meeting of Shareholders, scheduled for June 5, 1992, in support of an independent shareholders' resolution

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1. AFL-CIO is an acronym for the American Federation of Labor and Congress of Industrial Organizations.

2. The April 24 demand was made by means of facsimile. It was followed by an April 27 copy of the demand, delivered by certified mail.

> recommending that the Board of Directors establish a Special Committee to study and report to the Board of Directors and to the shareholders on the Company's buying policies and practices in China, with special attention to ensuring that no products purchased directly and/or indirectly from sources in China are produced wholly or in part by forced labor. The purpose of this demand for a stocklist is also to permit the undersigned to furnish the Company's stockholders with copies of proxy materials relating to that resolution and to solicit proxies from those stockholders.

Wal-Mart does not contend that the demand does not satisfy the formal requirements of Section 220. FAST, Wal-Mart concedes, owns twenty-three shares of Wal-Mart common stock and has submitted a demand under oath which includes a statement of the purpose for the inspection.

Wal-Mart does contend that the stated purpose is not "proper" as required by Section 220 because it is not "reasonably related to [FAST's] interest as a stockholder," 8 *Del. C.* § 220, as required by that section. Thus, the only question requiring an answer is whether FAST's purpose in seeking the shareholder list is proper. [1] Under Section 220, the burden of proof is on Wal-Mart.[3] In other words, FAST will be permitted inspection unless Wal-Mart establishes that FAST's purpose is *not* proper.

* * *

Following Wal-Mart's refusal to comply with FAST's demand, FAST filed this suit on May 5, 1992. On May 18, a trial was held at which the court heard the direct and cross-examination testimony of plaintiff's witness, FAST's president, Robert F. Harbrant, and received documentary evidence from both parties.

Mr. Harbrant described the events leading up to FAST's proposal of its resolution in the following manner. Sometime during 1991, particularly following the massacre in Tianamen Square and the related government arrests of students and workers, FAST grew concerned about the abuse of civil rights by the government of the

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3. Where the stockholder seeks to inspect the corporation's stock ledger or list of stockholders and he has complied with this section respecting the form and manner of making demand for inspection of such documents, the burden of proof shall be upon the corporation to establish that the inspection he seeks is for an improper purpose.

8 *Del. C.* § 220(b).

People's Republic of China. FAST then heard that the Chinese government was using forced prison labor in the manufacture of goods for export. Mr. Harbrant testified that the sale of goods produced by forced labor is not only morally repugnant, but a violation of United States law. He added that FAST, as a labor organization, sympathizes with workers throughout the world and, thus, has an interest in eliminating the worldwide purchase of goods produced by forced labor. Accordingly, FAST began to investigate the use of forced labor in China.

A FAST board member, Jeffrey Fiedler, travelled to China once during 1991 as part of a Congressional fact finding mission and has travelled there twice subsequently in search of more information about the production of goods by forced labor. In his capacity as a FAST board member, Fiedler testified on the subject of Chinese forced labor before various Congressional committees in September, October and November of 1991.

In late 1991, FAST helped organize a boycott of toys made in China and allegedly sold in the United States by "Toys R Us" and defendant Wal-Mart.

Also in 1991, FAST took issue with announcements by Wal-Mart, as part of its "Buy American" campaign, suggesting that its products were made in America. According to Harbrant, FAST did not believe Wal-Mart, in fact, acted consistently with its own public statements. FAST, thus, circulated to consumers leaflets explaining how to determine where a product is made from the "RN" number displayed on its label.

Finally, Harbrant testified that the impetus for the resolution now proposed by FAST came during Wal-Mart's 1991 shareholders' meeting where, in response to a question from a FAST representative, Wal-Mart's president, now chief executive officer, appeared to be too little concerned, in FAST's opinion, with the possibility that Wal-Mart was importing and selling in the United States a significant number of products that were produced by captive laborers in China. According to Harbrant, Wal-Mart had and still has no system in place for determining which, if any, of the Chinese products it sells are produced by forced labor. FAST believes that its proposed resolution calling, as it does, for a report to the shareholders by a special board committee, will rectify this situation.

According to FAST's counsel, FAST's proxy materials have been cleared by the Securities Exchange Commission and, thus, are ready to go out. It needs only the shareholder list to permit the solicitation. FAST is aware that Wal-Mart professes to be concerned

that, if granted access to the list, FAST will pass it on to union organizers who will use the employee names that appear on the list in their organization activities. Wal-Mart is not unionized. To meet this concern, FAST proposes that Wal-Mart excise from the materials FAST is to receive the names of individual employee shareholders who own stock through company benefit plans. Indeed, FAST concedes that it has never intended to contact all shareholders. That, says Harbrant, would not be cost effective. FAST also is prepared to agree that it be ordered not to use the list for any purpose other than soliciting proxies for the present resolution and to return the list following the meeting. These two measures, it says, will ensure against the unions using the list to recruit Wal-Mart's employees.

The principal argument of defendant is factual. It is that the proxy solicitation purpose is a pretext to get the shareholder list for an inappropriate purpose (organizing) and that, in all events, the purpose is to injure Wal-Mart, to the advantage of competitors who employ union workers.

[2] Defendant has not met its burden of proof on this assertion. The willingness of the plaintiff to agree to the restrictions on use of the list and the limitation of the names to be disclosed makes defendant's first supposition unlikely. But, even if those proposals had not been made, too little has been shown to justify that inference. The second explanation advanced is equally unsupported in the record. On cross-examination, Mr. Harbrant's testimony did not establish that FAST's largest union sponsor, the United Food and Commercial Workers International Union ("UFCW"), would have a motive to harm Wal-Mart. It did establish that the UFCW and FAST have been urging consumers to "buy American" and have been teaching them, as Harbrant also noted on direct, how to identify foreign made goods. Finally, Harbrant's testimony established that some of the efforts of FAST and the UFCW in this regard have been targeted at Wal-Mart. However, in my opinion, Wal-Mart has not met its burden of proof in establishing that FAST is seeking to harm Wal-Mart.

The more plausible explanation is the one that FAST offers: that it is motivated by a desire to try to combat the importation of goods made with forced labor both as a matter of international labor solidarity and as a self-interested effort to keep low-price foreign goods out of competitive American markets. Thus, I accept as truthful Mr. Harbrant's testimony that FAST's principal purpose in seeking the stockholder list is to facilitate its solicitation of proxies from Wal-Mart stockholders so that it more easily can get its proposed resolution

adopted at the June 5 stockholders' meeting or, if unsuccessful then, at some later date. As the owner of just twenty-three shares which it purchased for about $300, FAST cannot persuasively argue that its effort to see the resolution adopted is pursued in order to benefit its interest as a stockholder.

* * *

This leaves the question whether Section 220 permits a stockholder to inspect a corporation's stockholder list if that stockholder's purpose in seeking such inspection is to solicit proxies in support of a resolution that it has proposed solely for moral and political reasons. [3] While as a matter of public policy interesting arguments could be made on either side of this question, such an exercise, by this court, is no longer useful. The question is not an open one. It once was held that shareholders have no right to inspect their corporation's stockholder list unless their ultimate aim is the enhancement of the economic value of the corporation. *See Pillsbury v. Honeywell, Inc.*, Minn. Supr., 191 N.W.2d 406 (1971) (applying Delaware law). However, this result was disapproved by the Delaware Supreme Court. In *Credit Bureau Reports, Inc. v. Credit Bureau of St. Paul, Inc.*, Del. Supr., 290 A.2d 691 (1972), the Supreme Court of Delaware affirmed this court's order requiring the defendant corporation to permit inspection of its stockholder list by a stockholder whose purpose in seeking the list was to solicit proxies with the ultimate aim of inducing the corporation to deal more generously with its suppliers of which the stockholder was one.

[4] I believe *Credit Bureau Reports* is controlling here. There, as here, the plaintiff sought the stockholder list for the immediate purpose of soliciting proxies to be voted at an annual meeting. And there, as here, plaintiff's ultimate aim was not to enhance the value of the corporation's shares. In fact, in that case, the plaintiff's ultimate aim was even further removed from enhancement of share value than is FAST's aim which on some attenuated basis might arguably be said to foster corporate profit. Rather than seeking to benefit itself and certain nonshareholders at the expense of the corporation, FAST seeks to ensure that the corporation complies with its legal obligations in the interest of forced laborers in China. This purpose, while principally directed towards other interests, is consistent with management's conception of the corporation's long-term interest. I, therefore, conclude that FAST's purpose in seeking inspection is no less proper than was that of the plaintiff in the *Credit Bureau* case.

Judgment for plaintiff is entered hereby. Defendant shall produce the stockholder list materials, as modified herein, by the close of business tomorrow. It is so ordered.

GEYER v. INGERSOLL PUBLICATIONS CO.

No. 12,406

Court of Chancery of the State of Delaware, New Castle

June 18, 1992

Plaintiff, former shareholder and current noteholder of a Delaware corporation, brought this action against the corporation and the chairman of the board of directors, alleging, *inter alia*, breach of fiduciary duty, fraudulent conveyances, and the right to judgment on the promissory note. The defendant chairman, a citizen of Connecticut, moved to dismiss the case on jurisdictional grounds, claiming that because the corporation had not instituted statutory proceedings for insolvency, he owed no fiduciary duty to plaintiff as a creditor under the insolvency exception and, thus, could not be subject to service under the Delaware personal jurisdiction statute. Further, defendant argued that service would violate his due process rights because his status as director would not afford the minimum contacts necessary to confer jurisdiction because he owed no fiduciary duty to plaintiff. Defendant chairman also moved to dismiss all counts for failure to state a claim, asserting that he owed plaintiff no fiduciary duty because statutory insolvency proceedings had not been instituted; and that his alleged cancellation of management agreements did not constitute releases under the fraudulent conveyances statute, and that plaintiff's allegations of unfair consideration and insolvency were merely conclusory. Defendant also asserted that he could not be held personally liable on the promissory note because of the note's "no resource" provision, and because plaintiff failed to plead specific allegations supporting his conclusion that the corporation was his alter ego or instrumentality. Defendant also moved to stay discovery pending resolution of the motion to dismiss. Defendant corporation moved for judgment on the pleadings as to the count for fraudulent conveyances.

The court of chancery, per Vice-Chancellor Chandler, held that under the insolvency exception to the general rule that directors do not owe creditors duties beyond the relevant contractual terms, insolvency was established at insolvency in fact, rather than at the institution of statutory proceedings; hence, where plaintiff alleged

that the corporation was insolvent, a fiduciary duty arose, thereby authorizing service upon the chairman. The court also found that service under these circumstances would not violate defendant's due process rights under the Fourteenth Amendment. The court further held that plaintiff had stated claims for breach of fiduciary duty, in that a duty arose upon insolvency in fact; for fraudulent conveyances, in that alleged cancellation of management agreements constituted releases under the Fraudulent Conveyances Act, and plaintiff sufficiently plead facts supporting his conclusions that the corporation received inadequate consideration and was insolvent; and for personal liability on the promissory note, in that the no recourse provision did not bar equitable claims, and plaintiff had plead sufficient facts to allow the court to pierce the corporate veil and hold the chairman liable. The court thereby denied defendant's motion to dismiss, and dismissed the motion to stay discovery as the motion to dismiss was no longer pending. Finally, defendant corporation was not entitled to judgment on the pleadings as to the count for fraudulent conveyances, in that the court had already determined that plaintiff had stated a claim on this count.

1. Corporations ⟹355

A nonresident of Delaware who accepts a position as a director of a Delaware corporation is deemed to have consented from his acceptance of the directorship position to the appointment of the registered agent of such corporation (or, if there is none, the Secretary of State) as his agent upon whom service may be made in all civil actions or proceedings brought in Delaware, by or on behalf of, or against such corporation, in which such director is a necessary or proper party, or in any action or proceeding against such director for violation of his duty in such capacity, whether or not he continues to serve as such director at the time the suit is commenced. DEL. CODE ANN. tit. 10, § 3114(a) (Supp. 1990).

2. Corporations ⟹355

In order for a Delaware court to exercise personal jurisdiction over a nonresident defendant, a Delaware statute must authorize the obtaining of jurisdiction over that defendant.

3. Corporations ⟹355

Section 3114(a) of the Delaware Courts and Judicial Procedures Law authorizes service of process upon a nonresident director for

breaches of fiduciary duties. DEL. CODE ANN. tit. 10, § 3114(a) (Supp. 1990).

4. Corporations ⟹309(1), 548(4)

General rule is that directors do not owe creditors duties beyond the relevant contractual terms, absent the special circumstances of fraud, insolvency, or statutory violation.

5. Corporations ⟹548(4)

When insolvency exception to general rule arises, it creates fiduciary duties for directors for the benefit of creditors.

6. Corporations ⟹548(4)

The fact which creates the trust for the benefit of creditors is the insolvency, and when that fact is established, the trust arises, and the legality of the acts thereafter performed will be decided by very different principles than in the case of insolvency.

7. Corporations ⟹537

Insolvency is defined as a corporation in which the value of its assets has sunk below the amount of its debts.

8. Corporations ⟹548(4)

Chancery court decisions, in deciding that personal jurisdiction existed over directors because directors owed fiduciary duties to creditors when corporations filed for dissolution, did not hold that the institution of statutory proceedings was a prerequisite to the applicability of the insolvency exception; rather, courts were defining a fourth category (i.e., the institution of dissolution proceedings) of "special circumstances."

9. Corporations ⟹537, 548(4)

Delaware case law and ordinary meaning of the word insolvency require the holding that fiduciary duties to creditors arise when one is able to establish the fact of insolvency, rather than at the institution of statutory proceedings.

10. Corporations ⟹355
Pretrial Procedure ⟹554, 652

Defendant's motion to dismiss for lack of a statutory basis for the exercise of jurisdiction over him was denied where Delaware statute provided for the exercise of jurisdiction over directors in cases involving alleged breach of fiduciary duty, and court determined that fiduciary duty to corporation's creditor arose under the insolvency exception. DEL. CODE ANN. tit. 10, § 3114(a) (Supp. 1990).

11. Constitutional Law ⟹305(5)
Courts ⟹12(2.40)
Pretrial Procedure ⟹554, 652

Service on out-of-state director of Delaware corporation did not violate defendant's due process rights, and thereby entitle him to dismiss the action, where defendant owed a fiduciary duty to plaintiff, had consented to service of process by virtue of his acceptance of the directorship position, and could have reasonably anticipated being haled into a Delaware court, given Delaware statutory and common law.

12. Pretrial Procedure ⟹687, 689

In deciding motion to dismiss, court must take all well plead allegations as true, construe all inferences in the light most favorable to plaintiff, and ascertain whether the motion concedes conclusory allegations of law or fact which plaintiff does not support with allegations of specific facts.

13. Pretrial Procedure ⟹624

Court may not grant motion to dismiss unless it appears with a reasonable certainty that plaintiff would not be entitled to the relief sought under any set of facts which could be proven to support the action.

14. Corporations ⟹537, 538
Pretrial Procedure ⟹652

Plaintiff sufficiently alleged specific facts to support his claim that corporation was insolvent, so as to state a claim for breach of

fiduciary duty and avoid motion to dismiss, where he plead that corporation's liabilities were greater than its assets, it received inadequate consideration for the sale of its assets because the consideration for the assets was primarily paid to the co-defendant director, and that as a result, the corporation was unable to make payments due the plaintiff.

15. Fraudulent Conveyances ⟹ 33

Under Fraudulent Conveyances Act, the term conveyance includes every payment of money, assignment, release, transfer, lease, mortgage, or pledge of tangible or intangible property, and also the creation of any lien or encumbrance. DEL. CODE ANN. tit. 6, § 1301(2) (1974).

16. Fraudulent Conveyances ⟹ 24(2), 33

Under Fraudulent Conveyances Act, legislature intended the term release to include actions by a debtor to separate himself from assets which otherwise might be used to pay creditors. DEL. CODE ANN. tit. 6, § 1301(2) (1974).

17. Fraudulent Conveyances ⟹ 24(2), 33

Alleged cancellations of management agreements by corporate chairman fell within the ambit of the term release as defined by Fraudulent Conveyances Act because the agreements were assets that corporation could have used to pay its creditors notwithstanding the fact that corporation could not transfer the agreements. DEL. CODE ANN. tit. 6, § 1301(2) (1974).

18. Fraudulent Conveyances ⟹ 76(1)

A facet of Fraudulent Conveyances Act is the necessity of the property received in exchange for the property given up by the debtor in a particular transaction as being less than "fair consideration," which means a fair equivalent to the property given up. DEL. CODE ANN. tit. 6, § 1301(1) (1974).

19. Fraudulent Conveyances ⟹ 76(1)
Pretrial Procedure ⟹ 652

Plaintiff sufficiently alleged specific facts to support his claim that corporation did not receive fair consideration in the transaction

so as to withstand defendant's motion to dismiss where he alleged that chairman had cancelled management agreements with other corporation worth $50 million in return for agreement by other corporation to sell its assets to chairman, and the value of the consideration paid the corporation was meager.

20. Fraudulent Conveyances ⟹57(3)

A court may deem a conveyance fraudulent if the person making the conveyance is or will be rendered insolvent. DEL. CODE ANN. tit. 6, § 1304 (1974).

21. Fraudulent Conveyances ⟹54(2), 62

A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured. DEL. CODE ANN. tit. 6, § 1302(1) (1974).

22. Fraudulent Conveyances ⟹261
Pretrial Procedure ⟹642, 652

Plaintiff sufficiently alleged specific facts demonstrating corporation's insolvency for purposes of motion to dismiss, given that insolvency is a matter likely to be peculiarly within the knowledge of corporation and corporate chairman, and given that plaintiff has alleged that corporation was insolvent and unable to pay plaintiff and has provided specific examples of transactions which purportedly created this situation.

23. Fraudulent Conveyances ⟹33, 76(1), 261
Pretrial Procedure ⟹652

Defendant's motion to dismiss for failure to state a claim for fraudulent conveyances was denied where plaintiff adequately alleged that the cancellation of management agreements constituted releases under section 1301(2), that the corporation did not receive fair consideration, as defined by section 1303(1), in exchange for the cancellations, and that the corporation was rendered insolvent by the cancellations.

24. Corporations ⟹1.4(2)

Alter ego claim is distinct from contract claim and is equitable in nature.

25. Corporations ⟹473

A no recourse provision in a promissory note does not bar equitable claims.

26. Corporations ⟹1.4(4)

Court may pierce the corporate veil of an entity where there is fraud or where a subsidiary is, in fact, a mere instrumentality or alter ego of its owner.

27. Corporations ⟹1.4(4)
Pretrial Proceedings ⟹642, 652

For purposes of motion to dismiss, plaintiff plead sufficient factual allegations to support his conclusion that director was alter ego of corporation where he alleged that director caused corporation to cancel valuable management agreements in exchange for personal gains, and that director had stated that he personally would pay the balance on the note held by plaintiff; therefore, court could pierce corporate veil and hold director personally liable on the note.

28. Pretrial Procedure ⟹40, 693

Motion to stay discovery, when based on pending motion to dismiss, was denied when motion to dismiss was denied.

29. Pretrial Procedure ⟹624, 672

Motion for judgment on the pleadings is in the nature of a motion to dismiss or demurrer; court may grant a judgment on the pleadings when the admitted facts clearly entitle the moving party to judgment.

30. Pretrial Procedure ⟹693

Co-defendant was not entitled to judgment on the pleadings where court had ruled that other defendant was not entitled to motion to dismiss on the same count.

Andrew J. Turezyn, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for plaintiff.

Gregory P. Williams, Esquire, Matthew J. Ferretti, Esquire, and Sean P. McDevitt, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendants.

CHANDLER, *Vice-Chancellor*

Plaintiff, Thomas P. Geyer, instituted this action against defendants, Ingersoll Publications Company ("IPCO") and Ralph Ingersoll II, alleging, *inter alia*, breaches of fiduciary duties, fraudulent conveyances and the right to a judgment on a promissory note (the "Note"). Mr. Ingersoll has moved to dismiss all of plaintiff's claims and to stay discovery pending the resolution of his motion to dismiss. In addition, IPCO has moved for judgment on the pleadings as to count II of plaintiff's complaint.

This is my decision on defendants' motions. Part I of the decision provides a brief factual history. Part II addresses Mr. Ingersoll's motion to dismiss all of plaintiff's claims. Part III considers Mr. Ingersoll's motion to stay discovery. Part IV addresses IPCO's motion to dismiss count II of plaintiff's complaint. Finally, part V contains my conclusions.

I. FACTUAL HISTORY

According to the complaint, Mr. Geyer and Mr. Ingersoll, a resident of Connecticut, were principals in a partnership involved in the business of managing newspapers in the late 1970s or early 1980s. Subsequently, the principals replaced the partnership structure with a corporate structure causing the formation of IPCO, a Delaware corporation. Mr. Geyer and Mr. Ingersoll each received shares in the new entity, IPCO, in return for their interests in the partnership. Indeed, plaintiff received forty shares of IPCO and became an employee of IPCO. Mr. Ingersoll became the President, Chairman of the Board and controlling shareholder of IPCO.

In addition to his dealings with IPCO, Mr. Ingersoll together with E.M. Warburg, Pincus & Company ("Warburg"), a New York investment firm, assembled an international publishing empire in the late 1980s. Ultimately, after a dispute in 1990, Warburg and Mr. Ingersoll divided their empire at the Atlantic Ocean, with Mr.

Ingersoll retaining ownership of the international newspapers and Warburg retaining ownership of the domestic newspapers.

Before Mr. Ingersoll's dispute with Warburg, IPCO repurchased Mr. Geyer's IPCO shares in the fall of 1988 in return for the Note in the principal amount of $2 million. The Note obligated IPCO to make monthly payments of principal and interest in increasing amounts with a balloon payment of nearly $1 million due on October 15, 1991. However, plaintiff argues that IPCO failed to make its June 15, 1991, payment and has failed to make any payments since that time.

According to plaintiff, Mr. Ingersoll caused IPCO to surrender its major assets to third parties in return for his personal benefit, at the expense of IPCO, while IPCO remained indebted to Mr. Geyer. Plaintiff provides two examples of such conduct: (1) plaintiff alleges that Mr. Ingersoll caused IPCO to cancel a management agreement with Goodson Newspapers ("Goodson"), which agreement was worth approximately $50 million, in return for an agreement by Goodson to sell the New Haven Register to Warburg and Mr. Ingersoll; and (2) plaintiff alleges that when Warburg and Mr. Ingersoll divided their empire, Mr. Ingersoll caused IPCO to cancel its management agreements with domestic newspapers in return for Mr. Ingersoll receiving the British and Irish holdings held by Warburg and Mr. Ingersoll.

II. MR. INGERSOLL'S MOTION TO DISMISS

Mr. Ingersoll bases his motion to dismiss on two separate grounds. First, he argues that this Court lacks personal jurisdiction over him. Second, he argues that plaintiff fails to state a claim for which I can grant relief.

A. *Personal Jurisdiction*

Mr. Ingersoll contends that in order for this Court to exercise personal jurisdiction over him, there must be statutory authorization for service of process. Also, he argues, such service must not violate the fundamental fairness required by the Fourteenth Amendment of the United States Constitution. Mr. Ingersoll contends that there is no statutory authorization for service of process upon him and, if there was, such service would violate his Fourteenth Amendment due process rights.

1. Statutory Service of Process

[1] Plaintiff purportedly served Mr. Ingersoll with process pursuant to 10 *Del. C.* § 3114(a) (Supp. 1990). This statute provides that a

nonresident of Delaware who accepts a position as a director of a Delaware corporation is

> deemed [ ] to have consented [from his acceptance of the directorship position] to the appointment of the registered agent of such corporation (or, if there is none, the Secretary of State) as his agent upon whom service of process may be made in all civil actions or proceedings brought in this state, by or on behalf of, or against such corporation, in which such director, trustee or member is a necessary or proper party, or in any action or proceeding against such director, trustee or member for violation of his duty in such capacity, whether or not he continues to serve as such director, trustee or member at the time suit is commenced.

Id.

Mr. Ingersoll argues that Mr. Geyer lost his status as a shareholder when he sold his shares to IPCO. Therefore, Mr. Ingersoll contends, Mr. Geyer is merely a creditor of IPCO. According to Mr. Ingersoll, directors do not owe creditors duties beyond the relevant contractual terms absent fraud, insolvency or a violation of a statute. Thus, Mr. Ingersoll argues, since section 3114 authorizes service of process upon nonresident directors only in limited circumstances (e.g., for breaches of fiduciary duties) which are not applicable to this case, no statutory authorization exists for service of process upon him.

Mr. Geyer responds by arguing that directors owe creditors fiduciary duties no later than when insolvency exists in fact. Furthermore, plaintiff argues, IPCO was, in fact, insolvent. Accordingly, plaintiff contends that Mr. Ingersoll owed Mr. Geyer fiduciary duties and, therefore, that section 3114 is statutory authorization for service of process upon Mr. Ingersoll.

Mr. Ingersoll contends that plaintiff mistakenly applies the insolvency exception. That is, Mr. Ingersoll argues that for the insolvency exception to apply, some sort of statutory proceedings (e.g., bankruptcy) must have begun rather than insolvency merely existing in fact. Without such a rule, Mr. Ingersoll argues, the transaction costs of running a corporation that was bordering on insolvency in fact would be overwhelming.

[2-3] In order for a Delaware court to exercise personal jurisdiction over a nonresident defendant, a Delaware statute must authorize the obtaining of jurisdiction over that defendant. *See In re Cambridge Fin. Group, Ltd.*, Del. Ch., C.A. No. 9279, Hartnett, V.C. (Nov. 9,

1987), ltr. op. at 4. The parties do not dispute that section 3114 authorizes service of process upon a nonresident director for breaches of fiduciary duties. However, the parties do dispute whether Mr. Ingersoll owed Mr. Geyer, a creditor, fiduciary duties.

[4-5] As Mr. Ingersoll states, the general rule is that directors do not owe creditors duties beyond the relevant contractual terms absent "special circumstances . . . *e.g.*, fraud, insolvency, or a violation of a statute . . . ." *Harff v. Kerkorian*, Del. Ch., 324 A.2d 215, 222 (1974), *rev'd in part on other grounds*, Del. Supr., 347 A.2d 133 (1975). Furthermore, neither party seriously disputes that when the insolvency exception does arise, it creates fiduciary duties for directors for the benefit of creditors. Therefore, the issue the parties present to me is *when* do directors' fiduciary duties to creditors arise via insolvency.[1] That is, I must decide whether insolvency arises so as to create a fiduciary duty to creditors when insolvency exists in fact or when a party institutes statutory proceedings (e.g., bankruptcy proceedings).

[6-7] Two factors lead me to conclude that insolvency means insolvency in fact rather than insolvency due to a statutory filing in defining insolvency for purposes of determining when a fiduciary duty to creditors arises. The first and more important factor is that Delaware caselaw requires this conclusion. Indeed, one case explicitly states that "[t]he fact which creates the trust [for the benefit of creditors] is the insolvency, and when that fact is established, the trust arises, and the legality of the acts thereafter performed will be decided by very different principles than in the case of solvency." *Bovay v. H. M. Byllesby & Co.*, Del. Supr., 38 A.2d 808, 813 (1944) (citing *McDonald v. Williams*, 174 U.S. 397 (1899)). This passage clearly states that it is the fact of insolvency which causes the duty to creditors to arise. Moreover, the case cited by *Bovay* buttresses this conclusion because in its discussion of the distinction between the rights of creditors to a solvent company from the rights of creditors to an insolvent company, the Court, in effect, defines insolvency as

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1. In resolving this issue of when do fiduciary duties to creditors arise via insolvency, I note that the language in *Hoover Indus., Inc. v. Chase*, Del. Ch., C.A. No. 9276, Allen, C. (July 13, 1988), mem. op. at 7, which states that a court should construe the terms of § 3114 liberally, is not helpful because I refuse to use different interpretative guidelines for the determination of the existence of a fiduciary duty for personal jurisdiction purposes than for actual liability purposes. That is, either the fiduciary duty existed or did not exist no matter why its existence is an issue.

a corporation in which the value of its assets has sunk below the amount of its debts. *McDonald*, 174 U.S. at 403. *McDonald* does not suggest that the institution of statutory proceedings is relevant to the definition of when an entity is insolvent.

[8] Mr. Ingersoll cites a number of cases that purportedly stand for the proposition that insolvency means the institution of statutory proceedings. However, I disagree with his interpretation of those cases. First, in *Kidde Indus., Inc. v. Weaver Corp.*, Del. Ch., 593 A.2d 563 (1991) and in *Gans v. MDR Liquidating Corp.*, Del. Ch., C.A. No. 9630, Hartnett, V.C. (Jan. 10, 1990), the Courts, in deciding whether personal jurisdiction existed over directors, noted that the directors owed creditors fiduciary duties since the entities had filed for dissolution. In so ruling, the Courts did not hold that the institution of statutory proceedings was a prerequisite to the applicability of the insolvency exception. Rather, by so ruling, the Courts were defining a fourth[2] category (i.e., the institution of dissolution proceedings) of "special circumstances." I find this to be the case because both cases cite *Bovay* with approval and *Bovay* explicitly states that a fiduciary duty to creditors arises when insolvency exists in fact and because it is not necessary for a company to be insolvent in fact in order to dissolve and a holding that *Kidde* and *Gans* stand for the proposition that insolvency means the institution of statutory proceedings would render the use of the word insolvent by the Court in *Harff* meaningless.

Mr. Ingersoll also relies on *Asmussen v. Quaker City Corp.*, Del. Ch., 156 A. 180 (1931), in arguing that the institution of statutory proceedings are necessary for the insolvency exception to apply and cause directors to owe creditors fiduciary duties. However, as plaintiff argues, the Court's holding was much more narrow than Mr. Ingersoll argues. That is, the Court merely held that the institution of such proceedings were necessary in order for the establishment of fiduciary duties to creditors as to claims that the directors unjustly preferred one creditor over another. The Court in *Asmussen* did not hold that the institution of statutory proceedings was necessary for the establishment of fiduciary duties via the insolvency exception as to claims against directors for unjustly favoring shareholders over creditors, committing corporate waste or favoring creditors who are also directors over all other creditors.

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2. The three other categories are the original examples of "special circumstances": fraud, insolvency or a violation of a statute. *See Harff*, 324 A.2d at 222.

The basis for my conclusion that the *Asmussen* decision was so limited is twofold. First, the Court stated that "[i]f an insolvent corporation should undertake to turn its assets over to stockholders, leaving creditors unpaid, I think no dissent can be found to the proposition that the law would condemn the effort." *Id.* at 181. Since the Court makes a distinction between the institution of statutory proceedings and the existence of insolvency in fact throughout the decision, the Court's failure to mention that the institution of statutory proceedings is necessary in order to justify such condemnation clearly means that it viewed the condemnation justified by the existence of insolvency in fact, alone, under those circumstances. Second, a later case, in effect, holds that the *Asmussen* decision was limited to the applicability of the insolvency exception to claims that directors preferred certain creditors over others since the Court in the later decision noted that the general rule created by *Asmussen*, in creating an exception to the *Asmussen* holding as to the preference of creditors who are directors, was that it allowed directors of an insolvent corporation to prefer one creditor over another unless someone had instituted statutory proceedings. *Pennsylvania Co. for Ins. on Lives & Granting Annuities v. South Broad St. Theatre Co.*, Del. Ch., 174 A. 112, 115-16 (1934).

Mr. Ingersoll's reliance on *Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Hunt Int'l Resources Corp.*, Del. Ch., C.A. No. 7888, Jacobs, V.C. (Feb. 27, 1987), also is not persuasive. In that case, the Court merely held that a creditor could not maintain a claim for breach of fiduciary duty, as distinguished from a claim for fraud, against a director based on allegations of fraud. *Id.*, slip op. at 9. The Court did not address the issue of when fiduciary duties to creditors arise via insolvency.

Besides Delaware caselaw, the other factor upon which I rely in holding that the insolvency exception arises upon the fact of insolvency rather than the institution of statutory proceedings is the ordinary meaning of the word insolvency. An entity is insolvent when it is unable to pay its debts as they fall due in the usual course of business. Webster's Ninth New Collegiate Dictionary 626 (1988). That is, an entity is insolvent when it has liabilities in excess of a reasonable market value of assets held. *Id.* Although there may be other definitions of insolvency that are slightly different, I am not aware of any authority which indicates that the ordinary meaning of the word insolvency means the institution of statutory proceedings.

Parenthetically, Mr. Ingersoll expends considerable effort in arguing that policy concerns suggest that I should interpret the

insolvency exception to arise upon the institution of statutory proceedings. While it is true, as Mr. Ingersoll argues, that defining the exception as arising when statutory proceedings have begun would give directors a clear and objective indication as to when their duties to creditors arise, there are other policy concerns which suggest that I interpret the insolvency exception to arise when insolvency exists in fact. That is, it is efficient and fair to cause the insolvency exception to arise at the moment of insolvency in fact rather than waiting for the institution of statutory proceedings. *See Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, Del. Ch., C.A. No. 12,150, Allen, C. (Dec. 30, 1991), mem. op. at 83 n.55. The existence of the fiduciary duties at the moment of insolvency may cause directors to choose a course of action that best serves the entire corporate enterprise rather than any single group interested in the corporation at a point in time when shareholders' wishes should not be the directors only concern. Furthermore, the existence of the duties at the moment of insolvency rather than the institution of statutory proceedings prevents creditors from having to prophesy when directors are entering into transactions that would render the entity insolvent and improperly prejudice creditors' interests.

Mr. Ingersoll also contends as a policy matter that if I hold the insolvency exception to mean insolvency in fact, a court could hold a director of an insolvent in fact corporation liable to creditors but not liable to shareholders due to the scope of the statutory provision allowing the elimination of director liability (i.e., 8 *Del. C.* § 102(b)(7) (1991)), according to Mr. Ingersoll's interpretation of the scope of section 102(b)(7). In response to this argument, I first note that even if I assume that only my particular interpretation of the insolvency exception will cause this purported anomaly to arise, there is nothing I can do to rectify it since I still believe that Delaware caselaw and the ordinary meaning of the word insolvency require the interpretation of the insolvency exception which I have adopted. Second, the existence of the anomaly does not depend on the particular interpretation of the insolvency exception which I adopt since, under Mr. Ingersoll's interpretation of the scope of section 102(b)(7), the anomaly would exist even if I adopted his interpretation of the insolvency exception. That is, even if I held that the insolvency exception arises when statutory proceedings have begun, a court could hold a director of a corporation, for which statutory proceedings had begun, liable to creditors but not liable to shareholders, under Mr. Ingersoll's interpretation of the scope of section 102(b)(7).

[9-10] Ultimately, I find that Delaware caselaw, primarily, and the ordinary meaning of the word insolvency, secondarily, require me to hold that fiduciary duties to creditors arise when one is able to establish the fact of insolvency. Furthermore, I find that policy concerns do not necessarily call for a different conclusion. Thus, section 3114 provides a statutory basis for jurisdiction over Mr. Ingersoll. Accordingly, I deny Mr. Ingersoll's motion to dismiss based on his argument that this Court lacks a statutory basis for the exercise of jurisdiction over him.

2. Due Process

Mr. Ingersoll also argues that this Court lacks personal jurisdiction over him because the exercise of such jurisdiction would violate his due process rights. That is, Mr. Ingersoll argues that his only contact with this state as his status as a director of IPCO. He argues that this directorship is not a sufficient contact since he owed no fiduciary duty to plaintiff during the relevant time period because a statutory proceeding had not begun.

[11] It does appear that Mr. Ingersoll's contact with this state solely consists of his status as a director of IPCO, a Delaware corporation. However, as is clear from my discussion of the insolvency exception, above, fiduciary duties to creditors arise at the moment of insolvency rather than at the moment of the institution of statutory proceedings. Therefore, assuming IPCO was insolvent during the relevant time periods,[3] Mr. Ingersoll owed Mr. Geyer fiduciary duties. Furthermore, by virtue of his acceptance of the directorship position, Mr. Ingersoll has consented to service of process in lawsuits based on a breach of his fiduciary duties as a director of IPCO. *See Kidde*, 593 A.2d at 566. Moreover, Mr. Ingersoll should have reasonably anticipated being haled into a Delaware court for this type of lawsuit under section 3114 given the language in *Bovay* and the ordinary meaning of the word insolvency. Therefore, I find that the exercise of personal jurisdiction over Mr. Ingersoll in this case would not violate his due process rights. Accordingly, I deny Mr. Ingersoll's

3. Mr. Ingersoll does not argue that IPCO was not insolvent or that plaintiff has failed to allege insolvency sufficiently in this part of his argument. Rather, Mr. Ingersoll relies on his argument that fiduciary duties to creditors arise via the insolvency exception at the moment statutory proceedings have begun in arguing that the exercise of jurisdiction over him would violate his due process rights. Accordingly, I address the sufficiency of plaintiff's insolvency allegations in part II(B) of my decision.

motion to dismiss with respect to his argument that the exercise of personal jurisdiction over him by this Court would violate his due process rights.

B. *Failure to State a Claim*

[12-13] In deciding the facet of Mr. Ingersoll's motion to dismiss which alleges that plaintiff has failed to state a claim upon which I can grant relief, I note that I must take all well plead allegations of the complaint as true. *See Good v. Getty Oil Co.*, Del. Ch., 518 A.2d 973, 975 (1986). Further, I must construe all inferences in the light most favorable to plaintiff. *Weinberger v. UOP, Inc.*, Del. Ch., 409 A.2d 1262, 1263 (1979), *rev'd on other grounds*, Del. Supr., 457 A.2d 701 (1983). However, I also note that the motion does not concede conclusory allegations of law or fact which plaintiff does not support with allegations of specific facts. *Glaser v. Norris*, Del. Ch., C.A. No. 9538, Chandler, V.C. (Jan. 6, 1992), slip op. at 7. Ultimately, given these guidelines, I cannot grant Mr. Ingersoll's motion unless it appears with a reasonable certainty that plaintiff would not be entitled to the relief sought under any set of facts which could be proven to support the action. *Rabkin v. Philip A. Hunt Chem. Corp.*, Del. Supr., 498 A.2d 1099, 1104 (1985).

1. Count I

Count I of plaintiff's complaint purportedly states a claim for breach of fiduciary duty. Mr. Ingersoll argues that I should grant his motion with respect to count I because he did not owe Mr. Geyer, a creditor, fiduciary duties and because plaintiff's allegations of insolvency are conclusory.

[14] Mr. Ingersoll's argument that he could not have owed Mr. Geyer fiduciary duties obviously is without merit. As stated throughout this decision, it is the fact of insolvency and not the institution of statutory proceedings which causes fiduciary duties to creditors to arise. Moreover, plaintiff alleges that IPCO was insolvent (Comp. ¶¶ 16, 21, 29) and that, during the two years subsequent to the consummation of the repurchase agreement, IPCO's substantial assets were so liquidated that its liabilities probably were greater than the value of its assets (Comp. ¶¶ 13, 17). More specifically, plaintiff alleges that, in December 1989, Mr. Ingersoll caused IPCO to give up an asset worth approximately $50 million for consideration primarily paid to Mr. Ingersoll and Warburg (Comp. ¶ 14), that, in 1990, Mr. Ingersoll caused IPCO to cancel valuable management

agreements with the domestic newspapers retained by Warburg in return for consideration paid to Mr. Ingersoll (Comp. ¶ 15) and that, as a result of the transactions, IPCO failed to make payments due to plaintiff because it was unable (Comp. ¶ 11). Although these allegations do not completely persuade me that IPCO was insolvent in fact, I find that they sufficiently allege specific facts which support plaintiff's claim that IPCO was insolvent for purposes of defendants' motion to dismiss. Accordingly, I deny Mr. Ingersoll's motion to dismiss with respect to his argument that count I of the complaint fails to state a claim for which I can grant relief.

2. Count II

Count II of plaintiff's complaint purportedly states a claim for fraudulent conveyance based on IPCO's cancellation of its management agreements. Mr. Ingersoll argues that this claim is conclusory. More specifically, he argues that plaintiff has failed to plead adequately, under the relevant statutory scheme, that IPCO's cancellations of its management agreements were "conveyances," that IPCO did not receive "fair consideration" in exchange for the cancellations and that the cancellations rendered IPCO "insolvent."
[15-16] Under the Fraudulent Conveyances Act, the term conveyance "includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or encumbrance." 6 *Del. C.* § 1301(2) (1974). The parties' dispute with regard to the term "conveyance" rests on their dispute as to whether the cancellation of the management agreements constitutes a release as the term is used in section 1301(2). The Legislature intended the term release to include actions by a debtor to separate himself from assets which otherwise might be used to pay creditors. *Bellis v. Morgan Trucking, Inc.*, 375 F. Supp. 862, 866 (D. Del. 1974).
[17] Mr. Ingersoll's principal argument is that the cancellation of the management agreements is not a release within section 3101(2) because IPCO could not transfer or assign the agreements. It is true that, in *Bellis*, the Court relied, in part, on the non-transferable nature of the lease in holding that the cancellation of the lease was not a release. *Id.* at 866-67. However, the situation in this case is fundamentally distinct from the facts in *Bellis*. That is, the corporation-debtor in *Bellis* cancelled its lease with its *landlord*. In form and in substance, the lease was a liability to the corporation since it was not transferable and represented a duty to pay. In this case,

however, the management contracts represented an asset to IPCO. By cancelling the management agreements, IPCO did not give up a duty to pay, as was the case in *Bellis*. Rather, it gave up the right to a steady stream of income. Accordingly, I find that the alleged management agreement cancellations fall within the ambit of the term release as defined by section 1301(2) because the agreements were assets that IPCO could have used to pay its creditors notwithstanding the fact that IPCO could not transfer the agreements. [18-19] Mr. Ingersoll also argues that plaintiff's allegations that the transactions were not made with fair consideration are conclusory. A facet of the Fraudulent Conveyances Act is the necessity of the property received in exchange for the property given up by the debtor in a particular transaction as being less than "fair consideration," which means a fair equivalent to the property given up, *see* 6 *Del. C.* § 1303(1) (1974). In his complaint, plaintiff alleges that IPCO received less than fair consideration in the transactions at issue. (*See* Comp. ¶¶ 13, 28.) More specifically, plaintiff alleges that IPCO gave up a $50 million asset in exchange for an agreement by Goodson to sell the New Haven Register to Mr. Ingersoll and a release of Goodson's claims against IPCO. (Comp. ¶ 14.) Given the fact that part of the consideration went to Mr. Ingersoll rather than IPCO and that the value of the consideration paid to IPCO allegedly was meager,[4] plaintiff sufficiently alleges specific facts to support his claim that IPCO did not receive fair consideration in the transaction so as to withstand Mr. Ingersoll's motion to dismiss.

The same conclusion is true with respect to the transaction whereby IPCO cancelled its management contracts with the domestic newspapers. (*See* Comp. ¶ 15.) It certainly appears reasonable to infer that these contracts were valuable money making rights to IPCO because newspaper management was IPCO's business. It would not have been in this business if these contracts did not generate income. Thus, it appears from the complaint that IPCO gave up this valuable right for consideration that went completely to Mr. Ingersoll. Such an allegation sufficiently supports plaintiff's averment that IPCO did not receive fair consideration from the transaction.

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4. I conclude that this part of the consideration is meager according to plaintiff because the plaintiff uses the phrase "[t]he *only* consideration received by IPCO . . . ." (Comp. ¶ 14) (emphasis added).

[20-21] In addressing Mr. Ingersoll's argument regarding the term "insolvency," I note that a court may deem a conveyance fraudulent if the person making the conveyance "is or will be thereby rendered insolvent . . . ." 6 *Del. C.* § 1304 (1974). Furthermore, "[a] person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured." 6 *Del. C.* § 1302(a) (1974).

[22] In his complaint, plaintiff alleges that IPCO surrendered its major assets in exchange for paltry consideration beginning in 1989. (Comp. ¶¶ 13, 28.) More specifically, plaintiff alleges that IPCO canceled its management agreement with Goodson, which was worth approximately $50 million, and its management agreements with the domestic newspapers retained by Warburg in exchange for little or no consideration. (Comp. ¶¶ 14, 15.) As a result of these transactions, plaintiff alleges, IPCO was rendered insolvent and unable to pay its liability to plaintiff. (Comp. ¶¶ 6, 16, 29.) Given that insolvency is a matter likely to be peculiarly within the knowledge of IPCO and Mr. Ingersoll since plaintiff appears to have left his position at IPCO by October 1988 (*see* Comp. ¶ 7) and given that plaintiff has alleged that IPCO was insolvent and unable to pay Mr. Geyer and provides specific examples of the transactions which purportedly created this situation, I find that plaintiff's averments are not merely conclusory, but rather, sufficiently allege specific facts demonstrating IPCO's insolvency for purposes of Mr. Ingersoll's motion to dismiss.

[23] Since I have found, for purposes of Mr. Ingersoll's motion to dismiss, that plaintiff adequately alleges that the cancellation of the management agreements was a release as defined by section 1301(2), that plaintiff adequately alleges that IPCO did not receive fair consideration, as defined by section 1303(1), in exchange for the cancellation of its management agreements and that plaintiff adequately alleges that IPCO was insolvent or rendered insolvent by the management contract cancellations, I deny Mr. Ingersoll's motion to dismiss count II based on plaintiff's failure to state a claim for which I can grant relief.[5]

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5. In his reply brief, Mr. Ingersoll attempts to expand the scope of his arguments as to count II by arguing that plaintiff has failed to adequately allege that, after the transactions at issue, IPCO was left with unreasonably small capital, 6 *Del. C.* § 1305 (1974), and that Mr. Ingersoll had an actual intent to defraud, 6 *Del. C.* § 1307 (1974). As to the unreasonably small capital issue, plaintiff does

3. Count III

Count III purportedly provides authority for me to grant plaintiff a judgment on the Note. Mr. Ingersoll argues that count III fails to state a claim upon which I can grant relief because the Note contractually binds Mr. Geyer to look only to IPCO for its satisfaction and because Mr. Geyer has failed to plead facts sufficient to pierce IPCO's corporate veil.

Plaintiff concedes that the Note contains a no recourse provision.[6] However, plaintiff argues that count III states a contract claim against IPCO and an equitable claim, rather than a contract claim, against Mr. Ingersoll. Therefore, according to plaintiff, the no recourse provision does not justify dismissal of count III with respect to Mr. Ingersoll. Moreover, plaintiff contends, he has alleged specific facts that are not merely conclusory but are sufficient to pierce IPCO's corporate veil.

[24-25] If count III stated a contract claim against Mr. Ingersoll, I clearly would have to dismiss the claim because of the no recourse provision. *See Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, Del. Ch., C.A. No. 8578, Berger, V.C. (Jan. 27, 1988), mem. op. at 6. However, the complaint purports to hold Mr. Ingersoll liable for the Note not because he is bound contractually, but rather, because

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allege that the transactions occurred when IPCO was undercapitalized and unable to pay its debts as they became due. (Comp. ¶ 29.) Moreover, the particular capitalization of an entity is a matter likely to be peculiarly within the knowledge of Mr. Ingersoll and IPCO, of which company Mr. Geyer is not an employee. Further, plaintiff gives two concrete examples of the transactions which created this situation. Therefore, at this juncture I find that plaintiff's allegations sufficiently imply that IPCO was left with unusually small capital. Thus, I refuse to hold that plaintiff fails to state a claim under § 1305.

As to the sufficiency of the intent to defraud allegations, I find that the pleading requirements of Chancery Court Rule 9(b) do apply to a claim under § 1307. *See China Resource Prods. Ltd. v. Fayda Int'l, Inc.*, No. 90-159-JLL, slip op. at 5 n.6 (D. Del. Mar. 20, 1992). However, I find that plaintiff's complaint satisfies the requirements of Rule 9(b): plaintiff generally avers that Mr. Ingersoll fraudulently surrendered major assets of IPCO to the detriment of IPCO's creditors (Comp. ¶ 13) and specifically identifies the circumstances constituting the fraud (Comp. ¶¶ 14-15). Therefore, I refuse to hold that plaintiff fails to state a claim under § 1307.

6. The Note states that

> no officer, director, employee or agent of Obligor [i.e., IPCO] shall have any liability hereunder in his personal or individual capacity, but, instead, all parties shall look solely to the property and assets of Obligor for satisfaction of claims of any nature arising under or in connection with this Note.

(Comp. Exh. B at 3.)

he is the alter ego of IPCO. (Comp. ¶ 38.) Such an alter ego claim is distinct from a contract claim and is equitable in nature. *See Mabon, Nugent & Co.*, C.A. No. 8578, slip op. at 7. Furthermore, the no recourse provision does not bar equitable claims. *Id.*

[26-27] As to the sufficiency of plaintiff's alter ego claim, I note that a court can pierce the corporate veil of an entity where there is fraud or where a subsidiary is in fact a mere instrumentality or alter ego of its owner. *Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, Del. Ch., C.A. No. 8578, Berger, V.C. (Apr. 12, 1990), mem. op. at 11. In this case, plaintiff does make a number of conclusory averments that IPCO was the mere instrumentality of Mr. Ingersoll. (*See* Comp. ¶¶ 6, 13, 38.) However, plaintiff supports these statements with three specific allegations: IPCO cancelled its management agreement with Goodson, an asset worth approximately $50 million, basically in exchange for Goodson's agreement to sell the New Haven Register to Mr. Ingersoll (Comp. ¶ 14); IPCO cancelled its management agreements with the domestic newspapers retained by Warburg in exchange for Mr. Ingersoll receiving the British and Irish holdings held by Mr. Ingersoll and Warburg (Comp. ¶ 15); and Mr. Ingersoll stated that he, personally, would pay back the balance on the Note (implying that he viewed IPCO's debts as his own) (Comp. ¶ 18). For purposes of the motion to dismiss, these three examples provide sufficiently specific factual allegations to support plaintiff's conclusion that Mr. Ingersoll was the alter ego of IPCO and, therefore, that I can pierce IPCO's corporate veil and hold Mr. Ingersoll liable on the Note.

Since I have found that plaintiff's claim against Mr. Ingersoll in count III is equitable in nature and conclusory, I deny Mr. Ingersoll's motion to dismiss count III based on plaintiff's failure to state a claim for which I can grant relief.

III. MOTION TO STAY DISCOVERY

[28] Since Mr. Ingersoll primarily bases his motion to stay discovery on the pendency of his motion to dismiss and since his motion to dismiss is no longer pending because I have denied it, I deny the motion to stay discovery.

IV. MOTION FOR JUDGMENT ON THE PLEADINGS AS TO COUNT II

[29-30] As IPCO argues, "A motion for judgment on the pleadings is in the nature of a motion to dismiss or demurrer . . . ." *Gordon*

v. Rolfe, Del. Ch., C.A. No. 8171, Jacobs, V.C. (Feb. 26, 1986), mem. op. at 5. Indeed, a court may grant a judgment on the pleadings when the admitted facts "clearly entitle the moving party to judgment." *Id.* Given my analysis of count II under Mr. Ingersoll's motion to dismiss, above, I obviously do not believe that IPCO is clearly entitled to a judgment. Therefore, I deny IPCO's motion for a judgment on the pleadings with respect to count II of plaintiff's complaint.

V. CONCLUSIONS

I hold that there is a statutory basis for this Court's exercise of jurisdiction over Mr. Ingersoll and that the exercise of such jurisdiction would not violate his due process rights. Therefore, I deny Mr. Ingersoll's motion to dismiss based on this Court's lack of personal jurisdiction over him. Also, I deny Mr. Ingersoll's motion to dismiss plaintiff's claims because I find that they state a claim for which I can grant relief. Further, I deny Mr. Ingersoll's motion to stay discovery because I deny his motion to dismiss, the pendency of which he primarily relies upon in arguing for a stay. Finally, I deny IPCO's motion for judgment on the pleadings with respect to count II of plaintiff's complaint because, as explained in my analysis of Mr. Ingersoll's motion to dismiss, I find that IPCO is not clearly entitled to a judgment on this count.

IT IS SO ORDERED.

GLINERT v. WICKES COS.

No. 10,407

Court of Chancery of the State of Delaware, New Castle

July 13, 1992

Plaintiff, a former holder of warrants to purchase common stock of defendant brought suit on behalf of a class of warrantholders contending a merger and reclassification of stock was employed by defendants to defeat the warrantholders' right to receive common

stock. The suit was dismissed for failure to state a claim upon which relief could be granted. Plaintiff then requested that the court of chancery set aside the motion, or, in the alternative, that she be allowed to conduct further discovery. Plaintiff contended that new evidence would prove that defendants intended to provide its warrantholders with preferred stock as opposed to a more secure, special class of stock.

The court of chancery, per Chancellor Allen, denied plaintiff's motion under the fraud provisions of Chancery Court Rule 60(b). The court held that plaintiff did not show clear and convincing proof of fraud or circumvention by defendants in obtaining the judgment and was not convinced that defendants would have changed their decision had they known of the alleged improprieties. The court further held that a fiduciary duty was not owed to the warrantholders and that plaintiff could not allege that the warrantholders relied on the purported misdisclosure to their own detriment.

1. Judgment ⟹ 509

If a movant offers evidence that her opponent used fraud or circumvention in obtaining a judgment, she must ordinarily do so by proof of clear and convincing evidence and within a reasonable period of time after the final judgment has been entered.

2. Judgment ⟹ 509

Evidence of fraud must be of such a material nature that it would convince the court that it would probably change its decision had it known of the transgression or improprieties committed during the proceedings.

3. Corporations ⟹307
Securities Regulations ⟹49.26(3)

Fiduciary duty owed to shareholders does not extend to warrantholders; therefore, an alleged non-disclosure to the plaintiff did not affect the fact the shareholders authorized a reclassification of warrants.

4. Securities Regulations ⟹49.26(3)

Where warrantholders played no role in authorizing or approving a reclassification and merger, plaintiff can not allege

that the warrantholders relied on a purported misdisclosure to their detriment.

William Prickett, Esquire, and Wayne J. Carey, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Bruce S. Coleman, Esquire, of Coleman & Rhine, New York, New York, for plaintiff.

Michael D. Goldman, Esquire, and Stephen C. Norman, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; Kenneth J. Nachbar, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and C. Stephen Bigler, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendants.

ALLEN, *Chancellor*

In a Memorandum Opinion, dated March 27, 1990, and corresponding Order, dated April 24, 1990, this court granted defendants' motion to dismiss the class action complaint in this action for failure to state a claim upon which relief could be granted. *Glinert v. Wickes Cos.*, Del. Ch., C.A. 10,407 (Mar. 27, 1990). That decision and order were affirmed on appeal by the Delaware Supreme Court. *Glinert v. Wickes Cos.*, Del. Supr., 586 A.2d 1201 (1990).

Plaintiff now moves under Chancery Court Rule 60(b) for an order granting relief from final judgment in this case based on an offering of new evidence that allegedly shows that defendants made material misrepresentations both to the plaintiff class and to the court at the time in which they presented their motion to dismiss. If defendants' fraudulent behavior had been known to the court at that time, plaintiff contends, it would have had a material effect upon the court's decision to dismiss the complaint. Plaintiff requests that, based upon this new evidence, the court set aside its final judgment or that, in the alternative, it allow plaintiff to conduct discovery in order to substantiate further the factual allegations made in the pending motion.

For the reasons that follow, the motion will be denied.

I.

The factual allegations of the complaint were described in the opinion dismissing the action. *See Glinert v. Wickes Cos.*, C.A. No. 10,407, mem. op. at 1-9. Recalling the following background facts may, however, be helpful.

Plaintiff is a former holder of warrants to purchase common stock of Wickes Companies, Inc. As distributed, each warrant entitled its holder to purchase one share of Wickes common stock. The warrants contained an unusual feature at their issue: on their expiration date, January 26, 1992, each unexercised warrant would automatically convert, without any action by the holder, into a fraction of a share of Wickes common stock. *See id.*, memo. op. at 3-4.

In 1988, Wickes' board approved a merger agreement with WCI Holdings (partly owned by Blackstone Capital Partners, L.P. and Wasserstein, Perrella Partners, L.P.). Under the merger agreement, WCI Holdings agreed to make a two-step offer: 80% of Wickes' common stock would be purchased for cash, and the remaining stock would be converted, in a merger with WCI Acquisition (a subsidiary of WCI Holdings Corp.), into rights to fractional shares of WCI Holdings 15% cumulative exchangeable redeemable preferred stock ("WCI Holdings Preferred"). The warrants were to remain outstanding after the tender offer and merger. *See id.*, memo. op. at 5.

In 1989, prior to the merger but after the tender offer was successfully completed, Wickes and WCI Holdings distributed a joint proxy statement which disclosed that a reclassification of Wickes common stock would be effectuated immediately prior to the merger. The transaction outlined in the proxy statement had several steps, with the result that each share of Wickes' common stock (which in the merger would be converted into WCI Holdings Preferred) was converted just prior to the merger into a fraction of a share of a new class of Wickes $15^1/_2$% cumulative exchangeable redeemable preferred stock ("Intermediate Preferred") that mirrored the terms of the WCI Holdings Preferred stock to be issued in the merger.[1]

1. The reclassification and then merger involved several detailed steps. First, Wickes issued one share of intermediate common stock to WCI Holdings for $11.25 in cash. Second, on the next business day, each Wickes common share (but not the intermediate common) was reclassified into .45 of a share of a new class of Wickes $15^1/_2$% cumulative exchangeable redeemable preferred stock ("Intermediate Preferred"). Third, immediately after the reclassification became effective, Acquisition, a wholly-owned subsidiary of WCI Holdings, was merged into Wickes, the surviving corporation. At that point in time, each publicly owned share of Wickes Intermediate Preferred was converted into one share of WCI Holdings Preferred Stock and the Intermediate Preferred Stock and intermediate common stock held by WCI Holdings was canceled with no payment. *Glinert*, C.A. No. 10,407, mem. op. at 7-8.

At a special stockholders' meeting on April 12, 1989, Wickes' stockholders approved the reclassification and the WCI Holdings merger agreement. The follow-up merger was effectuated on April 13, 1989. *See id.*, mem. op. at 6-9.

As a result of the reclassification, each outstanding warrant was no longer exercisable or convertible into Wickes common stock, but instead became exercisable or convertible into a fraction of a share of Wickes Intermediate Preferred stock, which, at the option of the holder after the merger, could be exchanged into shares of WCI Holdings Preferred stock. The Intermediate Preferred stock had a financial preference over the WCI Holdings Preferred stock in that it was a direct obligation of Wickes not WCI Holdings Corporation, the parent. In all events, at the expiration date, any outstanding warrants would be automatically converted into Intermediate Preferred shares.

In March 1990, Glinert brought this multi-count action, on behalf of a class of warrantholders. Plaintiff contended that the merger and reclassification was employed as a device to defeat the warrantholders' right to receive common stock. The reclassification was, according to plaintiff, a sham, perpetuated to preclude warrantholders from realizing the potentially unlimited upside potential from holding an instrument that would convert into common stock of Wickes. It was said to represent a breach of contract, a breach of fiduciary duty and a fraud.

This court dismissed plaintiff's complaint. The principal reasoning for dismissing the complaint is discussed below (*see infra* pp. 8-12). The Delaware Supreme Court affirmed this court's decision in an Order dated December 12, 1990.[2]

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2. On December 27, 1990, plaintiff moved in the Supreme Court for a rehearing *en banc* or for remand based on an alleged finding of new and relevant evidence. Plaintiff claimed to have discovered evidence that Wickes permitted its common stock to be traded during an alleged one-day period between the reclassification of the common stock into preferred shares and the effective date of the follow-up merger. Plaintiff claimed that Wickes' alleged failure to request a stop of trading in its common stock during this period was conclusive proof that the reclassification was a sham transaction, having no effect upon the common stock and effectively destroying the value of the outstanding warrants. The evidence offered was a stock quotation page from the *Wall Street Journal* and a summary of a Wickes filing with the Delaware Secretary of State. The Supreme Court found no basis for plaintiff's assertion, since defendants offered conclusive evidence that the reclassification and the merger took place on the same day, and denied her motion by an Order dated January 25, 1991.

II.

Plaintiff now moves for either an order granting relief from the final judgment or an order allowing for discovery into her factual allegations. Plaintiff brings her motion under the fraud provisions of Chancery Court Rule 60(b), which state in pertinent part:

> On motion and upon such terms as are just, the Court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons: . . . (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation or other misconduct of an adverse party . . . . This Rule does not limit the power of a Court to entertain an independent action to relieve a party from a judgment, order or proceeding . . . or to set aside a judgment for fraud upon the Court.

Plaintiff argues that new and significant evidence has come to light which demonstrates, as a factual manner, that defendants had no intention in 1989 or 1990 of carrying out the specific terms of the reclassification that purported to have the effect of making any warrants outstanding on January 26, 1992 convertible into shares of Wickes *Intermediate Preferred stock*. Specific acts taken by defendants in the months prior to the expiration date, plaintiff argues, demonstrate that the defendants intended to provide to the warrantholders the arguably less secure WCI Holdings Preferred shares instead of Intermediate Preferred.

Plaintiff contends that defendants' intent concerning the reclassification was material and was relied upon by the court in dismissing the complaint. She argues that the court was influenced by defendants' representations that the reclassification had independent significance to the warrantholders (e.g., that the warrantholders would receive preferential Intermediate Preferred stock). It was these representations, plaintiff argues, which convinced the court of the legitimacy of the reclassification. Thus, if the court had been aware of the posited intention to deny the warrantholders' legal rights to Intermediate Preferred stock, plaintiff argues, it would not have dismissed plaintiff's claims.

In support of her contention, plaintiff offers as evidence three different notices that were sent to warrantholders between June 1991 and February 1992. The first two of these notices appear to have provided incorrect information concerning the conversion and exercise of the warrants and the last, which defendants assert corrected

any error, also contained a material omission, according to plaintiff.

In the first notice, sent in response to specific requests made by warrantholders, defendants made no mention of the reclassification and stated that the warrants were then exercisable (or would be automatically converted on January 26, 1992) into WCI Holdings Preferred shares. *See* Pl.'s Exh. 3. The second notice, sent out to inquiring warrantholders in January 1992, also failed to mention the reclassification and also stated that the warrants were exercisable or automatically convertible into WCI Holdings Preferred. *See* Pl.'s Exh. 2. Finally, a notice was sent to all warrantholders on February 25, 1992, which corrected the omission and misstatements in the two previous letters. Plaintiff argues, however, that this notice was not sent until after she filed her present motion (i.e., it was prompted by her motion) and also contains a significant omission since it does not state that the Intermediate Preferred shares enjoy a financial advantage over the WCI Holdings Preferred shares.

As additional evidence, plaintiff offers recent reports published by Standard & Poors and the CCH Capital Changes Reporters which state that the warrants would convert into WCI Holdings Preferred stock upon their expiration. The existence of these reports is enough, plaintiff contends, to show that defendants provided incorrect information to these two agencies. *See* Pl.'s Exh. 10. Finally, plaintiff offers evidence of several brokerage account statements to show that some of the warrants were actually converted by defendants into WCI Holdings Preferred stock on January 26, 1992. *See* Pl.'s Exhs. 4-6.

In summary, plaintiff argues, that all of this evidence, supports her contention that there was, in 1989 and 1990, a secret intention not to implement the reclassification in all respects; and that the defendants committed a fraud upon the warrantholders, at the time the reclassification was adopted and approved by Wickes' shareholders, and a fraud upon this court at the time when defendants argued in favor of their motion to dismiss plaintiff's complaint. That is, it is charged that defendants knowingly made false representations to the warrantholders and the court as to the purposes for, and effects of, the reclassification. Both the court and warrantholders assertedly relied upon these representations.

III.

[1-2] Rule 60(b) provides an escape valve to prevent injustice. But it may not be resorted to casually or on less than a powerful showing

that a substantial risk of an injustice is present. If a movant offers evidence that her opponent used fraud or circumvention in obtaining a judgment, she must ordinarily do so by proof of clear and convincing evidence and within a reasonable period of time after the final judgment has been entered. *See, e.g., Metlyn Realty Corp. v. Esmark, Inc.*, 763 F.2d 826, 829-32 (7th Cir. 1985); *H.K. Porter Co. v. Goodyear Tire & Rubber Co.*, 536 F.2d 1115, 1121 (6th Cir. 1976); *see also* 11 C. Wright & A. Miller, *Federal Practice and Procedure* §§ 2860, 2870 (1973) (cases cited therein). A movant bears a heavy burden of proof in order "to protect the finality of judgments against efforts to turn the vicissitudes of litigation into grounds for more litigation still." *Metlyn Realty Corp.*, 763 F.2d at 832. Furthermore, evidence of fraud must also be of such a material nature that it would convince the court that it would probably change its decision had it known of the transgressions or improprieties committed during the proceedings. *See id.* at 820, 831, 836-37; *H.K. Porter*, 536 F.2d at 1122. *Cf. Levine v. Smith*, Del., 591 A.2d 194, 202 (1991).

For the reasons set forth below, I conclude that even if plaintiff were able to meet her burden of proof of clear and convincing evidence to establish the factual predicate for her argument—that there was from the beginning an intention to ignore the existence of the Intermediate Preferred when automatic conversion of warrants was to take place—establishment of such a fact would have had no material effect upon the reasoning and conclusions reached in the March 27, 1990 Memorandum Opinion.

* * *

The March 27, 1990 Memorandum Opinion addressed the five counts alleged by plaintiff in her complaint. The counts challenged the reclassification and merger as: (1) a breach of the agreement governing the warrants; (2) a constructive redemption of the warrants; (3) a breach of good faith and fair dealing implied in the warrant agreement; (4) a breach of fiduciary duty owed to the warrantholders by defendants; (5) a breach of duty of complete disclosure and a fraud upon the warrantholders. *See* Suppl. Compl. ¶¶ 36-37.

Plaintiff's new evidence, if found to be convincing, in my opinion, would relate only to three of these counts: (1), (3) and (5). Counts (2) and (4) were disposed of as a matter of Delaware law, and in my mind, no factual allegations now made by plaintiff would change the results reached.

The Memorandum Opinion analyzed counts (1) and (3) together since both related to interpretation of specific provisions (sections 10

and 12)[3] of the warrant agreement. I gave, I thought, close scrutiny to these two counts, since they represented, in my mind, the most viable of the plaintiff's claims. Plaintiff argued in count (1) that the reclassification was a breach of Section 10(a) of the warrant agreement, and in count (3), that it was a breach of an implied obligation to treat the warrantholders fairly. Even assuming the reclassification was consistent with the express terms of Section 10(a), plaintiffs argued, that step could not be consistent with an obligation of good faith fair dealing implied in contracts governed by California law.

It was determined that plaintiff's first count failed to state a claim, since Section 10(a) of the warrant agreement, in my mind, by its plain language allowed for a reclassification of the stock into which the warrants were exercisable. Thus, I concluded that the warrant agreement contained no express limitation upon the power of the issuer to engage in such reclassification.

Plaintiff's more promising argument, in my mind, rested on her claim (count 3) that the defendants breached an implied promise not to decrease the economic value of the warrants in a reclassification and merger in which Wickes was the surviving entity. There, plaintiff claimed that under Section 12 of the warrant agreement Wickes could only adversely affect the warrants' economic value where Wickes

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3. Section 10(a) states in pertinent part:

The Purchase Price, the number of shares covered by each Warrant and the number of Warrants outstanding are subject to adjustment from time to time upon the occurrence of the events enumerated in this Section 10.

(a) In case the Company shall . . . (iv) issue any shares of its capital stock in a reclassification of the Common Stock (*including any such reclassification in connection with a . . . merger . . . in which the Company is the continuing corporation*), *the Purchase Price in effect at the time . . .* of the effective date of such . . . reclassification, and *the number and kind of shares of capital stock issuable on such date shall be proportionately adjusted* so that the holder of any Warrant exercised or converted after such time *shall be entitled* to receive the aggregate *number and kind* of shares of capital stock which, if such Warrant had been exercised or converted immediately prior to such date . . . he would have owned upon such exercise or conversion and been entitled to receive by virtue of such reclassification . . . .

Section 12 states in pertinent part:

Consolidation, Merger or Sale of Assets

If . . . the Company shall at any time . . . merge into another corporation, the holder of any outstanding Warrants will thereafter receive, upon the exercise thereof . . . the securities, property or cash to which the holder of the number of shares of common stock then deliverable upon the exercise of such warrants would have been entitled upon such . . . merger . . . .

Glinert, C.A. No. 10,407, mem. op. at 14.

was not the surviving entity. I concluded, however, that this merger and reclassification did not breach an implied promise.

In my opinion, Section 12 revealed that the parties to the warrant agreement must have understood that the economic value of the *option feature* of the warrants could properly be destroyed by merger in which Wickes disappeared. I concluded that the contracting parties would have regarded another form of transaction that accomplished the same thing but left Wickes surviving as implicitly permissible under Section 12. Thus, I concluded that under the terms of the warrant agreement, the defendants had the right (actual and implied) to effectuate the reclassification and merger which eliminated the value of the warrants' option feature. *See Glinert*, C.A. No. 10,407, mem. op. at 13-20.

Consideration of evidence consistent with plaintiff's recent assertion would not have any impact upon the reasoning supporting the dismissal of her claims. It was held that the warrant agreement allowed Wickes to reclassify the warrants, effectively eliminating the value of their stock option feature. The court's decision did not rest upon Wickes' motivation for effectuating the reclassification, rather it rested upon an interpretation of specific language found in Sections 10 and 12 of the warrant agreement. Defendants were found to be authorized to reclassify the instruments into which the warrants would be converted on expiration. The evidence now offered by plaintiff does not cast any doubt, in my mind, as to the contractual rights available to defendants.

Plaintiff's fifth count alleged that defendants breached a duty of full and complete disclosure by issuing a materially false and misleading proxy statement. Plaintiff claimed that the proxy statement contained omissions and misstatements of material facts in violation of both the fiduciary duty of candor and contractual duty of disclosure and that the warrantholders were harmed as a result. The contractual duty arose from a provision of the warrant agreement which required Wickes to give warrantholders notice specifying the date of any reclassification.

These claims were dismissed after concluding that defendants owed no fiduciary duty of candor to warrantholders. Furthermore, I declined to find any breach of the disclosure requirements that were in the warrant agreement, since plaintiff did not allege that Wickes failed to give to warrantholders the notice required by the warrant agreement.

[3] Plaintiff's new evidence might arguably assist in proving that material misstatements were made in the proxy materials that were

submitted to Wickes *shareholders* who authorized the reclassification. However, that proof was found to be irrelevant. Although shareholders were owed a duty of candor, that duty did not extend to the plaintiff warrantholders. More practically, at the time of the vote, voting control of the company was held by defendants. Therefore, it would be a complete fiction (and demonstrably false) to assert that but for this alleged non-disclosure the plaintiff warrantholders might have not been affected by the reclassification. *Cf. Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2761-66 (1991). Therefore, the proffered evidence has no relevance to this plaintiff claim of disclosure violation.

[4] Finally, plaintiff's fifth count also alleged that defendants committed fraud on the warrantholders because the proxy statement apparently misstated the number of shares of Wickes common stock that would be issued in exchange for shares of the acquisition company established to merger with Wickes. Again, I concluded that since the warrantholders played no role in authorizing or approving the reclassification and merger, plaintiff could not allege that the warrantholders relied on the purported misdisclosures to the warrantholders' detriment. Thus, the reliance element of plaintiff's fraud claim was found to be missing and the claim was dismissed.

Once again, plaintiff's new evidence, if considered by the court, would not assist her argument. The missing reliance element would still exist, even if there was further evidence of the defendants' intent to defraud or intent to misdisclose certain facts. The warrantholders were not in a position to act upon the defendants' representations or disclosures.

* * *

In summary, I conclude that plaintiff has not raised a sufficient specter of injustice to warrant reopening this case.

Even assuming that plaintiff's darkest imaginings could be shown to be correct—that is, that defendants all along intended to try to implement an exchange of WCI Holdings Preferred stock instead of the Intermediate Preferred stock that the reclassification contemplated—that evidence would not in my opinion "be so material as to probably change the result" reached in this case. This is so, in part, because the fundamental holding, which was the basis of the dismissal of the principal claims, was that it was not a violation of contract (good faith and fair dealing) for the issuer to employ the reclassification process simply for the purpose of precluding the warrants from being exercised into common stock, and that the reclassification in fact did just what the defendants represented it would

do. The rights associated with the warrants were effectively converted from rights on maturity to receive common stock to rights on maturity to receive Intermediate Preferred stock. That was the court's understanding and remains the case.

What now has been asserted is not that that understanding was incorrect but that there was (allegedly) an undisclosed intention to deny those legal rights and to substitute WCI Holdings Preferred stock for the required Intermediate Preferred stock. But even if one were to accept that speculation, it would not affect the legal rights of the warrantholders in the analysis of the court. It would mean that the warrantholders were at risk of a breach of contract at the time the warrants expired. But that breach, if it were to occur, would constitute a distinct legal wrong that could be remedied. The prospect of even a secret plan to effectuate such a breach would not change the existence of legal rights that were the subject of the analysis leading to dismissal of the complaint.

* * *

For the foregoing reasons, plaintiff's motion is therefore denied.

IN RE GRACE ENERGY CORP. SHAREHOLDERS LITIGATION

No. 12,464 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

June 26, 1992

Plaintiffs, minority shareholders of defendant corporation, moved to preliminarily enjoin the closing of a tender offer made by the defendant for the minority shares, alleging the offer contained material omissions and misrepresentations as it failed to make adequate disclosures of third-party offers and inquires.

The court of chancery, per Vice-Chancellor Hartnett, denied plaintiffs' motion for a preliminary injunction. The court found that the plaintiffs failed to meet their burden of showing a reasonable probability that there was a breach of the duties of care and loyalty. In addition, the court found that plaintiffs had failed to show that

the nondisclosure of information in the tender offer was harmful and that they would suffer harm if an injunction were not granted.

1. Corporations ⟹310(2)
   Pleading ⟹16

A showing of inconsistencies in the language of a board member's deposition testimony, taken out of context, does not alone satisfy a plaintiff's burden of showing the reasonable probability that there was a breach of a fiduciary duty of care.

2. Corporations ⟹310(1)
   Pleading ⟹16

To establish a breach of the fiduciary duty of loyalty, actual conflicting financial interest must be shown; conclusory allegations of mere personal affinity alone are not sufficient to establish conflicting director interest.

3. Corporations ⟹310(1)
   Pleading ⟹16

To establish that a board member has an economic conflict of interest, it must be shown that he has an interest that is in opposition to that of the corporation on whose board he sits. That a board researcher is employed by a company who owns shares of the corporation for which he sits does not establish a conflict of economic interest absent a showing that his interests are other than maximizing the best interests of the company on whose board he sits.

4. Corporations ⟹310(1), 320(13)
   Pleading ⟹9, 16
   Injunction ⟹22

A showing that third-party offers and inquiries were not disclosed to shareholders by the offerors prior to the completion of a tender offer transaction is not alone sufficient to warrant a preliminary injunction; there must be an additional showing of resulting harm that would occur if the completion of the tender offer is not enjoined.

Pamela S. Tikellis, Esquire, Carolyn D. Mack, Esquire, James C. Strum, Esquire, and Robert J. Kriner, Jr., Esquire, of Greenfield

& Chimicles, Wilmington, Delaware; Joseph A. Rosenthal, Esquire, and Kevin Gross, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; Berger & Montague, Philadelphia, Pennsylvania, of counsel; Abbey & Ellis, New York, New York; Lowey, Dannenberg, Bemporad & Selinger, P.C., New York, New York; and Goodkind, Labaton, Rudoff & Sucharow, New York, New York, for plaintiffs.

R. Franklin Balotti, Esquire, William F. Mongan, Esquire, David L. Zicherman, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Cravath, Swaine & Moore, New York, New York, of counsel, for defendants Grace Energy Corporation, and Messrs. Broun, Hutton, and Moore.

Anthony W. Clark, Esquire, Rodman Ward, Jr., Esquire, Jay W. Eisenhofer, Esquire, and Stuart M. Grant, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for defendants W.R. Grace & Company, and Messrs. Grace, Bolduc, Wright, Robbins, and Grimm.

HARTNETT, *Vice-Chancellor*

Plaintiffs, minority shareholders of defendant Grace Energy Corporation, have moved to preliminarily enjoin the closing of a tender offer for the minority shares made by Grace Energy's majority stockholder, defendant W.R. Grace & Company. Because plaintiffs have failed to show the reasonable probability that facts essential to their claims are true, and because the equities favor defendants, the motion for a preliminary injunction must be denied.

I

Grace Energy Corporation ("Energy") is a diversified energy holding company, comprised of seven individual companies: Grace Petroleum Company, Colowyo Coal Company, Support Terminal Services, Grace Drilling Company, Grace Offshore Company, Homco International, and Sea Oil Homco Limited. There are approximately 24.57 million shares of Energy outstanding, and defendant W.R. Grace & Company ("Grace") owns 83.4% of those shares. The remaining 16.6% of Energy's shares are listed and traded on the New York Stock Exchange.

Grace announced in mid-January 1991 that it planned a restructuring that would permit it to focus only on its core businesses of specialty chemicals and healthcare. One aspect of this restructuring would be the divestiture of Grace's interest in Energy. This was announced to Grace's shareholders in November 1991 as part of the company's new strategic plan.

On February 28, 1992, Grace's Board of Directors met to consider a recommendation by Grace management that Grace make a proposal to Energy's Board whereby Grace would acquire for cash all outstanding shares of Energy. After consulting with its legal advisors and its financial advisor, First Boston Corporation ("First Boston"), the Grace directors authorized an offer of $16.50 per share to the minority shareholders of Energy. Just prior to that authorization, Energy stock was trading at $12.50 per share.

J.P. Bolduc, President and Chief Operating Officer of Grace, contacted those directors of Energy who held no director or management positions with Grace and informed them of the terms of Grace's offer. Those directors are Edward L. Hutton, Edwin C. Broun, and Thomas P. Moore. Each owns stock in Energy.

Energy's Board of Directors met on March 5, 1992, in order to consider Grace's offer. Directors Hutton, Broun and Moore were appointed as a Special Committee that was charged with exploring Grace's offer and making recommendations to the full Board. The Board also authorized the Special Committee to engage its own legal and financial advisors to assist it. The Special Committee thus retained Cravath, Swaine and Moore as its legal counsel, and Goldman Sachs & Company ("Goldman Sachs") and Simmons & Company International ("Simmons") as its financial advisors.

Goldman Sachs and Simmons conducted separate due diligence reviews of Energy and its component businesses, with members of the Special Committee periodically reviewing their work and offering additional guidance. After completion of the due diligence reviews, the Special Committee met with its legal and financial advisors on April 20 and 21, 1992, to discuss and evaluate the findings.

After reviewing the Goldman Sachs and Simmons analyses, the Special Committee "concluded that the proposed price of $16.50 per share was not fair to the minority shareholders and that the Committee should endeavor to negotiate an improved transaction with Grace." The Special Committee advised Grace that the offered price of $16.50 per share was not fair to Energy's minority shareholders and that the offer was, therefore, rejected.

Having rejected Grace's initial offer, the Special Committee then undertook to negotiate a higher price for the minority shares. Goldman Sachs and Simmons were advised to develop a range of values that the Special Committee could utilize in the negotiation process. The range developed by the financial advisors was "in the high teens to the mid-twenties per share." It remains disputed whether this range was an expression of fair value or whether it was simply meant to provide the Special Committee with leverage for the negotiations.

On April 22, 1992, senior executives of Grace and First Boston met with the Special Committee and its advisors, Goldman Sachs and Simmons. Each side presented its negotiation ranges and discussed their calculations. Due to the broad discrepancies between the ranges, the meeting was adjourned without further progress. Grace and the Special Committee authorized their respective financial advisors to continue meeting so that they could identify the source of the differences between the ranges.

In the ensuing weeks, the financial advisors resolved some of those differences, which apparently resulted in First Boston raising its negotiation range and Goldman Sachs and Simmons lowering their range. This process was explained to the Special Committee in a meeting with its financial advisors on May 20, 1992.

Immediately after that meeting with its financial advisors, the Special Committee reconvened its negotiations with Grace. As was done before, each of the financial advisors presented their negotiation ranges. The Special Committee and its financial and legal advisors then met separately to discuss the presentations. The Special Committee then returned to the closed meeting with Grace and an offering price of $19 per share was tentatively agreed upon.

After receiving an offer of $19 per share from Grace, the Special Committee again met separately with Goldman Sachs and Simmons. Both financial advisors indicated that they would, after following their own mandated procedures, formally opine that the new offering price was fair to the Energy minority shareholders. The Special Committee felt it was unlikely that Grace would go any higher and, therefore, determined to recommend the offer to the entire Energy Board.

On May 26, 1992, after Goldman Sachs and Simmons delivered their written opinions that the $19 per share offering price was fair to the minority shareholders, Energy signed the Merger Agreement with Grace. Grace announced the execution of the Merger Agreement that same day, and on June 1, 1992, commenced the Tender Offer

for the minority shares of Energy with the filing of its Schedule 14D-1 with the Federal Securities and Exchange Commission ("SEC").

II

The genesis of this litigation is four class action suits that were filed by minority shareholders of Energy against Energy, its Board of Directors, and Grace when the initial $16.50 per share offer was announced. Those class actions were consolidated by this Court, and on June 3, 1992, plaintiffs filed a consolidated amended complaint. After expedited discovery, plaintiffs filed a motion to preliminarily enjoin the completion of Grace's Tender Offer, that is now due to expire at midnight on June 26, 1992.

The issue underlying all of plaintiffs' claims is whether Grace and the Energy Board sufficiently disclosed to the minority shareholders of Energy the existence of certain third-party offers and inquiries regarding the assets of Energy that were received by Grace after it announced the proposed divestiture of Energy in January 1991.

Grace's original disclosure documents filed with the SEC purported to include two lists of expressions of interest in Energy, as "Schedule 4.09" and "Schedule 5.05," but neither document was filed with the SEC at that time. Rather, those schedules were filed by Grace last week, and apparently will not be disseminated to the minority shareholders before the Tender Offer deadline, if at all.

Plaintiffs contend that due to an inadequate disclosure of third-party offers and inquiries, Grace's Offer to Purchase contains material omissions and misrepresentations. Plaintiffs also claim that the Special Committee's decision-making process was flawed and this flaw was not disclosed to the minority shareholders. Plaintiffs conclude that the minority shareholders are without adequate information and guidance to make an intelligent decision about whether to tender, and that Grace's offer should, therefore, be enjoined.

III

Plaintiffs first allege that the members of the Special Committee breached their fiduciary duty of care in reaching the decision to recommend the $19 per share offer to Energy's full Board and that this breach was not disclosed in the Offer to Purchase materials. Plaintiffs claim that the Committee members failed to obtain from Grace a complete list of all third-party expressions of interest in acquiring Energy or its component businesses. Plaintiffs rely exclu-

sively on language in the deposition testimony of one of the Special Committee members, Thomas Moore, wherein he indicated that the Committee had reviewed only one third-party offer or inquiry, and that he had no recollection of ever seeing Schedules 4.09 or 5.05.

Plaintiffs have, however, taken Mr. Moore's remarks out of context. Earlier in his deposition Mr. Moore indicated that he had seen a list of third-party expressions of interest in Energy, although perhaps not in the finalized form as it appears in Schedules 4.09 and 5.05. The most plaintiffs have shown, therefore, is that there appear to be some inconsistencies in his rather vague statements.

[1] The Court, from the present record, cannot determine that the Special Committee was actually uninformed about outside offers for Energy. Plaintiffs have, therefore, failed to meet their burden of showing the reasonable probability of success on this claim. *See In Mesa Ltd. Partnership Preferred Unitholders Litig.*, Del. Ch., C.A. No. 12,243-NC, Hartnett, V.C. (Dec. 10, 1991); *McConnell v. Emory*, Del. Ch., C.A. No. 10,678-NC, Hartnett, V.C. (Sept. 28, 1989). Plaintiffs' motion for a preliminary injunction, therefore, cannot be granted on this ground.

IV

Plaintiffs also allege that Mr. Moore and Mr. Hutton, members of the Special Committee, breached their fiduciary duty of loyalty by taking on the role of an independent negotiating committee when in fact they had conflicts of interest. Plaintiffs point to the fact that two directors from the Grace Board also serve as directors on the board of Chemed Corporation, a specialty chemical company whose President and Chief Executive Officer is Special Committee Edwin Hutton. Chemed Corporation was financed by Peter Grace, a major stockholder of Grace, and Mr. Hutton is apparently a long time friend of the Grace family. Plaintiffs, therefore, conclude that Mr. Hutton is beholden to Grace.

[2] Plaintiffs have failed, however, to carry their burden of showing that Mr. Hutton is currently financially beholden to the Grace family or that he would favor the financial interests of Grace over those of the Energy minority. Defendants have sufficiently demonstrated that whatever financial assistance the Grace family once provided Mr. Hutton has since been repaid. All that remains of plaintiffs' contentions of Mr. Hutton's interest in the transaction is the personal friendship he enjoys with the Grace family, and the Delaware Supreme Court has made it clear that conclusory allegations of such

personal affinity alone are not sufficient to establish director interest. Actual financial interest must be shown. *See Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985); *cf.* 8 *Del. C.* §144(a).

Plaintiffs' next claim that a single ambiguous statement in Thomas Moore's deposition, taken out of context, reveals that Mr. Moore has an economic conflict of interest. The statement, however, as defendants have demonstrated, does not show that Mr. Moore had any conflict.

[3] Plaintiffs also find fault with the fact that Mr. Moore's employer, State Street Research and Management, controls over 700,000 shares of Energy. Plaintiffs have failed to show, however, how this would cause Mr. Moore to have any interest other than maximizing the value to be received by the minority shareholders of Energy, including his employer and himself.

Having failed to meet their burden of showing the reasonable probability that the Special Committee breached its duty of loyalty due to conflicts of interest, plaintiffs are not entitled to a preliminary injunction on that ground.

V

In further support of their motion for a preliminary injunction, plaintiffs allege that Grace, as Energy's majority shareholder, has breached its fiduciary duty to Energy's minority. Plaintiffs claim that Grace's offer is not entirely fair to the minority shareholders because Grace is trying to eliminate the minority so that it can reap the profits of the subsequent divestiture of Energy. *See Roland Int'l Corp. v. Najjar*, Del. Supr., 407 A.2d 1032, 1034 (1979). Plaintiffs maintain that Grace's Offer to Purchase omits and misrepresents material information in Grace's possession regarding the interest of third parties in acquiring Energy or its component businesses, as well as the Special Committee's lack of knowledge of those third-party inquiries.

VI

Plaintiffs contend that Grace has breached its disclosure duties because Grace's Offer to Purchase misrepresents the Special Committee's knowledge of third party's expressions of interest in acquiring Energy, in whole or in part. Plaintiffs cite the following language from the Offer to Purchase:

> [S]ince the Grace announcement in January 1991 that the Company . . . would be divested, a number of parties had

> indicated an interest in acquiring certain assets of the Company or its subsidiaries and in some cases indicated a potential price at which they would be interested. *The Company disclosed all such indications of interest to the Special Committee and its advisors prior to the delivery of the Special Committee's Financial Advisors' written fairness opinions and prior to the execution of the Merger Agreement.*

Offer to Purchase at 21 (emphasis added).

According to plaintiffs, this statement is false. This assertion seems to be based, at least in part, on Special Committee member Thomas Moore's deposition testimony that the Committee had reviewed only one third-party offer or inquiry, and that he had no recollection of ever seeing Schedules 4.09 or 5.05.

When Mr. Moore's statement is read in connection with the rest of his deposition testimony, however, it is unclear exactly which of the third-party inquiries were brought to the attention of the Special Committee. Furthermore, the deposition testimony of the representatives of the Special Committee's advisors is similarly unclear as to their knowledge of outside interest in Energy.

In short, plaintiffs have not adequately demonstrated that the Special Committee and its advisors were not aware of the indications of third-party interest. That contention is simply not supported by the present factual record. Plaintiffs are, therefore, not entitled to a preliminary injunction on this ground.

VII

Finally, plaintiffs allege that the Offer to Purchase is materially false and misleading because the Schedules 4.09 and 5.05 are not attached to the Merger Agreement despite that the Merger Agreement states that they are attached thereto. Even though the Schedules have since been filed with the SEC, defendants will apparently not be disseminating them directly to the shareholders. Plaintiffs argue that filing the documents only with the SEC is not effectively disclosing the information contained therein because in order to see them a shareholder would have to order copies at his own expense.

According to plaintiffs, the information contained in the Schedules regarding third-party expressions of interest in Energy's assets is exactly the type of information a shareholder would want to possess when deciding whether to tender his stock. Because these Schedules were omitted from the Offer to Purchase, plaintiffs conclude that Grace has violated its duty to disclose this material information.

Plaintiffs are correct that the disclosure of third-party inquiries and informal offers for Energy or its components normally would have "significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The information contained in the Schedules is, therefore, material and should have been disclosed. *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929 (1985).

[4] The difficulty with plaintiffs' argument that this failure of disclosure justifies enjoining the completion of the Tender Offer is the unusual fact that if the Schedules had been timely disseminated to the shareholders, the information would have encouraged them to tender their shares in response to Grace's offer. This is so because, as defendants have demonstrated, the informal third-party offers that indicated an offering price would have yielded a value less than the $19 per share offered by Grace; in fact, they would have yielded much less. Any reasonably informed shareholder would, therefore, find Grace's offer more desirable, rather than less, against a background of the offers. Plaintiffs, therefore, have not demonstrated how the minority shareholders could suffer any harm if completion of the Tender Offer is not enjoined. *See Ivanhoe Partners v. Newmont Mining Corp.*, Del. Supr., 535 A.2d 1334 (1987).

In fact, if the Court were to enjoin the completion of Grace's Tender Offer, it will be the minority shareholders who will suffer harm, not Grace. As plaintiffs themselves have noted, Grace will remain Energy's majority and controlling shareholder even if the offer is enjoined to allow for supplemental disclosures and it is highly unlikely that the $19 per share offer price will be increased. Any delay, therefore, would result in injury to the minority shareholders because the distribution of their Tender Offer consideration of $19 per share will be delayed. A preliminary injunction is, therefore, inappropriate on these facts. *Allen v. Prime Computer, Inc.*, Del. Supr., 540 A.2d 417 (1988); *Eastern Shore Natural Gas Co. v. Stauffer Chem. Co.*, Del. Supr., 298 A.2d 322 (1972); *Data Gen. Corp. v. Digital Computer Controls, Inc.*, Del. Supr., 297 A.2d 437 (1972).

VIII

In summary, plaintiffs have failed to carry their burden of demonstrating the reasonable probability of success of their claims that the Special Committee breached its duty of care in reviewing and recommending Grace's offer. They have also failed to show that the Special Committee had any real conflicts of interest when negotiating with Grace on behalf of the minority shareholders.