some recipients of that benefit included a majority of the corporation's directors. The plaintiff alleged breach of duty of care based on defendant directors' gross negligence in wasting corporate assets and diluting the class' equity interest, and breach of duty of loyalty based on the majority of the board personally and improperly benefiting from the transaction. The plaintiff amended his complaint after defendants' motion to dismiss the complaint.

The court of chancery, per Vice-Chancellor Jacobs, dismissed the amended complaint because it should have been brought as a derivative action and no derivative claim was pled. The court then examined the sufficiency of the allegations which would be re-pled when the plaintiff modified his complaint to become a derivative action. The court concluded that the plaintiff's claim against the directors for breach of duty of care was barred by a provision in the corporation's certificate of incorporation which barred such claims. The provision was authorized by Delaware Code Annotated tit. 8, § 102(b)(7) (1991). However, the court found that the plaintiff's breach of duty of loyalty claim was legally cognizable and would be sufficient to survive defendant's motion to dismiss because the court could infer from the complaint the necessary requirements were met. Specifically required were that (1) a majority of the directors had tendered their shares in the original exchange offer, and (2) the directors expected to benefit personally as a result of the extension of the exchange offer and the reduction of its floor exchange value.

1. Corporations ⟹202, 204, 211(2)

When the harm alleged by the plaintiff was the diminution of the value of common stock held by all of the corporation's stockholders, and all shareholders were harmed equally, the action was classified as derivative. Under those circumstances, only the corporation could recover damages for injury.

2. Pretrial Procedure ⟹621, 622, 644

When a complaint which should properly be brought as a derivative action alleges only an individual and class claim, without purporting to allege a derivative claim, it should be dismissed.

3. Pretrial Procedure ⟹534, 695

When the court determines that the complaint should be dismissed but that it is highly likely that the plaintiff will amend his

complaint to re-plead the identical claims, the court may rule on the legal sufficiency of those claims to prevent needless delay and duplication of effort.

4. Pretrial Procedure ⟹211(3)

When a plaintiff's claim is derivative, it is subject to the demand requirement of Chancery Court Rule 23.1. DEL. CH. CT. R. 23.1.

5. Pretrial Procedure ⟹677, 644
Corporations ⟹211(5), 211(6)

When a plaintiff mischaracterizes his derivative claim as an individual or class claim, he should first amend his complaint to allege a derivative claim and include specific, focused reasons why the demand requirement of Chancery Court Rule 23.1 was excused; only then is the demand issue properly before the court. DEL. CH. CT. R. 23.1.

6. Pretrial Procedure ⟹561, 562

A defense based on an exculpatory certificate provision is by its nature an affirmative defense.

7. Pretrial Procedure ⟹561, 562, 534

When a defendant bases an affirmative defense in his motion to dismiss on an exculpatory provision in the corporation's articles of incorporation, the court may consider the provision; it is not necessary that the plaintiff refer to the provision in his complaint.

8. Pretrial Procedure ⟹561, 562

When a defendant asserts an affirmative defense, he normally shoulders the burden of establishing the required elements of that defense and the inapplicability of the exceptions which the plaintiff may allege apply.

9. Corporations ⟹18, 310(1), 310(2)

The Delaware Code Annotated title 8, section 102(b)(7) permits a corporation to draft a director exculpatory provision into its articles

of incorporation which will protect directors from financial liability for their breach of duty of care, i.e. liability for gross negligence. DEL. CODE ANN. tit. 8, § 102(b)(7) (1991).

10. Corporations ⟹310(1), 310(2)

While the purpose of section 102(b)(7) is to enable a corporation to eliminate director liability for monetary damages for duty of care violations, the statutory exceptions to section 102(b)(7) address other types of director misconduct. DEL. CODE ANN. tit. 8, § 102(b)(7) (1991).

11. Corporations ⟹310(1), 310(2)

When a corporation's certificate of incorporation includes a director exculpatory provision which is modeled after section 102(b)(7), and the plaintiff's complaint undisputedly alleges the corporation's directors breached their duty of care, the provision's exceptions which address other types of director misconduct, i.e., the statutory exceptions, do not apply to that claim as a matter of law. DEL. CODE ANN. tit. 8, § 102(b)(7) (1991).

12. Corporations ⟹310(1), 310(2), 320(1), 320(2), 320(4)

When a corporation's certificate of incorporation includes a director exculpatory provision which is modeled after section 102(b)(7), the provision bars the assertion of a claim against the corporation's directors for breach of their duty of care. DEL. CODE ANN. tit. 8, § 102(b)(7) (1991).

13. Corporations ⟹314(1), 320(7), 320(8)

The plaintiff's complaint, which alleged that the directors had breached their duty of loyalty by modifying an exchange offer, was required to have stated either specifically or by inference that (a) a majority of the directors had tendered their shares in the original exchange offer, and (b) the directors expected to benefit personally as a result of the modification of the exchange offer and the reduction of its floor exchange value.

14. Corporations ⟹314(1), 320(7), 320(8)

A complaint which contained allegations by which the court could logically infer that the requirements for assertion of directors'

breach of duty of loyalty were met, survived the defendant's motion to dismiss, was considered to be legally cognizable, and would be permitted to be re-pled when plaintiff re-amended his complaint.

Joseph A. Rosenthal, Esquire, and Norman M. Monhait, Esquire, of Rosenthal, Monhait & Gross, P.A., Wilmington, Delaware; and Jeffrey H. Squire, Esquire, New York, New York, for plaintiff.

R. Franklin Balotti, Esquire, and Daniel A. Dreisbach, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Alan N. Salpeter, Esquire, Scott J. Davis, Esquire, Bennet W. Lasko, Esquire, and Michele Odorizzi, Esquire, of Mayer, Brown & Platt, Chicago, Illinois, for defendants.

JACOBS, *Vice-Chancellor*

On September 28, 1990, the plaintiff, a shareholder in Santa Fe Pacific Corporation ("Santa Fe"), filed this action individually and on behalf of other shareholders similarly situated. The gist of the complaint was that Santa Fe's directors breached various fiduciary duties to a certain class of shareholders in an Exchange Offer that is described below. The defendants, who are Santa Fe and its directors, moved to dismiss the complaint on November 26, 1990, and after briefing on that motion, the plaintiff amended his complaint on April 18, 1991. The defendants then moved to dismiss the amended complaint on May 2, 1991. That motion has been briefed and argued. This is the Opinion of the Court on the defendants' motion to dismiss the amended complaint.

I. *RELEVANT FACTS*[1]

Santa Fe is a publicly-held Delaware corporation engaged in the transportation, natural resources, and real estate businesses. On April 24, 1990, Santa Fe's board of directors authorized the company's management to develop a plan to "spin-off" to its shareholders, on a tax-free basis, the company's interests in its real estate development subsidiary and in one of its natural resources subsidiaries. To accomplish that and other objectives, Santa Fe proposed

1. The following facts, based upon allegations in the amended complaint, will be taken as true on this motion to dismiss. *Grobow v. Perot*, Del. Supr., 539 A.2d 180 (1988).

to retire a significant portion of its 16% Senior Subordinated Debentures due in 2003 (the "debentures").

As of July 1990, Santa Fe had outstanding approximately $780 million in principal amount of the debentures. To further the proposed spin-off, Santa Fe proposed an exchange offer to acquire up to a maximum of $200 million in principal amount of those debentures (the "Exchange Offer").

The Exchange Offer would involve Santa Fe exchanging $1060 worth of its common stock for each $1000 in principal amount of debentures (up to a maximum of $200 million) that were tendered before the offer expired on August 27, 1990. The exchange value of Santa Fe common stock for purposes of the Exchange Offer would be based upon Santa Fe's average common stock closing price on the New York Stock Exchange for the ten trading days ending August 27, 1990. However, the common stock exchange value was given a ceiling of $22 per share (at which $1060 would equal 44.18 shares), and a floor of $18 per share (at which $1060 would equal 58.88 shares). As stated in the Offering Circular, if less than $200 million of debentures were tendered, Santa Fe could "in its sole discretion, purchase and make offers for debentures subsequent to the Expiration Date on a cash or exchange of securities basis. The terms of such purchases or offers may differ from the terms of the Exchange Offer." (Amended Complaint, ¶20.)

As of August 28, 1990, only about $145 million in principal amount of the debentures had been tendered. Given Santa Fe's average common stock closing price for the ten trading days before the Exchange Offer expired, the exchange value at that point would have been about $17.50 per share. Therefore, the $18 floor exchange value would govern, and Santa Fe would have to issue and exchange about 8,055,000 shares of its common stock to acquire the $145 million worth of tendered debentures.

Those, however, were not the terms of the Exchange Offer as it ultimately evolved. Dissatisfied with the relatively low principal amount of debentures that had been tendered, Santa Fe's directors (i) extended the Exchange Offer until September 11, 1990, and (ii) reduced the floor exchange value to $15 per common share for *all* tendering debentureholders, including those who had previously tendered their debentures at the original $18 exchange value. That extended—and modified—Exchange Offer yielded improved results: this time around, about $260 million face total amount of debentures were tendered. Of that amount, Santa Fe accepted $215.6 million worth of debentures for exchange at the downwardly-revised $15.75

per share exchange value, requiring Santa Fe to issue and exchange a total of 13,690,000 of its common shares. Approximately 9,205,000 of those shares were distributed to the holders of the $145 million of debentures that had previously been tendered at the original $18 per share exchange value. To those debentureholders that represented a gain—for no additional consideration—of about 1,150,000 shares (9,205,000-8,055,000) above the number of shares they would have received under the original Exchange Offer. Included among these beneficiaries of the reduced floor exchange value were a majority of Santa Fe's directors.

II. *THE CONTENTIONS*

The plaintiff sues on behalf of a class of all Santa Fe common stockholders as of August 27, 1990 (excluding the defendants and related entities) who did *not* tender their debentures in the Exchange Offer. The plaintiff alleges that by reducing the floor exchange value for those debentureholders who had already tendered at the $18 per share exchange value, Santa Fe's directors breached their fiduciary duties of care and loyalty to the nontendering shareholder class. The plaintiff contends that Santa Fe's directors were grossly negligent (and, therefore, breached their duty of care), in that they wasted corporate assets and diluted the class's equity interest in Santa Fe, by causing it to issue over one million additional shares to those debentureholders for no additional consideration. The plaintiff also claims that the directors breached their duty of loyalty in that a majority of the board personally and improperly benefited from that reduction in the original $18 per share floor exchange value.

In support of their motion to dismiss, the defendants advance five separate arguments, including: (i) the plaintiff's claim is derivative, not an individual or class claim, and the plaintiff has not excused his failure to make a pre-litigation demand on the board of directors; (ii) the plaintiff is barred from recovering money damages from Santa Fe; (iii) Santa Fe's directors would have violated federal securities laws if they had not reduced the floor exchange value for those debentureholders who had already tendered; (iv) the plaintiff's duty of care claim is barred because Santa Fe's charter eliminates the directors' personal liability for damage claims arising out of a breach of the duty of care, and no other remedies would be available; and (v) the amended complaint fails to state a claim for breach of the duty of loyalty, because it does not adequately allege that a majority of the directors expected to derive a personal financial benefit from the transaction.

I conclude that the amended complaint must be dismissed for the reasons which follow.

III. *THE DERIVATIVE CHARACTER OF THE PLAINTIFF'S CLAIM*

The defendants first argue that the complaint must be dismissed in its entirety on the ground that this action is derivative, and the plaintiff does not even purport to allege a derivative claim, but alleges only an individual and class claim. (*See* Amended Complaint, ¶¶10-12.)

[1] At oral argument (*see* Or. Arg. Tr. at 42), the plaintiff virtually conceded that this action is derivative, on the basis of *In re Tri-Star Pictures, Inc. Litig.*, Del. Ch., C.A. No. 9477, Jacobs, V.C. (June 14, 1990). In that case the plaintiffs claimed that the corporation (Tri-Star) had issued too much of its stock in a stock-for-assets exchange with The Coca-Cola Company, thereby diluting the plaintiffs' equity interest in Tri-Star. That claim was derivative because "[a]n injury of that kind affects equally the value of the shares held by all Tri-Star stockholders, including Coca-Cola." *Id.* at 11. Such reasoning is equally applicable here. The alleged harm to the nontendering shareholder class is that the directors authorized the issuance of additional shares for no consideration. But such dilution would have diminished the value of the shares held by *all* Santa Fe stockholders, including those stockholders who held debentures and tendered them in the original Exchange Offer. Because the alleged dilution would have affected all shareholders equally, only the corporation could recover damages for the injury. The action, therefore, is derivative. *Id.* at 12.

[2] Stated differently, because the plaintiffs allege that the corporation issued too many of its shares to those debentureholders who had already tendered, it is the corporation that would be entitled to recover for that overpayment. Since the amended complaint alleges only an individual and class claim and does not purport to allege a derivative claim, it must be dismissed in its entirety, with leave to amend.

[3-5] Because the complaint must be dismissed, the Opinion could, as a technical matter, end at this point. However, because it is highly likely that the plaintiff will amend his complaint to replead the identical claims (although couched in "derivative" terms), it would serve little useful purpose not to rule on the legal sufficiency of those claims at this point. That would only postpone to the next procedural

stage issues that would have to be determined in all events. To await a further amendment of the complaint would not provide the Court any new information in that regard, and to require the parties to re-brief those same issues would likely cause needless delay and duplication of effort.[2] Given these unique circumstances, the Court elects to decide, in Part IV, *infra*, of this Opinion, the legal sufficiency of the plaintiff's duty of care claim, and in Part V, *infra*, the sufficiency of his duty of loyalty claim.[3]

IV. *DUTY OF CARE CLAIM*

The defendants argue that the plaintiff's duty of care claim must be dismissed on a separate, independent ground: in April 1987, Santa Fe adopted a new provision in its certificate of incorporation, pursuant to 8 *Del. C.* §102(b)(7), eliminating its directors' personal liability for damages for breaches of the duty of care. That certificate provision ("Article TENTH") tracks the language of section 102(b)(7)[4] and pertinently provides that:

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2. That reasoning does not, however, apply to the demand question which the plaintiff asks this Court to decide. Being derivative, the plaintiff's claim is subject to the demand requirement of Chancery Court Rule 23.1. *See Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 812 (1984). The plaintiff invites the Court to decide, based on the facts alleged in the complaint, that demand was excused. The Court declines that invitation. The better approach is for the plaintiff first to amend his complaint to allege a derivative claim, as well as specific, focused reasons why demand was excused. Only if that is done will the demand question be properly before the Court.

3. The Court does not address the defendants' contention that Santa Fe's directors would have violated federal securities laws had they not reduced the floor exchange value for those debentureholders who had previously tendered into the original Exchange Offer. Putting to one side any potential jurisdictional issue, such an adjudication would, in all events, be inadvisable because it would require the Court to make complex rulings on the basis of an inadequate record.

4. 8 *Del. C.* §102(b)(7) pertinently provides that:

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
>
> . . . .
>
> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.

> [n]o director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty by such director as a director; provided, however, that this Article TENTH shall not eliminate or limit the liability of a director to the extent provided by applicable law (i) for any beach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law, (iii) under Section 174 of the General Corporation Law of Delaware, or (iv) for any transaction from which the director derived an improper benefit.

(Def. Op. Br., Exh. A.) The defendants argue that because no remedy other than damages could be awarded in this case, the entire duty of care claim must be dismissed by reason of Article TENTH.
[6-7] The plaintiff responds that the defendants' argument may not be considered on this motion, because he did not refer to Article TENTH in the amended complaint. This Court has recently held, however, that a defense based on an exculpatory certificate provision such as Article TENTH is by its nature an affirmative defense. *Boeing Co. v. Shrontz*, Del. Ch., C.A. No. 11,273, Berger, V.C., mem. op. at 7 (Apr. 20, 1992). In their dismissal motion, the defendants raised Article TENTH as an affirmative defense,[5] and no one disputes its substantive content. Thus, even if Article TENTH could not be considered on the defendants' motion to dismiss under Rule 12(b)(6) (an issue that the Court need not decide), it may properly be considered on the defendants' separate dismissal option grounded upon their affirmative defense(s).
[8] Because Article TENTH is an affirmative defense, the defendants would normally shoulder the burden of establishing each of its elements, and the inapplicability of each of its four exceptions. 31A C.J.S. *Evidence* §104(b) (1964) ("[D]efendant has the burden of establishing special or affirmative defense."); 29 Am. Jur. 2d *Evidence* §129 (1967) ("The burden of proof is upon the defendant as to all affirmative defenses which he sets up . . . ."). In this case, however, the Court determines that to the extent that the amended complaint states a claim for breach of the duty of care, Article TENTH is

5. Although the text of Article TENTH was not set forth in the defendants' dismissal motion, it was appended to the defendants' Opening Brief.

applicable, and its four exceptions are inapplicable, to that claim as a matter of law.

[9-11] Section 102(b)(7) permits a corporation, by so providing in its certificate of incorporation, "to protect its directors from monetary liability for duty of care violations, *i.e.*, liability for gross negligence." 5 Balotti & Finkelstein, *The Delaware Law of Corporations and Business Organizations*, ch. 4, §4.19, at 200.10 (1986); *see also John Hancock Capital Growth Management, Inc. v. Aris Corp.*, Del. Ch., C.A. No. 9920, Jacobs, V.C., mem. op. at 4 (Aug. 24, 1990). Santa Fe has done that in Article TENTH, which (to repeat) is modeled on section 102(b)(7). Because the plaintiff undisputedly alleges in his complaint that Santa Fe's directors breached their duty of care (*see* Amended Complaint, ¶¶1, 33, 34), that claim is clearly covered by Article TENTH. Moreover, since the purpose of section 102(b)(7) is to enable corporations to eliminate director liability for money damages for duty of care violations, it follows that the statutory exceptions to section 102(b)(7) concern director conduct that involves other than breaches of the duty of care. Because Article TENTH's exceptions track those set forth in section 102(b)(7), those exceptions are, therefore, inapplicable to the plaintiff's duty of care claim as a matter of law.[6]

[12] Accordingly, to the extent that the amended complaint states a claim for breach of the duty of care, Article TENTH of Santa Fe's certificate of incorporation bars that claim.[7]

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6. Indeed, two of the exceptions in Article TENTH (and §102(b)(7)) do not refer to duty of care violations at all. Exception (i) refers to violations of the "duty of loyalty." Exception (iii) refers to 8 *Del. C.* §174, which provides for the liability of directors for the unlawful payment of dividends or stock purchase or redemption. And whatever may be the precise meaning of the other two exceptions, they plainly are directed to violations of obligations other than the duty of care.

From the above analysis, it follows that Article TENTH will not operate as a bar to the plaintiff's claims that the directors breached their duty of loyalty (Amended Complaint, ¶¶1, 35, 36), that they received an improper personal benefit (*id.*), or that their actions were not in good faith (*id.* ¶¶1, 33).

7. In his brief, the plaintiff argues (correctly) that neither §102(b)(7) nor Article TENTH bars *claims* for breach of the duty of care, but only the *remedy* of damages. On that basis, the plaintiff urges that the due care claim should not be dismissed at this stage, because (i) "[t]he appropriate remedy awaits determination of defendants' liability" (Pl. Br. at 15), and (ii) other potential remedies are available here, including ordering "Santa Fe . . . to issue additional shares to compensate the Class for the improper dilution." (*Id.* at n.2.)

However, such nonmonetary remedies would not be available unless the plaintiffs' claim were a class claim, which it is not. Moreover, to order Santa Fe

V. *DUTY OF LOYALTY CLAIM*

The defendants also argue an independent ground for dismissing the plaintiff's duty of loyalty claim, namely, that the plaintiff has not adequately alleged that a majority of the defendant directors "expected to derive personal financial benefit from the transaction" at the time it was approved. *Lewis v. Leaseway Transp. Corp.*, Del. Ch., C.A. No. 8720, Chandler, V.C., mem. op. at 12 (May 16, 1990). The defendants argue that to state that claim validly, the amended complaint must allege that (a) a majority of the directors had tendered their shares in the original Exchange Offer, and (b) the directors expected to benefit personally as a result of the extension of the Exchange Offer and the reduction of its floor exchange value.

In this regard, the amended complaint pertinently states that:

> [d]efendants' actions constituted self-dealing and a conflict of interest on the part of a great majority of Santa Fe's directors. Defendants Reichman and Dodd had an interest in the additional shares O & Y received.[8] Further, defendants Krebs, Alibrandi, Gilmore, Morphy, Munroe, Parker, Runnells, Sisco, Swift and Wriston, constituting a majority of Santa Fe's directors, participated in the Exchange Offer. They each personally benefited from the reduction in Exchange Value by the receipt of thousands of additional shares of Santa Fe.

(Amended Complaint, ¶36.)

[13-14] In my view, those allegations state a cognizable claim for breach of the duty of loyalty. Although the complaint does not say, in so many words, that the directors had previously tendered, it does allege that they "personally benefited from the reduction in Exchange Value." (Amended Complaint, ¶36.) From that it can be inferred that the directors had already tendered their debentures under the

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to issue additional stock without consideration seems a questionable way to remedy waste resulting from an earlier issuance of stock without consideration. To provide additional shares to those persons who held Santa Fe stock as of August 27, 1990, Santa Fe would have to dilute the interests of its current shareholders, many of whom did not participate in the Exchange Offer. Finally, at the oral argument, the plaintiff conceded the Court's observation that if the charter provision can be considered, "the due care claim is either one for damages or it is not a claim at all." (Or. Arg. Tr. at 54.)

8. Olympia & York Developments Limited ("O & Y") is Santa Fe's largest common stockholder. Defendant Reichman is O & Y's President and Secretary, and defendant Dodd is its Chief Operating Officer. (Amended Complaint, ¶¶6, 7.)

original Exchange Offer; otherwise how could they have "benefited?"[9] It can also be inferred that the defendant directors expected to benefit from the reduction in the floor exchange value. An expectation of benefit is implicit in the allegation that "[t]here was no rational business purpose for defendants to give away more than one million shares to debenture holders who had freely, knowingly and voluntarily agreed to exchange their debentures for an Exchange Value of $18 per share." (*Id.* ¶33; *see also id.* ¶35.) That is, the amended complaint can fairly be read to allege that the directors knew that they were giving away more than one million shares and expected to benefit for that act.

The amended complaint is hardly a model of artful pleading. Nonetheless, it does sufficiently allege a breach of the directors' duty of loyalty to survive a motion to dismiss.

* * *

For the reasons discussed, the amended complaint must be dismissed with leave to amend, because the plaintiff's claim is derivative and no derivative claim has been pled. In addition, the plaintiff's duty of care claim is barred by Article TENTH of Santa Fe's certificate of incorporation. Should the plaintiff re-amend his complaint, he may re-plead the duty of loyalty claim alleged here, which has been found to be legally cognizable.

Counsel shall submit an appropriate form of order implementing the rulings set forth in this Opinion.

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9. The defendants point out that the directors could have achieved the same result by withdrawing from the original Exchange Offer and then re-tendering their debentures under the revised offer. On this basis the defendants argue that it is "absurd to suggest that a director whose primary interest was his own welfare would agree to the extension of the offer for all debentureholders in order to benefit himself." (Def. Op. Br. at 10 n.5.) However, that argument amounts to a factual defense which, while it might ultimately prevail, cannot be employed at the pleading stage to defeat this claim.

SALOMON BROTHERS, INC. v. INTERSTATE BAKERIES CORP.

No. 10,054

Court of Chancery of the State of Delaware, New Castle

May 1, 1992

Petitioner, a dissenting stockholder, sought determination of the fair market value of its Interstate Bakeries Corporation (IBC) stock. IBC was acquired by and merged with IBC Acquisition Corporation shortly after IBC's restructuring and turnaround. Both parties provided expert testimony as to the fair value of IBC on the merger date. Petitioner's expert employed a discounted cash flow analysis and an historical earnings analysis. IBC's expert used discounted cash flow, historical earnings and market value approaches.

The court of chancery, per Vice-Chancellor Berger, found that much of the disparity between the experts' opinions was attributable to petitioner's expert's reliance upon projections and other data generated after the tender offer in preparing his discounted cash flow analysis, petitioner's expert's adjustment of historical earnings to correct for an "implicit minority discount," and each expert's apparent bias toward a result that would yield the highest or lowest possible number in accordance with his client's interests. The court averaged the experts' historical earnings values in order to eliminate the apparent bias and adjusted the result slightly to account for IBC's positive future prospects rather than its poor historical earnings before the turnaround. Finally, the court determined the amount of interest to which petitioner was entitled by considering both a prudent investor's fair rate of return and the corporation's cost of borrowing.

1. Corporations ⟹584

When calculating fair value of stock on the date of a merger, it is contrary to the mandate of section 262(h) of the Delaware General Corporation Law to include elements of value arising from the accomplishment or expectation of the merger and any valuation using such projections must be disregarded. DEL. CODE ANN. tit. 8, § 262(h) (1991).

2. Corporations ⟹584

When a corporation merges, a dissenting stockholder is entitled to its proportionate interest in the value of the entire company as a going concern.

3. Corporations ⟹ 584

When a corporation merges, the number of shares owned by the dissenting stockholder is not to be considered in the valuation process either by application of a discount or a control premium adjustment at the stockholder level.

4. Corporations ⟹ 584

A market value adjustment to compensate for an "implicit minority discount," as far as it is a control premium adjustment, is inappropriate.

5. Corporations ⟹ 584

When reconstructing a market value, the choice of a starting date for unaffected market price cannot be based on a jump in price which is explainable by many equally plausible explanations, and not just a possible leak of the sale of the corporation.

6. Corporations ⟹ 584

When each parties' expert's reports and testimony show that their assumptions and choices in determining the fair value of stock were colored by their respective clients' interest, an average of the values eliminates the apparent bias.

7. Corporations ⟹ 584

When determining the appropriate rate of interest to be awarded from the date of the merger through the payment, both a prudent investor's fair rate of return and the corporation's cost of borrowing should be considered.

Lawrence A. Hamermesh, Esquire, and Alan J. Stone, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for petitioner.

R. Franklin Balotti, Esquire, and Nathan B. Ploener, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; Peter E. Strand, Esquire, and Joseph S. Gall, Esquire, of Shook, Hardy & Bacon, Kansas City, Missouri, of counsel, for respondent.

BERGER, *Vice-Chancellor*

This is the decision after trial in an appraisal proceeding brought by Salomon Brothers, Inc. ("Salomon") to determine the fair value of its Interstate Bakeries Corporation ("IBC") stock pursuant to 8 *Del. C.* §262. Salomon was the record and beneficial owner of 122,300 shares of IBC common stock on April 29, 1988, when IBC Acquisition Corporation ("Acquisition") merged with and into IBC. Salomon contends that the fair value of IBC common stock on the merger date was $39.60 per share, whereas IBC claims that the fair value was between $21.00 and $24.00 per share. For the reasons that follow, I find that the fair value was $32.50 per share and that Salomon is entitled to receive simple interest on that amount at the rate of 11% per year pursuant to section 262(i).

I.

IBC is in the business of manufacturing and distributing bakery products throughout the United States. Before the merger, the company was organized into separate divisions for each of its four principal products: breads, cakes, dry products and food service items. The Bread Division produced an assortment of bread products under its own brand names, including "Butternut" and "Sunbeam," as well as through licensing arrangements for the production of "Roman Meal," "Sun Made" and "Pritikin" breads. In fiscal year 1987, which ended on May 31, 1987, the Bread Division generated approximately 52% of IBC's net sales. The Cake Division produced snack food items, primarily under the trade name "Dolly Madison," and during fiscal 1987 accounted for approximately 44% of IBC's net sales. The Dry Products Division and the Food Service Division together contributed the remaining 4% of the company's net sales.

Prior to 1984, IBC had been suffering from a decline in earnings. Robert W. Hatch ("Hatch") joined the company that year as Chief Executive Officer and helped orchestrate IBC's turnaround. Under Hatch's leadership, the company: (1) restructured an over-funded pension plan and used the money from the restructuring to pay off bank debt; (2) increased advertising and promotional budgets by 53%; (3) closed and consolidated poorly performing plants; (4) revamped operations by imposing tighter financial controls at the plant level and modernizing equipment; and (5) established annual and long-term management incentive plans based upon performance. As

a result of these and other steps implemented by Hatch and a new management team, earnings and revenues increased steadily between 1984 and 1987. Not surprisingly, the market price of IBC common stock also rose during this period—from $8.00 to over $25.00 per share.

On February 10, 1987, Howard P. Berkowitz ("Berkowitz"), Chairman of the Board of IBC, told Hatch that Berkowitz was interested in selling the company. Berkowitz then owned approximately 12% of the 7.6 million shares of IBC stock outstanding. On February 23, 1987, the IBC board of directors decided that it would be in the best interest of the company to explore a possible sale. A special committee was formed for that purpose, and Goldman, Sachs & Company ("Goldman, Sachs") was retained as the financial advisor to the special committee. Goldman, Sachs made a preliminary estimate that, in a controlled auction, IBC could be sold for $32.00 to $35.00 per share, with a possibility of obtaining as much as $40.00 per share.

During the spring of 1987, Goldman, Sachs contacted twenty-four prospective buyers and provided those who were interested a confidential brochure about the company. The response, however, was less than enthusiastic and, by late June 1987, Hatch and other members of management thought that the sale process should be terminated. In a letter to Berkowitz, Hatch repeated his view that the company was worth at least $35.00 per share as well as his concern that the continued exploration of a sale of IBC would jeopardize confidential proprietary information and employee morale. Nonetheless, the board decided to go forward and by August 5, 1987, several preliminary, non-binding indications of interest had been received from prospective purchasers. One such proposal was submitted by Hatch on behalf of himself and other members of management, The First Boston Corporation ("First Boston") and George K. Baum Group, Inc. (collectively, the "LBO Group"), offering $32.00 per share in cash. On August 11, 1987, IBC made its first public announcement that the company had solicited interest from possible acquirors and, in response, the market price jumped from $28.00 to $36.25 the following day.

Goldman, Sachs told the potential bidders that their definitive bids were due on September 11, 1987. The only bid that was submitted on that date was from the LBO Group at $38.00 per share in cash. After two days of negotiations, the parties entered into a merger agreement that provided for a tender offer at $40.50 per share in cash for approximately 89% of the outstanding shares to

be followed by a merger in which each of the remaining publicly held shares would be converted into preferred stock with a liquidation preference of $40.50 per share. Goldman, Sachs opined that the tender offer and merger, taken together, were fair to the public stockholders of IBC and estimated that the blended value of the transaction would be between $39.25 and $39.75 per share.

The tender offer commenced on September 19, 1987, and was successfully completed by October 26, 1987. The merger, however, did not take place until April 29, 1988. During the intervening six months, there were numerous structural and financial changes at IBC. IBC Holdings, Inc. replaced five of the nine members of IBC's board of directors, thereby gaining control of the company. In December 1987, IBC commissioned an evaluation of the company by Standard Research Consultants ("SRC") for the purposes of securing a loan to repay the interim bank financing that had been used to purchase the shares in the tender offer. SRC concluded that the fair value of the company as a going concern was $41.20 per share. At about the same time, in order to assist in the financing effort and to understand why the company's recent financial performance had been below projections, First Boston examined each of IBC's divisions and prepared revised financial projections for the company. On January 29, 1988, Acquisition repaid its interim bank financing with funds borrowed under a Credit Agreement which, among other things, restricted IBC's ability to make capital expenditures for the years 1989 through 1996.

II.

Both parties offered expert testimony as to the fair value of IBC on the merger date. John E. Hempstead ("Hempstead"), Salomon's expert, employed a discounted cash flow analysis and an historical earnings analysis. Anthony J. Magro ("Magro"), IBC's expert, used three approaches: discounted cash flow, historical earnings, and market value. Much of the disparity between the experts' opinions is attributable to three factors: (1) Hempstead's reliance upon projections and other data generated after the tender offer in preparing his discounted cash flow analysis; (2) Hempstead's adjustment of historical earnings to correct for an "implicit minority discount"; and (3) each expert's apparent bias toward a result that would yield the highest or lowest possible number in accordance with his client's interests. Each of these concerns will be addressed, in turn, after a summary of the experts' analyses.

A.

Hempstead ran two sets of numbers in performing his discounted cash flow analysis. First, he used the projections contained in the January 1988 SRC report and arrived at a value of $43.48 per share. He assumed that net working capital would be maintained at 2.5% of sales, that capital expenditures would equal depreciation, and that the constant long-term growth in free cash flow would be 6% per year. Hempstead then undertook a similar analysis using projections prepared by First Boston in January 1988. However, Hempstead adjusted the depreciation figures used by First Boston, since those figures reflected the stepped-up book values that would result from the merger. Using the First Boston projections, Hempstead arrived at a value of $41.25 per share. He then averaged the two results and concluded that fair value, as determined by discounted cash flow analysis, was $42.37 per share.

Hempstead also used a comparative company analysis to determine certain financial performance ratios that were then applied to IBC. The three companies Hempstead selected were Flowers Industries, Inc. ("Flowers"), Lance, Inc. ("Lance") and Tasty Baking Company ("Tasty"), all publicly traded baking companies. He determined the ratio of market value of capital to operating cash flow for each of the comparable companies during the twelve-month period ending May 31, 1987, and as a three year average. Hempstead used operating cash flow rather than earnings or net income in order to eliminate variations based upon the comparable companies' capital structure or depreciation policies. He chose a twelve-month and three-year period in order to assess both short- and long-term earnings. Based upon these ratios, Hempstead derived multiples ranging from 7.7 to 9.9 based upon the fiscal 1987 operating cash flow and 7.8 to 10 based upon the three-year average operating cash flow.

Hempstead then had to select a multiplier to apply to IBC. He selected 9.0 times recent operating cash flow and 9.5 times the three-year average operating cash flow. Those selections were based upon Hempstead's view that IBC was prospering and that it could eventually double its profit margin to a rate near that of Flowers, the company Hempstead considered to be most similar to IBC. Using these multipliers, Hempstead arrived at a market value of $29.26 per share. However, Hempstead then adjusted this number upward by 15% to account for what he called an "implicit minority discount." This calculation yielded a value of $34.04 per share.

Hempstead weighted his two values of $42.37 per share and $34.04 per share in reaching his conclusion that fair value on the merger date was $39.60 per share. He explained the greater emphasis given to the discounted cash flow value by stating his view that investors place greater weight on future prospects than historical earnings. Hempstead believed this to be especially true here where IBC had recently undergone a turnaround.

B.

As noted earlier, Magro used discounted cash flow, historical earnings and market value in determining the fair value of IBC. His discounted cash flow valuation was based upon management's 1988 three-year business plan prepared in June 1987. Magro extended the 1988 plan to cover a ten-year period by assuming revenue growth of 7% per year and a constant margin of earnings before interest and taxes. He derived a multiplier of 13.55 by assuming a discount rate of 6.36% for debt and 14.72% for equity on an 86/14 debt to equity ratio. Using these assumptions and multipliers, Magro reached a discounted cash flow valuation in the range of $24.00-$27.00 per share.

In his historical earnings analysis, Magro selected the same three comparable companies as did Hempstead. He found that the market price of the comparable companies' stock as a multiple of net income ranged from 15.3 to 19. Magro also examined the S&P Food Index and the S&P 400 as of April 29, 1988, and derived multiples of 15.1 and 13.6 respectively. From this data, Magro selected a price/earnings ("P/E") multiple for IBC in the range of 14-15. Magro chose multiples in the lower end of the range based upon IBC's relatively poor performance as compared to the comparable companies between the years 1982 and 1987. Finally, Magro applied the derived P/E multiple to IBC's most recent twelve-month earnings as of April 5, 1988—$1.48 per share—to arrive at a value of between $21.00-$22.00 per share.

Magro's market analysis started with IBC's market price on February 10, 1987, the last day on which he believed IBC's common stock was unaffected by any expectation of the merger. He chose that date because on February 11, 1987, IBC stock rose to a record high price of $26.125 per share, up from $24.625 the previous day. Magro concluded that the jump in price was attributable to the fact that on February 10, 1987, IBC's Chairman informed Hatch of the Chairman's desire to explore the possible sale of IBC. Although this

information was conveyed in private, Magro assumed that it was leaked to the public and affected the market.

Magro then determined the average stock price of IBC for the three months prior to February 10, 1987—$24.23 per share—and brought that number forward to the date of the merger. He projected the unaffected market price on the merger date based upon consideration of several market indices and the relative stock prices of comparable baking companies. From this analysis, Magro determined that the unaffected price on April 29, 1988, would have been in the range of $22.00-$24.00 per share.

Although the values Magro derived ranged from $21.00-$27.00 per share, he concluded that the fair value of IBC stock on the merger date was between $21.00 and $24.00 per share. In his report, Magro explained that IBC's failure to meet its projections during the first three quarters of 1988 led him to conclude that the values obtained under the discounted cash flow model should be discounted.

III.

[1] I find that Hempstead's discounted cash flow analysis conflicts with the appraisal statute. Hempstead based his analysis on two sets of projections prepared in January 1988, after the tender offer. Those projections were prepared and used to assist the LBO Group in obtaining financing for the acquisition of IBC. Indeed, the First Boston projections were specifically designed to revise the 1988 business plan to take into account the tender offer and the anticipated merger. The projections, therefore, included elements of value arising from the accomplishment or expectation of the merger, contrary to the mandate of 8 *Del. C.* §262(h). *See Cede & Co. v. Technicolor, Inc.*, Del. Ch., C.A. No. 7129, Allen, C. (Oct. 19, 1990). As a result, I conclude that Hempstead's discounted cash flow valuation must be disregarded.

Magro's discounted cash flow analysis is also flawed. He based his calculations on management's 1988 three-year business plan prepared in June 1987. Magro extended the 1988 plan to cover a ten-year period by assuming revenue growth of 7% per year and capital expenditures as a percentage of revenues. This choice of assumptions meant that over a seven-year period Magro projected approximately $125 million more in capital expenditures for the company than did Hempstead, who assumed capital expenditures would equal depreciation. I find that Magro's assumption on capital expenditures was inappropriate.

It is undisputed that IBC had undergone an extensive capital acquisition program in the years since 1984, when Hatch became Chief Executive Officer. The merger proxy statement confirms that significant capital expenditures had recently been devoted to expansion and modernization of IBC facilities and that such outlays for capital improvements would not be necessary in the near future. Rather, the proxy statement discloses IBC's expectation that capital expenditures in the future will approximate depreciation charges. Given this evidence, I conclude that, in performing his discounted cash flow analysis, Magro should have made the same assumption about capital expenditures approximating depreciation as did management. Had he done so, Magro's discounted cash flow valuation would have resulted in a range of $32.50 to $35.29 per share.

The experts' historical earnings valuations, likewise, present some problems. The most notable one is Hempstead's use of a 15% adjustment to compensate for what he called an "implicit minority discount." Hempstead explained that the adjustment was necessary because his historical earnings analysis used multipliers that were designed to reflect the market value of IBC on a minority interest basis. Therefore, according to Hempstead, the 15% adjustment factored out the minority discount inherent in a market value.

I find that the 15% adjustment should not be considered in the determination of fair value. First, I am not satisfied from the record in this case that a market value adjustment to compensate for an implicit minority discount is a valuation method that is generally accepted in the financial community. *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701, 713 (1983). Magro testified that he never heard of the expression "implicit minority discount" or the concept as articulated by Hempstead. Moreover, Magro does not agree with the underlying premise that market value is inevitably less than intrinsic value. Hempstead testified that the concept is widely recognized in the financial community. However, on cross-examination, he could not recall ever using an implicit minority discount in any of the many other cases for which he has provided expert testimony on appraisal. Thus, there is a real question whether an adjustment of the sort Hempstead advocates is recognized and accepted in the financial community.

[2-3] Even assuming that it is, Hempstead failed to adequately distinguish between an implicit minority discount adjustment and a control premium. A dissenting stockholder is entitled to its proportionate interest in the value of the entire company as a going concern. *Cavalier Oil Corp. v. Harnett*, Del. Supr., 564 A.2d 1137, 1144 (1989).

The number of shares owned by the dissenting stockholder is not to be considered in the valuation process either by application of a discount or a control premium adjustment at the stockholder level. *Id.* at 1145 (minority discount); *Cede & Co. v. Technicolor, Inc.*, C.A. No. 7129, slip op. at 50-52 (control premium); *cf. Rapid-American Corp. v. Harris*, Del. Supr., C.A. No. 6462 (Jan. 23, 1992), slip op. at 23-28 (holding that an adjustment for control premium at the corporate level was appropriate and expressly declining to state a view on the *Cede* case, which is on appeal).

[4] There is no question but that the adjustment made by Hempstead is a stockholder level adjustment. Thus, to the extent that it is, in whole or in part, a control premium adjustment, it is inappropriate. Hempstead admitted that his 15% adjustment for an "implicit minority discount" was the same as the adjustment made by SRC that was labeled a control premium, and he conceded that the two concepts are related. Having acknowledged this relationship, Hempstead should have provided some support for his apparent belief that the 15% adjustment yielded a fair value for the entire company on a going concern basis rather than a premium value, as is often offered in an acquisition. Hempstead apparently did not undertake any analysis of the difference between market values and what he called "whole company" values in order to determine an appropriate adjustment. He simply thought about it and decided that 15% was a reasonable figure. I do not find this level of analysis to be sufficiently reliable to form the basis of a decision on fair value. Accordingly, Hempstead's 15% adjustment to historical earnings value will be ignored.

[5] Only IBC's expert undertook the third valuation approach—a reconstructed market value. The weak point in this analysis is the choice of a starting date for unaffected market price. Magro chose February 10, 1987, more than one year prior to the merger date and six months prior to the first public announcement that IBC was soliciting acquisition bids. Magro decided that news of a possible sale had leaked out by February 11, 1987. He reached this conclusion without anything to corroborate a linkage between Hatch's private discussion about the possible sale of IBC and a $1.50 per share jump in market price the following day.

In fact, there are other plausible explanations for IBC's jump in market price on February 11, 1987. First, Hatch addressed the New York Society of Securities Analysts on February 9, 1987. He reported strong operating gains in IBC's most recent quarter and stated management's expectation that profits would continue to im-

prove in the coming year. Second, the February 9, 1987, issue of *Forbes* included an article titled "Putting the Yeast Back Into Profits" that described IBC's turnaround under Hatch's direction. Third, IBC's stock price could have reached a new high as part of its general upward trend. On two other occasions during the four months prior to February 11, 1987, IBC's price rose to what were then record highs in similar incremental jumps. Finally, although the rise in trading price on February 11, 1987, might suggest takeover rumors, the relatively low trading volume suggests otherwise. As Magro conceded, one would expect to see higher trading volumes if there were takeover rumors on the street. The February 11, 1987, volume of approximately 24,000 shares, however, was less than the trading volume on twenty-five trading days during the prior six months.

None of this data establishes why IBC's stock rose on February 11, 1987. Rather, it demonstrates that there are many equally plausible possibilities. Under these circumstances, I am not prepared to accept Magro's selection of February 10, 1987, as the starting point for his reconstructed market value analysis. Since Magro attempted to reconstruct a market value on the merger date based upon market changes and IBC's performance over a period of time, it is not possible at this point to substitute a different unaffected market price on a date other than February 10, 1987, and determine what the reconstructed market value would be on the merger date. Accordingly, Magro's market value analysis must be rejected in full.

Having thus modified and/or eliminated certain portions of each expert's valuation, the following remain for the Court's consideration: (1) Magro's discounted cash flow analysis as adjusted to reflect capital expenditures equaling depreciation; (2) Hempstead's historical earnings analysis as adjusted to delete the 15% increment for the implicit minority discount; and (3) Magro's historical earnings analysis. The values derived through each of these approaches are $32.50-$35.29 per share under the discounted cash flow model; $29.26 per share under Hempstead's historical earnings approach; and $21.00-$22.00 per share under Magro's historical earnings analysis. I am satisfied that each of these three remaining valuation approaches is based upon supportable assumptions and, therefore, should be accorded some weight in determining the fair value of the shares.

[6] After considering all of the evidence, I conclude that the fair value of IBC's common stock on the merger date was $32.50 per share. It appeared to me, both from the experts' reports and their testimony, that their assumptions and choices of multiples were colored by their respective clients' interests. In their historical earn-

ings analyses, for example, Hempstead chose a high multiplier because IBC's profitability had been improving whereas Magro chose a low multiplier because IBC's performance was below that of the comparable companies. Although there were facts to support each expert's reasons, I was left with the definite impression that Magro was accentuating the negatives and Hempstead was doing the opposite. As a result, I averaged the historical earnings values to eliminate the apparent bias on each side.

With that adjustment, the two remaining sets of values were a discounted cash flow valuation of $32.50-$35.29 and an averaged historical earnings valuation of $25.00 per share. I agreed with Hempstead's decision to give greater weight to the discounted cash flow model than the historical earnings approach for the reasons he expressed and, accordingly, arrived at the value of $32.50 per share.

IV.

Finally, this Court must determine an appropriate rate of interest to be awarded from the date of the merger through the date of payment. Pursuant to 8 *Del. C.* §262(h), the Court "may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding." Salomon notes that IBC's post-merger borrowings have ranged from approximately 12% on bank borrowings to 15-16% on senior subordinated notes. From this evidence, Salomon contends that a fair rate of interest would be 13% per year. IBC argues that the "prudent investor" standard should be used and that a fair rate of interest based on an average of yields for short-term U.S. Treasury bills, commercial paper, certificates of deposit and Moody's AAA corporate bonds would be 8.83% per year.

[7] I conclude that both a prudent investor's fair rate of return and the corporation's cost of borrowing should be considered and that, taking both elements into account, a fair rate of return is 11% per year, simple interest.

Salomon is requested to submit an order in accordance with this opinion on notice. Costs are to be assessed against IBC.

IN RE APPRAISAL OF SHELL OIL CO.

No. 8080 (Consolidated)

SMITH v. SHELL PETROLEUM, INC.

No. 8395

Court of Chancery of the State of Delaware, New Castle

July 20, 1992

Movants sought reargument and alteration of their motion to intervene in two separate but related actions for the purpose of seeking an award of fees, rescission of committee membership contracts, and repayment of loans. Movant formed a committee of Shell Oil Stockholders, which eventually joined the plaintiff classes in actions, to challenge the adequacy of disclosure documents disseminated in a short-term merger and appraise the value of stock. The chancery court found for the plaintiff class in both actions. The movants' motions to intervene in both actions were deferred pending appeal in the Delaware Supreme Court, which affirmed both decisions. The chancery court denied movants' motions to intervene.

The court of chancery, per Vice-Chancellor Hartnett, repeated its analysis and held that no movant could intervene in either action because movants' services and loans to the subsequently disbanded committee were not discernable benefits conferred to the plaintiff class "in" either litigation. It further held that the equitable fund doctrine does not allow non-professionals to recover from the judgment fund fees for services rendered outside the litigation; and that the movants did not have standing to intervene in either action. Their claims were limited to a contractual claim against a defunct committee with whom there had been a contractual relationship.

1. Pretrial Procedure ⟹551

When a movant's arguments have been previously considered and rejected by the court, the motion for reargument and alteration to the same court should be denied. DEL. CH. CT. R. 59(e), (f).

2. Attorney and Client ⟹155
   Corporations ⟹214
   Securities Regulation ⟹157

The equitable fund doctrine requires a showing of a causal nexus between the claimant's effort and the benefit achieved in the litigation.

3. Attorney and Client ⟹155
Corporations ⟹207
Costs ⟹85
Securities Regulation ⟹157
Parties ⟹40(1), 40(4)

Movant's solicitation of members to a committee, who eventually became part of the plaintiff class in the appraisal action, did not qualify him to receive a fee award from the judgment funds based on his granting of a benefit to the plaintiff class because it was done on his own initiative before the request for appraisal had been filed.

4. Attorney and Client ⟹155
Corporations ⟹207
Costs ⟹85
Securities Regulation ⟹157
Parties ⟹40(1)

Movant's recommendation of an expert, who discovered the critical $1 billion understatement by the corporation, to two plaintiff classes, did not qualify the movant to receive a fee award from the judgment funds based on his granting of a benefit to the plaintiff classes.

5. Attorney and Client ⟹155
Corporations ⟹214
Securities Regulation ⟹157

The equitable fund doctrine requires a threshold showing that the services for which compensation was sought conferred a perceptible benefit upon the plaintiff class in the litigation. The movants' services rendered outside of the litigation did not meet the threshold requirement.

6. Contract ⟹185
Corporations ⟹207
Parties ⟹40(4)

Movants who had no direct contractual relationship with the members of either shareholder class and whose only direct contractual relationship was with a subsequently disbanded committee whose

members joined the plaintiff class, did not have standing to enforce the committee's rights against its members.

7. Corporations ⟹207
   Parties ⟹40(1), 40(2)

Movant who solicited membership to committee whose members eventually became part of a plaintiff class in an appraisal action, but who was never a shareholder himself, did not have standing to intervene in action involving the plaintiff class.

8. Corporations ⟹207
   Parties ⟹40(1), 40(2)

Movant who was party to settlement whereby he waived statutory appraisal rights in exchange for money and who was no longer a shareholder at time disclosure documents at issue were disseminated had no standing to intervene in the actions for return of monetary benefits he bestowed on plaintiff class in that action.

9. Securities Regulation ⟹157
   Contract ⟹185
   Corporations ⟹207

A party's status as an appraisal participant does not confer automatic standing for him to assert a claim in the appraisal action for repayment of loans when the loans were not made to the plaintiff class but to a subsequently disbanded committee.

10. Attorney and Client ⟹155
    Corporations ⟹207
    Costs ⟹85
    Securities Regulation ⟹157
    Parties ⟹40(1), 40(2)

The equitable fund doctrine does not allow professionals to recover from the judgment fund their fees for services rendered outside the litigation.

M. Jane Brady, Esquire, Lewes, Delaware, for movants.
Clark W. Furlow, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

Pursuant to Chancery Rules 59(e) and (f), James F. McElroy, William O.M. and Mary P. Hurley (collectively "Movants") seek alteration and reargument of this Court's June 16, 1992 Opinion ("Intervention Opinion") that denied their motions to intervene in *Smith v. SPNV Holdings, Inc.*, C.A. No. 8395-NC, and *In re Appraisal of Shell Oil Co.*, C.A. No. 808-NC. Movants, who sought intervention in order to seek fees from the judgment funds created in the two litigations, were denied leave to intervene because their claims were not sufficiently related to the subject matter of either case. *Intervention Opinion* at 9-16. Movants now contend that this Court erred in holding that their services and loans did not confer such a benefit as would entitle them to assert a claim against the judgment funds. The motion for reargument and alteration, however, merely restates arguments already made in slightly different form and rejected by the Court and, therefore, must be denied.

I

The factual background of these matters is more fully set forth in the Court's prior Opinion. *Intervention Opinion* at 2-6.

On January 24, 1984, Royal Dutch Petroleum Company, the majority stockholder of Shell Oil Company ("Shell"), announced that it would be merging Shell into its subsidiary, SPNV Holdings, Inc., and would thereby cash out Shell's minority stockholders at $55 per share. Movant McElroy, a business consultant but not a Shell stockholder, formed the Shell Oil Stockholders Committee ("Committee") to urge the minority stockholders to seek an appraisal of their shares.

Royal Dutch later changed the form of the acquisition to a tender offer of $58 per share, to be followed by a short-form merger. The tender offer was enjoined due to the inadequacy of the disclosure materials accompanying it. *Joseph v. Shell Oil Co.*, Del. Ch., 482 A.2d 335 (1984). After further disclosures were made, the tender offer continued, and a majority of the minority shares were tendered. A settlement was reached in the *Joseph* action, providing that the tendering stockholders and non-tendering stockholders who waived their statutory appraisal rights would receive an extra $2 per share.

During this time of negotiations, the Committee, through McElroy, sent mailings to Shell stockholders to solicit their mem-

bership in the Committee for the purpose of pursuing an appraisal. The terms of membership were an initial $.20 per share contribution, as well as subsequent scaled contributions. The funds generated by membership contributions were to be used to defray the costs of an appraisal action.

The Hurleys, beneficial owners of 600 shares of Shell, executed a Committee membership and made their initial contribution. They also loaned the Committee $300, and received from the Committee a promissory note for that amount plus 10% interest. They are not part of the stockholder class in either *Smith* or the Appraisal, because they accepted the $2 per share *Joseph* settlement consideration.

The Committee engaged a consulting firm, The Stockholders Consulting Group ("SCG"), to increase Committee membership and funding. McElroy, the principal of SCG, maintains that he was to receive payment for these services at a rate of $90 per hour.

A dispute soon arose among the Committee officers regarding the choice of class counsel in the Appraisal action. McElroy, therefore, decreased his activities on behalf of the Committee, but he did send at least one more mailing to the Shell stockholders and allegedly recommended an appraisal expert.

In *Sommer v. McElroy*, Del. Ch., C.A. No. 8402-NC, Hartnett, V.C. (Mar. 18, 1986), the Court enjoined a proposed communication by McElroy to the stockholders. In that action McElroy represented to the Court that he had resigned from his position as an officer of the Committee.

The Appraisal action was initiated by several minority stockholders of Shell on July 9, 1985. The *Smith* action, which challenged the adequacy of the disclosure documents disseminated in the short-form merger which followed the tender offer, was commenced on February 24, 1986, by those stockholders who had not accepted the *Joseph* settlement offer.

After trial in the *Smith* action, this Court held that the short-form merger disclosure documents were materially misleading because they failed to disclose over $1 billion worth of Shell's oil and gas reserves. *Smith v. SPNV Holdings, Inc.*, Del. Ch., C.A. No. 8395-NC, Hartnett, V.C. (June 19, 1990). As the measure of damages, the Court awarded the stockholders $2 per share. *Smith v. SPNV Holdings, Inc.*, Del. Ch., C.A. No. 8395-NC, Hartnett, V.C. (Dec. 26, 1990).

On December 11, 1990, the Court rendered its decision in the Appraisal action, finding that on the date of the cash-out merger, the minority shares had a fair value of $71.20. The Court also

awarded simple interest at a rate of 10%. *In re Appraisal of Shell Oil Co.*, Del. Ch., C.A. No. 8080-NC (Consolidated), Hartnett, V.C. (Dec. 11, 1990).

While appeals were pending before the Delaware Supreme Court in both the Appraisal action and in *Smith*, the Movants filed their motions to intervene in both actions for the purpose of seeking an award of fees (McElroy) and the rescission of Committee membership contracts (the Hurleys). As no application for attorney fees had yet been considered in either action, the motions were deferred until after the appeals were completed.

The appeals have since been completed and the Delaware Supreme Court affirmed both the *Smith* decision, *Shell Petroleum, Inc. v. Smith*, Del. Supr., 606 A.2d 112 (1992), and the Appraisal decision, *In re Appraisal of Shell Oil Co.*, Del. Supr., No. 351, 1991, Walsh, J. (May 26, 1992).

On June 16, 1992, this Court denied the motions to intervene on a number of grounds. *Intervention Opinion*. The Court found that the Movants had no standing to intervene for various reasons, including that neither McElroy nor the Hurleys were entitled to participate as stockholders in either *Smith* or the Appraisal action. At best, the Movants were creditors of the now-defunct Committee, and as such had no interest in the subject matter of either action that would justify their intervention.

II

The Movants now seek "reargument and alteration" of this Court's denial of their motions to intervene. Movants contend that the Court made three errors in its June 16, 1992 decision. First, Movants assert that they did confer a benefit on the plaintiff class in both actions, and that the benefit was in furtherance of the litigation. Secondly, Movants posit that the Court erroneously focused on the issue of whether a benefit was conferred in the litigation rather than on the issue of whether non-attorneys can collect a fee. Finally, they argue that they do have standing to intervene in these actions, independent of the existence of the Committee.

[1] Because Movants' arguments have already been considered and rejected by this Court, the motion for reargument and alteration must be denied. *Quigley v. State Board of Pension Trustees*, Del. Ch., C.A. No. 7389-NC, Hartnett, V.C. (Apr. 7, 1987). Due to the Movants' apparent misunderstanding of the June 16, 1992 opinion, however, the Court will again set forth its analysis of Movants' contentions.

III

Movants first claim that the Court erroneously found that they did not confer a benefit on the plaintiff class in both *Smith* and the Appraisal action. According to Movants' somewhat tenuous argument, the benefit is quite clear; but for their Committee membership recruiting efforts, there would have been no Appraisal action. They further maintain that without the Appraisal action there would have been no recovery in *Smith* because it was an expert witness in the Appraisal action who discovered the $1 billion of assets that had not been disclosed by Shell.

Movants have, however, misread this Court's opinion. The crux of the Court's decision was not the truth (or untruth) of Movants' allegations regarding their solicitation efforts, but whether those efforts could have conferred on the plaintiff classes a benefit that arose from the litigation of either action.

[2] The equitable fund doctrine, that Movants contend entitles them to a fee award from the judgment funds, requires a showing of a causal nexus between the claimant's efforts and the benefit achieved *in the litigation. Trustees v. Greenough,* 105 U.S. 527 (1881). Movants attempt to ignore the words "in the litigation" as mere surplusage; despite that they alternatively argue that their efforts were in direct furtherance of the litigation because their recruiting efforts prompted the participation of enough stockholders to make the Appraisal action economically viable. They cite as support for their claim cases, allegedly "overlooked by this Court," in which fees were awarded from a class recovery fund to so-called "locator firms."

Movants' reliance on those cases is misplaced. All of the cited cases involved the use of "locator firms" after a recovery fund had already been created by the litigation. The firms were employed, with court approval, to locate stockholders who had already been found to be qualified to share in the recovery fund but whose original notices of the litigation had been returned as undeliverable. Indeed, in some of those cases the court's order allowing the use of the locator firm expressly stated that the firm's fee would be paid by the individual stockholder who was found to be entitled to the litigation benefit by the firm's services. *See Honeycutt v. Emcor Petroleum, Inc.*, D. Colo., C.A. No. 85-V-12915, Naves, J., ORDER (Oct. 10, 1990); *Shidler v. All Am. Life & Fin. Corp.*, S.D. Iowa, C.A. No. 75-1002, O'Brien, J., ORDER (Apr. 6, 1991).

[3] The chief distinction between the factual circumstances in the cases cited by Movants and those existing here is the stage of the

litigation. In the "locator firm" cases, the solicited stockholders were found and brought into the litigation with a guaranteed recovery because the judgment fund had already been created. In the case at bar, Movants on their own initiative solicited stockholders before a request for an appraisal had even been filed. The burden of creating a recovery in this case, i.e., demonstrating to the Court that the value of the Shell shares was higher than the cash-out merger consideration, fell on the plaintiff class representatives and their counsel, not Movants.

[4] Movants further claim that they conferred a benefit on the plaintiff class in both actions because McElroy recommended the expert who much later discovered the $1 billion of oil and gas reserves that Shell had been disclosed in its short-form merger disclosure documents. Assuming, *arguendo*, that McElroy did indeed influence plaintiff's counsel in retaining that expert's services, this fact still does not entitle McElroy to recover a fee from either fund. McElroy may have recommended the expert, but it was the expert who conducted the research that revealed the $1 billion understatement. If McElroy has any claim against whoever hired the expert, his remedy is a suit on that claim in a proper forum.

The allegation that Movants solicited participants in the Appraisal action and recommended an expert for the Appraisal action, and nothing more, is inadequate to show that Movants' efforts produced a discernible benefit arising from either the litigation in the *Smith* action or the Appraisal action.

IV

In the alternative, Movants argue that the focus of the Court's inquiry should not be whether their services conferred a benefit on the classes in the litigation, but should be whether non-attorneys can collect a fee from the common fund. Movants miscite *In re Continental Illinois Securities Litig.*, 7th Cir., 962 F.2d 566 (1992), for their claim that professionals other than attorneys can recover fees for services rendered *outside* the litigation. They further assert that this Court's analysis and application of *Continental Illinois* in the *Intervention Opinion* was erroneous, presumably because the Court does not agree with their interpretation of the *Continental Illinois* decision.

Because they mischaracterize and inaccurately quote both the *Continental Illinois* and this Court's opinion, Movants have demonstrated a fundamental misunderstanding of the equitable fund doctrine. The only question as to the applicability of the equitable fund

doctrine that the court in the *Continental Illinois* decision considered was whether the named plaintiff could recover his "case-specific expenses" from the common fund. The court was not confronted with the issue of whether services rendered outside of the litigation could be compensated under the doctrine. Movants' suggestion that *Continental Illinois* stands for the proposition they assert is disingenuous—at best.

[5] The United States Supreme Court has held that the threshold requirement for a recovery under the equitable fund doctrine is a showing that the services for which compensation is sought conferred a perceptible benefit upon the plaintiff class in the litigation. *Trustees v. Greenough*, 105 U.S. 527 (1881). Movants have not provided this Court with any authority that could lead to a different conclusion.

V

Movants next contend that the Court erred in its conclusion that they do not have standing independent of the Committee to intervene in either the *Smith* action or the Appraisal action. Movants maintain that although the Committee no longer exists, they are somehow entitled to bring their claims directly against the judgment funds. They draw an analogy to the fact that attorneys in a law firm that disbands may still have a fee claim for prior services, even independent of the firm's existence. Finally, Movants advance the antithetical argument that they belatedly seek to add the non-existent Committee as a third party defendant in order to "rescind" the Committee membership contracts.

[6] Setting aside the fact that Movants have made diametrically opposite arguments in support of their claim of independent standing, Movants have again displayed a basic misunderstanding of this Court's opinion. Movants have chosen to ignore that they have no direct contractual relationship with the members of the shareholder class in either *Smith* or the Appraisal action. Their only direct contractual relationship (the McElroy claim for services rendered, the Hurley class claim for loans backed by promissory notes) was with the Committee, which no longer exists. The unfortunate circumstance of the Committee's demise does not confer standing on Movants "to step into the Committee's shoes" and enforce the Committee's contractual rights against its members who are members of the plaintiff classes. *Cf. Williamsport Firemen Pension Bds. I & II v. E.F. Hutton & Co.*, M.D. Pa., 567 F. Supp. 140 (1983).

In short, Movants' contractual claims against the now non-existent Committee, if those claims exist at all, are too far removed

from *Smith* and the Appraisal action to permit Movants' intervention. *See In re Copperweld Corp. Shareholders Litig.*, Del. Ch., C.A. No. 11341-NC, Berger, V.C. (June 6, 1991).

VI

[7-8] Finally, Movants criticize the second aspect of the Court's standing analysis. In addition to the holding that the Movants had no standing to assert the Committee's claims, the Court held that the Movants had no standing to intervene in either action because they could not have been a member of either plaintiff class. McElroy was never a Shell shareholder. The Hurleys were precluded from seeking an appraisal by the terms of the *Joseph* settlement, and were no longer shareholders at the time the disclosure documents at issue in *Smith* were disseminated.

Movants insist that the Court has misunderstood the basis for their motions to intervene. They have stated that they do not seek to participate in the two actions; they just want to collect fees and loan repayments. In the alternative, they point out that another movant to intervene, Richard Seba, is in fact an Appraisal action participant, and should be recognized as having standing even if they are not so recognized. In a footnote in their motion for reargument, Movants request that the Court rule on the Seba motion, which they claim the Court "overlook[ed]."

The Court did not consider the Seba motion because no ruling on it was ever previously requested. *Cf.* Chancery Rule 173. The Court will, however, rule on that motion at this time.

[9] The fact that Mr. Seba is an appraisal participant does not confer automatic standing on him for the purpose of asserting a claim in the Appraisal action for repayment of loans he made to a now non-existent entity. As with McElroy and the Hurleys, Mr. Seba's claim is against the now non-existent Committee for monies furnished by him to the Committee outside of the litigation. McElroy, Seba and the Hurleys cannot bring these claims in either *Smith* or the Appraisal action, because they are claims against a now non-existent entity that was never a party to either litigation. Only the Committee had arguable standing to intervene in either action and, as was noted above, McElroy, Seba and the Hurleys have shown no basis to assert claims on the Committee's behalf. *See Industrial Trust Co. v. Stidham*, Del. Supr., 33 A.2d 159 (1942).

VII

[10] In summary, no movant may intervene in either the *Smith* action or the Appraisal action because McElroy's services and the