complaint contains no allegation the directors (other than the former defendant, Hall) knowingly or deliberately withheld information they knew to be material for the purpose of misleading shareholders. The record fails to suggest that a single defendant director obtained a personal financial benefit as a result of the publication of the allegedly misleading proxy statement.[2]

When pressed to explain a basis for a contention that the individual defendants acted in bad faith or in breach of their duty of loyalty, Plaintiff speculates that the defendant directors preferred their friendship with Hall over stockholders' best interests and asserts that there can be no other explanation for Defendants' conduct over the course of the Merger process. (Oral Argument, March 7, 1995, at 60-61) Plaintiff urges the Court to ". . . look imaginatively beneath the surface of events . . ." to recognize the possibility of bad faith or a breach of the duty of loyalty as a genuine issue of material fact. (Oral Argument, March 7, 1995, at 76-77 (citing ***In re Fort Howard Corp. Shareholders Litig.***, Del. Ch., C.A. No. 9991, Allen, C., slip op. at 30 (Aug. 8, 1988) (denial of a motion to preliminarily enjoin the closing of a public tender offer)). Now that Plaintiff has had more than adequate time for discovery, however, the Court's imagination cannot substitute for a showing sufficient to establish the existence of an element essential to Plaintiff's case, on which the Plaintiff bears the burden of proof at trial. *See* ***Buckhart v. Davies***, Del. Supr., 602 A.2d 56, 59 (1991) (quoting ***Celotex Corp. v. Catrett***, 477 U.S. 317, 322-323 (1986) (construing the summary judgment provisions of the Federal Rules of Civil Procedure), *cert. denied*, 118 L.Ed. 2d 551 (1992)).

A review of the record in light most favorable to Plaintiff reveals no factual support for Plaintiff's assertion of bad faith or director disloyalty in proxy statement disclosure decisions. While Plaintiff's complaint and briefs recite facts that might raise a question as to the judgment and care of the defendant directors, they state no position as to the defendant directors' motives. In the absence of a genuine dispute of material fact concerning the good faith and loyalty of the defendant

---

the issue of loyalty with respect to Count II emerged only after the Supreme Court confirmed the applicability of Section 102(b)(7) to directors' disclosure obligations. *Arnold*, 650 A.2d at 1287.

[2]In fact, insofar as it reveals that three of the four defendant directors or their affiliates were May Petroleum shareholders at the time of the Merger, the record supports the opposite inference. (Proxy Statement at 57-58) The shareholder directors must have acted to their personal financial detriment if, in accordance with Plaintiff's theory, they issued a false proxy statement that induced shareholders to approve merger terms undervaluing their company.

directors, summary judgment is appropriate. I find that May Petroleum's Article FIFTEENTH shields the individual defendants from liability.

V. LIABILITY OF THE CORPORATION

The question of the liability of the corporate defendant remains. Count II charges all defendants with inducing shareholders to approve the Merger by means of a false and misleading proxy statement, without differentiating between the nature of the duty of disclosure owed to shareholders by the individual defendants and by the corporate defendant. [12] The corporation owes no fiduciary duties to shareholders independently from its agents, and the corporation itself is not liable for a breach of fiduciary duties by its directors. ***Gaffin v. Teledyne, Inc.***, Del. Ch., C.A. No. 5786, Hartnett, V.C., slip op. at 6-7 (Oct. 9, 1987), *rev'd on other grounds*, Del. Supr., 611 A.2d 467 (1992); ***Wheelabrator*** , slip op. at 18; ***Dataproducts***, slip op. at 13-14. Thus, a corporation may be liable for improper disclosure only if a plaintiff successfully advances a direct claim against the corporation for legal or equitable fraud. *Id.* While it is not clear Plaintiff intended to plead such a claim, I now address this possibility in order to resolve any potentially outstanding issues.

[13] An action for legal or equitable fraud must allege a false representation or a concealment of material fact by the defendant, the plaintiff's action or inaction taken in justifiable reliance upon the misrepresentation or concealment, and damage to the plaintiff as a result of its reliance. In addition, in an action for legal fraud, a plaintiff must also allege the defendant knew or believed the representation was false. For equitable fraud, a plaintiff may plead merely an intent to induce the plaintiff to act or refrain from acting. ***Dataproducts***, slip op. at 13-14.

[14-16] The possibility of legal or equitable fraud need be investigated no further here, however, because it is apparent, as a matter of law, that neither the plaintiff class nor the plaintiff individual can prevail on such a claim. Even if Plaintiff did allege and could establish a material, fraudulent omission by May Petroleum, Plaintiff is precluded from bringing the action as a class action suit. A class action may be maintained pursuant to Chancery Rule 23 if the Court finds, *inter alia*, that "the questions of law or fact common to the members of the class predominate over any questions affecting only individual members . . ." Ch. Ct. R. 23(b)(3). The Supreme Court has ruled a class action for fraud is inappropriate because "individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact." ***Gaffin v. Teledyne,***

Inc., Del. Supr., 611 A.2d 467, 474 (1992). An individual action for fraud against the corporate defendant cannot be successful because Plaintiff fails to allege in the complaint or indicate in subsequent briefs facts from which the Court might infer justifiable reliance by Emerald Partners. As a matter of law, any claim for fraud must fail.

VIII. CONCLUSION

The undisputed facts reveal there is no basis for liability on the part of Defendants for the proxy statement omissions complained of in Count II. The individual defendants are shielded from liability as a matter of law for possible errors in judgment regarding the extent of information that ought to have been disclosed in connection with shareholders' vote on the Merger. The corporate defendant may not be found liable for fraud where Plaintiff cannot demonstrate class or individual reliance upon the allegedly misleading May Petroleum proxy statement.

For the foregoing reasons, Defendants' motion for summary judgment is ***granted*** except as to those disclosure claims that have been abandoned by Plaintiff and are therefore dismissed. Plaintiff's cross-motion for summary judgment is denied.

IT IS SO ORDERED.

HAFT v. HART

No. 14,425

Court of Chancery of the State of Delaware, New Castle

November 14, 1995

The current action was one of several arising from the transfer of a block of Class B common stock in Dart Group Corporation from defendant, founder and chief executive officer of Dart, to plaintiff. In exchange for the Class B stock, defendant received cash, a promissory note, and the grant of an irrevocable proxy. Business relations between plaintiff and defendant deteriorated after the transfer, and plaintiff alleged claims for breach of contract, breach of fiduciary duty to himself as

grantor of the proxy, and breach of fiduciary duty to Dart, the nominal defendant. Plaintiff also sought a declaration that the proxy given to defendant was validly revoked or, in the alternative, that the proxy would be revocable once the promissory note given in consideration of the transfer of the Class B stock was satisfied. Defendant counterclaimed for breach of contract and sought rescission of the transfer of the Class B stock based on several theories. Pending before the court in this instance were cross-motions for summary judgment; plaintiff and defendant both moved for summary judgment on the plaintiff's two claims relating to the revocability of the proxy, and defendant also moved for summary judgment to dismiss plaintiff's claims for breach of contract and breach of fiduciary duties, and on his counterclaim seeking rescission of the transfer.

The court of chancery, per Chancellor Allen, held that as the senior executive officer of Dart, the defendant had a sufficient security interest in the Class B common stock to support the enforceability of the express contract for the irrevocable proxy, thus the proxy was irrevocable when created and the purported revocation by defendant had no legal effect. Plaintiff's motion for summary judgment was denied.

1. Judgment ⇐ 181(1), 182

A motion for summary judgment will be granted when (1) the record establishes that, viewing the facts in the light most favorable to the nonmoving party, there is no genuine issue of material fact; and (2) in light of the relevant law and those facts, the moving party is legally entitled to judgment.

2. Corporations ⇐ 198(6), 298(6)

A proxy is irrevocable if it states that it is irrevocable and if it is coupled with an interest sufficient in law to support an irrevocable power. DEL. CODE ANN. tit. 8, § 212(e) (1991).

3. Corporations ⇐ 198(6), 298(6)
Secured Transactions ⇐ 2, 11

A security interest in stock itself would be sufficient to support an irrevocable proxy.

4. Secured Transactions ⇦ 1, 2, 11

Article 9 generally governs the creation, perfection, and enforcement of security interests in property and applies to any transaction (regardless of its form) which is intended to create a security interest in personal property. DEL. CODE ANN. tit. 6, § 9-102(1)(a) (1991).

5. Secured Transactions ⇦ 1, 11, 19

Security interests in share certificates (or certificateless shares for that matter) are not excluded from the provisions of Article 9. DEL. CODE ANN. tit. 6, § 9-104 (1991).

6. Secured Transactions ⇦ 1, 2, 11

A security interest is a property right in identified property created by contract for the purpose of protecting in some respect some right, title, or interest of the secured party.

7. Contracts ⇦ 14, 15, 147(1)

It is elementary that the intention necessary to form a contract is not found in the private subjective mental state of either of the parties to a negotiation, but is the meaning that a reasonable person would attribute to their expressions of assent, given the context of the words and acts that preceded their claimed agreement and culminated in it.

8. Contracts ⇦ 14, 147(1)

Courts do not look for and give legal force to a private subjective state of mind (intent) but to objective acts (words, acts, and context) that constitute the enforceable contract and the objective (reasonable person) interpretation of what the contracting parties meant (intended) to do.

9. Contracts ⇦ 14, 147(2), 152, 154

Under the objective theory of contracts, when a writing is clear, the writing itself is the sole source for gaining an understanding of intent.

10. Secured Transactions ⇐ 1, 2, 41

A security interest created by agreement is generally enforceable when (1) the debtor has rights in the specific collateral, (2) value is given by the creditor, and (3) the collateral is identified either by possession of the creditor or description in a signed security agreement. DEL. CODE ANN. tit. 6, § 9-203 (1991).

11. Secured Transactions ⇐ 1, 2, 41, 133

In order for a security interest in securities to attach and be enforceable it must satisfy the requisites of sections 9-203 and 8-321 of the Delaware Code. DEL. CODE ANN. tit. 6, § 9-203 (1991).

12. Secured Transactions ⇐ 24, 133, 143

Where the collateral is a security, it is insufficient, in order for the security interest to attach and be enforceable, simply to identify the collateral; the collateral must also be transferred to the secured party or a person designated by him pursuant to a provision of section 8-313(1) of the Delaware Code. DEL. CODE ANN. tit. 6, § 8-321(1) (1991).

13. Judgment ⇐ 182, 185(5)

Summary judgment is appropriately granted even where colorable or insignifigantly probative evidence is present in the record, if no reasonable trier of fact could find for the plaintiff on that evidence.

14. Judgment ⇐ 181(2), 185(1), 185(5), 185.2 (4)

The mere existence of a scintilla of evidence in support of the plaintiff's motion for summary judgment is not sufficient; thus, plaintiff's affidavit standing alone does not raise a genuine issue of fact.

15. Corporations ⇐ 397
Principal and Agent ⇐ 15, 26

An escrow agent who acts for two principals, both of whom agree to the terms of the arrangement, qualifies as a "person designated by" either such person.

16. Corporations ⇐ 397
Principal and Agent ⇐ 26, 62(2), 100(1)
Secured Transactions ⇐ 24, 117, 131, 163

Notice of the creation of rights in the collateral is the primary purpose served by the possession requirement. Placing securities in the hands of an escrow agent serves this notice function by alerting third parties that the debtor does not have unfettered control over (cannot deliver) the securities.

17. Corporations ⇐ 198(1), 198(4), 198(6), 199

A proxy may be made irrevocable if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. DEL. CODE ANN. tit. 8, § 212(e) (1991).

18. Corporations ⇐ 397
Principal and Agent ⇐ 1, 26, 32, 33
Secured Transactions ⇐ 11, 22

Irrevocable powers or powers in which the holder has a property right are an exception to the general rule that agency powers are terminable by the grantor of the power at will. An irrevocable power or power given as security is a power held for benefit of the power holder and given to secure the performance of a duty or to protect a title, such power being given when the duty or title is created or given for consideration. RESTATEMENT (SECOND) OF AGENCY § 138 (1957).

19. Corporations ⇐ 198(2), 198(6), 408
Secured Transactions ⇐ 11, 19, 143

A security interest sufficient to support an irrevocable proxy must be either an interest in the stock itself or an interest in the corporation generally. DEL. CODE ANN. tit. 8, § 212(e) (1991).

20. Corporations ⇐ 198(1), 198(2), 198(5), 199

A proxy is generally a means to temporarily split the power to vote from the residual ownership claim of the stockholder.

21. Contracts ⇐ 3
Corporations ⇐ 198(1), 198(6), 397
Secured Transactions ⇐ 2, 4, 21

A security interest held by the senior executive officer of a corporation is sufficient under Delaware law to render specifically enforceable the express contract for an irrevocable proxy.

Stuart M. Grant, Esquire, Jay W. Eisenhofer, Esquire, and Jonathan M. Korn, Esquire, of Blank, Rome, Comisky & McCauley, Wilmington, Delaware, for plaintiff.

Elizabeth M. McGeever, Esquire, Ronald A. Brown, Esquire, and Thomas A. Mullen, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Scott W. Muller, Esquire, and Michael F. Orman, Esquire, of Davis Polk & Wardwell, Washington, D.C., of counsel, for defendant Herbert H. Haft.

Arthur G. Connolly, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware; and Stephen J. Brogan, Esquire, of Jones, Day, Reavis & Pogue, Washington, D.C., of counsel, for nominal defendant Dart Group Corporation.

ALLEN, *Chancellor*

The questions presented are whether a proxy to vote shares of stock was validly made irrevocable when granted and, if so, whether it continues to be irrevocable.

The case arises from a July 28, 1993 transaction in which Herbert H. Haft transferred a block of the Class B common stock of Dart Group Corporation ("Dart") to his younger son Ronald S. Haft in exchange for cash, a note, and the grant of a "lifetime" irrevocable proxy to vote the stock transferred. The stock in question is a block of 172,730 shares of Class B common stock of Dart, the sole class of voting stock of the corporation. The Class B shares that were transferred constituted 57% of the then outstanding Class B shares and thus carried with them the power to elect the board of directors of Dart.

The July 1993 transaction arose in the context of a complex and apparently acrimonious family dispute that included the dissolution of the long-term marriage between Herbert and Gloria Haft. The three children of the marriage were pulled to one side of that dispute or the other. Elder son Robert and daughter Linda sympathized with their mother.

Their brother Ronald may have been inclined differently. In any event, the July 1993 transaction might be interpreted as an alliance between Herbert and Ronald. At the time of Herbert's transfer of legal title to the Dart Class B stock to him, Ronald also signed a employment contract with Dart to become President and Chief Operating Officer of the company, a position that had formerly been held by Robert. In connection with acceptance of that office Ronald acquired from the Company, options to buy additional shares of Class B stock, or so it is alleged.

If it was a long term alliance that was envisioned in July 1993 by Herbert and Ronald, events were to disappoint those expectations. On September 12, 1994, Ronald instituted suit against Dart seeking the specific performance of his alleged option to purchase additional Class B stock. That suit (the "option litigation") was one of a complex welter of suits instituted among members of the Haft family in this court, in the United States District Court for the District of Delaware, and in the courts of the District of Columbia, relating to control of Dart or to claims against it. On July 18, 1995, Ronald instituted this litigation against his father. This suit (the "proxy litigation") purports to allege claims for breach of contract, for breach of fiduciary duty to Ronald as the grantor of a proxy, and, derivatively, for breach of fiduciary duty to Dart itself. Importantly, the suit seeks a declaration that the proxy given to Herbert was validly revoked on June 30, 1995, or, in the alternative, that the proxy will be revocable once the promissory note given in consideration of the transfer of the Class B common stock is satisfied.

Herbert Haft has counterclaimed for breach of contract and seeks rescission of the transfer of the Class B stock on several theories, including an alleged breach of contract, failure of consideration, attempted partial rescission by Ronald, mutual mistake, and unilateral mistake.

Now pending are cross-motions for summary judgment. Ronald Haft has moved for partial summary judgment on two counts of his complaint: that the proxy given to his father was validly revoked or, in the alternative, that the proxy will be revocable once the promissory note is satisfied. Herbert Haft, in turn, has moved for summary judgment on these counts as well and for summary judgment dismissing plaintiff's claims for breach of contract and breach of fiduciary duties. Finally, Herbert has moved for summary judgment on his counterclaim seeking rescission of the transfer.

[1] A motion for summary judgment will be granted when (1) the record establishes that, viewing the facts in the light most favorable to the nonmoving party, there is no genuine issue of material fact, and (2) in

light of the relevant law and those facts, the moving party is legally entitled to judgment. *Burkhart v. Davies*, Del.Supr., 602 A.2d 56, 58-59 (1991). This opinion addresses only a portion of the various issues presented by these cross motions. In this opinion, I address and reject Ronald Haft's motion for summary judgment with respect to his claim that he effectively revoked the proxy that was part of the July 1993 transaction and I reject, as well, plaintiff's claim that the proxy will (has) become revocable once the note that he gave to Herbert Haft in July 1993 is satisfied.[1]

I. General Background

Herbert H. Haft is the founder of Dart and has been Dart's Chief Executive Officer and Chairman of the Board since 1960. In still other related litigation ("The Class A shareholders derivative suit") it is claimed that Herbert Haft has dominated and mismanaged Dart, enriching himself at the cost of the corporation. These claims are not pertinent to the pending motions, but are noted simply as further context. Dart's capital structure comprises two classes of stock: Class B common stock which has voting rights and has always been held only by members of the Haft family, principally Herbert, and Class A common stock which has no voting rights and is publicly traded. Prior to the July '93 transfer to Ronald, the B stock was owned by Herbert (172,730 shares or 57%); Gloria (18%); Robert (8.33%); Linda (8.33%) and Ronald (8.33%). Herbert also owns 122,747 shares of the Class A Dart common stock.

As mentioned, as part of the July transfer Ronald Haft acquired an option to purchase certain authorized but unissued shares of Dart Class B stock. That option covered up to 197,048 shares at a price equal to 110% of the then current market price of the non-voting Class A common stock.

---

[1]After these motions were taken under consideration, the parties informed the court that a complex (revocable in part) transaction between Dart and Ronald has subsequently been agreed to and closed, which purported, *inter alia*, to advance the necessary funds to Ronald to pay off his father's note according to its terms, and take other steps including the purported settlement of disputes between Dart and Ronald Haft. While the evidentiary record contains nothing about these later developments, I recognize that whether Herbert's proxy was supported by an additional cognizable interest sufficient to render it irrevocable despite the prepayment of the note, is a question that may have a bearing on the effectiveness at law or in equity of the actions purportedly taken by those Dart directors who authorized the transaction with Ronald. Given these later developments and their possible importance, I find it prudent to reach this legal question despite the fact that Herbert Haft's security interest in the proxy shares was (is) sufficient, in and of itself, to make the proxy irrevocable as of the time of submission of this motion to the court.

The terms of the July 1993 stock transfer were as follows: Herbert transferred to Ronald all 172,730 shares of Class B stock that he owned in exchange for stated consideration of $13,818,400, consisting of $2.8 million in cash and a twenty year promissory note (due on August 1, 2013) for the balance. This sale was made pursuant to a Contract for the Transfer of Securities (the "Transfer Contract"), in conjunction with which Ronald executed and delivered the promissory note (the "Note"). At the same time, Ronald granted a "lifetime" irrevocable proxy back to his father. Notably, of course, the irrevocable proxy that accompanied the transfer would make it more likely that Herbert would be able to continue to elect the board of Dart, despite any division of the proceeds of the sale that a marital court might order as part of a division of marital property.

Some ten months later, on May 17, 1994, all five members of the Haft family signed two settlement agreements that attempted to settle all disputes among the family members, including a divorce settlement. After this settlement, business relations between Ronald and Herbert appear to have deteriorated. On September 6, 1994, Ronald Haft attempted to exercise the option purportedly granted in his employment contract to purchase 197,048 shares of Dart Class B stock. The Company's board of directors, however, refused to recognize that right at that time.[2] On September 7, 1994, an Executive Committee, comprised of four non-Haft directors, was formed to act in areas of disagreement between Ronald and Herbert Haft, and by October 11, 1994, the role of this Executive Committee is claimed to have been expanded to include all affairs of Dart, effectively removing Herbert (the fifth director) from board deliberations. Sometime shortly after this, Herbert, who continued as Dart CEO, advised the Executive Committee that Ronald should be terminated from his positions with Dart. The board did not do so; a standstill order entered by this court in the option litigation precluded such action at that time without prior notice and hearing, a procedure that was not employed.

On June 30, 1995, Ronald Haft sent his father a letter purporting to revoke the proxy Herbert held. Without indicating the grounds for revocation, the letter simply stated that it "hereby revokes the Proxy . . . [t]hat the Proxy is no longer in effect and [that Ronald] shall retain the vote" of the Class B common stock. In response Herbert Haft purported to rescind the transfer of the Dart Class B stock asserting that the

[2]Ronald Haft eventually brought the option litigation in this court seeking to enforce his claims. The option litigation has, subsequent to the submission to the court of the pending cross motions in this suit, been voluntarily dismissed. *See* note 1 above.

purported revocation by Ronald was a material breach of the stock sale contract. This suit was then instituted by Ronald in order to secure a declaratory adjudication of the validity of Ronald's revocation of the proxy, or in the alternative, a declaration that the proxy would be revocable when the Note is satisfied.

For the reasons that follow I conclude that the proxy was irrevocable when created and, putting wholly aside any effect of the purported purchase of the shares by the Company pursuant to the proposed settlement of Ronald's option litigation, remains so. By this I mean to express the opinion not only that Herbert Haft held a security interest in the stock, but that beyond that he had and has sufficient interests with respect to Dart to support the present irrevocability of the proxy without regard to his interest as a secured creditor of Ronald Haft. Thus I conclude that the purported revocation was without legal effect.

II. The Proxy Was Irrevocable When Granted

In order for Ronald Haft to establish that the proxy has been validly revoked, he must first show that the proxy, which on its face purported to be irrevocable, is in fact revocable under Delaware law. For the reasons set forth in this section I conclude that at the time that Ronald Haft purported to revoke the proxy it was irrevocable in law and that the revocation was therefore without legal effect.

[2-3] Under Section 212(e) of the Delaware General Corporation Law, a proxy is irrevocable "if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power." The obvious first candidate for an "interest" that would support the irrevocability of the proxy in this instance would be a security interest in the stock protecting Herbert's right to be paid the principal amount of the Note, plus interest. The parties agree that a security interest in the stock itself would be sufficient to support an irrevocable proxy.[3] They disagree, however, on the more basic question, whether any security interest in the Class B shares was created in this instance.

---

[3]*See, e.g., In re Chilson*, Del.Ch., 168 A. 82, 85 (1933); 5 Fletcher Cyc. Corp. § 2062 (Perm ed. 1987) ("The interest necessary in order to support irrevocability may be security for a loan . . .").

1. The Parties Created a Security Interest in the Class B Shares Under Delaware Law.

[4-5] It is agreed that Delaware law governs the question whether a security interest was created.[4] The applicable law is Articles 8 and 9 of the Delaware version of the Uniform Commercial Code. Article 9 generally governs the creation, perfection, and enforcement of security interests in property and applies to "any transaction (regardless of its form) which is intended to create a security interest in personal property." 6 *Del. C.* §9-102(1)(a)(1991). Security interests in share certificates (or certificateless shares for that matter) are not excluded from its provisions. *See* 6 *Del. C.* §9-104(1991). Thus, in determining the validity of a claimed security interest in securities, one must turn first to Article 9.

(a). Intent to create the security interest:

[6] A security interest is a property right in identified property created by contract for the purpose of protecting in some respect some right, title, or interest of the secured party. Recognizing the fundamental fact that security interests result from the contractual act of a grantor, Ronald Haft asserts that he, as the property owner (after the transfer of the stock) had no intention at the time he gave the proxy that it should be held and used to protect any right, title, or interest of Herbert. He presents his own sworn affidavit to that effect and points to the fact that after the closing of the July 1993 transfer his father presented him with a formal security agreement, which he did not sign.

[7-8] It is elementary that the intention necessary to form a contract is not found in the private subjective mental state of either of the parties to a negotiation, but is the meaning that a reasonable person would attribute to their expressions of assent, given the context of the words and acts that preceded their claimed agreement and culminated in it. Thus, courts do

---

[4]In the Transfer Contract, the parties agreed that Delaware law would govern any claims or rights arising from the transaction. However, the Note provides the basis for the claimed security interest and it indicates that it shall be governed by the laws of the District of Columbia. Moreover, for certificated securities, Article 9 of the Delaware Uniform Commercial Code, section 9-103(1)(b), indicates that perfection of a security interest is governed by the law of the jurisdiction "where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected." In this case, that jurisdiction appears to be the District of Columbia. Thus, it may be that the laws of the District of Columbia should control. Nonetheless, the District of Columbia and Delaware have adopted the Uniform Commercial Code without changes to the provisions germane to this issue and therefore this court will adhere to the parties' agreed-upon application of Delaware law.

not look for and give legal force to a private subjective state of mind (intent) but to objective acts (words, acts and context) that constitute the enforceable contract and the "objective" (reasonable person) interpretation of what the contracting parties meant (intended) to do. *See Leeds and Parkview Convalescent Ctr., Inc. v. First Allied Connecticut Corp.*, Del. Ch., 521 A.2d 1095 (1986). Looking to the objective evidence reflected in the record, I find no material dispute concerning the relevant circumstances surrounding the transfer. The intent that the law requires for the creation of a security interest is, in my opinion, certainly present here.

[9] The most important circumstance is the clear language of the operative legal document executed by Ronald Haft. The Note contains a paragraph entitled "Collateral" in which it states that the note "shall be secured solely by the collateral, the Shares." This language is part of an effective legal act that created rights. In light of this language in a signed document, no inconsistent private reservation is effective to create a material issue of fact concerning "intent" to create a security interest. No magic words are needed to create a security interest. *United Virginia Bank/Seaboard Nat'l v. B.F. Saul Real Estate Inv. Trust*, 641 F.2d 185, 189 (4th Cir. 1981). Under the objective theory of contacts, when a writing is clear, "the writing itself is the sole source for gaining an understanding of intent." *City Investing Co. Liquidating Trust v. Continental Cas. Co.*, Del.Supr., 624 A.2d 1191, 1198 (1993).

Notwithstanding the terms of the Note, Ronald now argues that Herbert's repeated subsequent attempts to get him to sign a prepared draft of a pledge agreement and his later refusal, evidence the fact that there was no intent to create a security interest at the time the Note, Contract, and Proxy were originally executed. Such evidence is, however, legally irrelevant given the legal standard referred to above. In other circumstances such conduct might create a fact issue, but here, given the terms of the Note itself, this extrinsic evidence creates no litigable issue with respect to the question whether the parties acted in a way in which a reasonable person would have concluded that they intended to create a security interest.

(b) The Security Interest is Enforceable:

[10-11] Given the existence of an agreement to grant a security interest, Section 9-203 lays out the formal requisites of the enforceability of such an interest. Generally a security interest created by agreement is enforceable when (1) the debtor has rights in the specific collateral, (2) value is given by the creditor and (3) the collateral is identified either by

possession of the creditor or description in a signed security agreement. Section 9-203, however, also provides that it is "subject to the provisions of . . . Section 8-321 on security interests in securities." Thus, in order for a security interest in securities to attach and be enforceable it must satisfy the requisites of Section 8-321.

[12] Under Section 8-321(1), where the collateral is a security, it is insufficient, in order for the security interest to attach and be enforceable, simply to identify the collateral. In the context of securities, the collateral must be "transferred": "a security interest in a security is enforceable and can attach only if it is transferred" to the secured party or a person designated by him pursuant to a provision of Section 8-313(1).[5]

(i) Transfer of securities to "a person designated by" the secured party under Section 8-313(1).

In contending on this motion that no security interest was created, Ronald Haft contends that no transfer occurred that would satisfy the requirements of Section 8-313(1) described above. The record, however, shows that the multi-part test for creation of a security interest in securities was satisfied when Herbert Haft accepted the Note and the proxy in partial payment for his transfer of the Class B stock to Ronald and the shares were delivered to Herbert's attorneys at Wilmer, Cutler & Pickering.

Section 8-313(1) provides several ways in which such a transfer may occur. With respect to certificated securities (as here), where the transfer does not involve a financial intermediary, subsections (a), (e), (h)(ii), and (i) of section 8-313(1) are all valid methods of satisfying the requirement of a transfer to the secured party or a person designated by him.[6] Principally involved in this case is the process defined by subsection (a). That subsection simply requires possession of the certificated securities by the secured party or a person designated by him. The critical question thus becomes who was in possession of the share certificates following the transaction and in what capacity.

---

[5]Under the terms of Subsection 8-321(2) "a security interest so transferred pursuant to agreement by [1] a transferor who has rights [2] to a transferee who has given value, is . . . perfected."

[6]Subsection (e), however, is not applicable under the current circumstances because it concerns a situation in which a third party had possession of the securities prior to the granting of a security interest and the third party continues to possess the securities for the secured party after the transaction. *See* 6 *Del. C.* §8-313(1)(e)(1991).

It is agreed that the firm of Wilmer, Cutler & Pickering ("WC&P") has held and continues to hold the certificates. The capacity in which WC&P holds the shares is, however, actively disputed. Herbert Haft contends that WC&P were his lawyers and hold the shares as his agent. If Herbert is correct in this view then the requirements of Section 8-313(1)(a) would be satisfied and he would have an enforceable security interest in the Dart Class B stock. Ronald Haft, however, asserts that WC&P actually held the shares for him for safekeeping and not for his father. If Ronald is correct about this no security interest was created. Both parties admit, however, that WC&P has stated, and is of the belief that, it holds the shares as escrow agent for and as an accommodation for both parties.

(ii) Evidence with respect to the capacity in which WC&P possesses the Class B shares.

In my opinion, there is insufficient evidence to raise a triable issue concerning Ronald's position that the law firm holds the shares for him solely. The Transfer Contract specifically states that WC&P represented Herbert in the transaction. Although WC&P's own statement that they hold the shares for both men may be thought to contain a possible contradiction of this,[7] the most that can be made of that circumstance is that a trial might be necessary to determine if WC&P holds as Herbert's agent or as agent of both men. Crucially, however, there is no evidence that WC&P ever held the stock for Ronald alone. The Transfer Contract specifically states not only that WC&P represented Herbert but that Ronald had separate counsel. Even taking into account the fact, as asserted by plaintiff, that WC&P may have represented Ronald on other matters, retention of the shares by Herbert's counsel in the transaction is wholly inconsistent with any claim that Ronald retained unrestricted access and possession of the shares. The record is devoid of any evidence of plaintiff's contention other than his own conclusory affidavit. This record does not create a triable issue on the assertion that WC&P have acted solely for Ronald.

[13-14] The Supreme Court of the United States has noted that summary judgment is appropriately granted even where "colorable . . . or [in]significantly probative [evidence]" is present in the record, if no reasonable trier of fact could find for the plaintiff on that evidence. *See*

---

[7]But not necessarily so, as it is possible that WC&P represented Herbert in the transaction, but agreed with his concurrence after the closing, to accommodate the needs of the parties by acting as an escrow agent for both parties.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249-50 (1986) (citations omitted). The "mere existence of a scintilla of evidence in support of the plaintiff's position" is not sufficient. *Id.* at 252. In my opinion, for similar reasons, plaintiff's affidavit standing alone does not raise a genuine issue of fact with respect to the factual claim that WC&P held the certificates solely for him.

Thus, the factual predicate for resolution of the question whether there was compliance with Section 8-313(1)(a) is either (1) WC&P represented Herbert alone when it took possession of the certificated shares of Dart Class B stock or (2) it represented both Herbert and Ronald. There is substantial evidence that would support either finding. For the reasons that follow however, I am of the opinion that under either finding Herbert's interest in the B stock would constitute an enforceable security interest under Section 8-321.

(iii) WC&P was "designated" by Herbert Haft whether that firm acted for Herbert alone or jointly for both men.

In my opinion the requirements of section 8-313(1)(a) are met in either event because under either scenario the principal purpose of the possession requirement - to place potential creditors on notice that the shares may be encumbered - is satisfied.

[15-16] Ronald contends that if WC&P holds the shares for both Ronald and Herbert, the requisite transfer to a "person designated by" Herbert did not occur. First, I note that on the most literal level of analysis, an escrow agent who acts for two principals, both of whom agree to the terms of the arrangement, qualifies as a "person designated by" either such person. More fundamentally, however, the underlying purpose of the transfer/possession requirement is satisfied when the words in question are given this ordinary meaning interpretation. Notice of the creation of rights in the collateral is the primary purpose served by the possession requirement. Placing securities in the hands of an escrow agent serves this notice function by alerting third parties that the debtor does not have unfettered control over (cannot deliver) the securities. Ronald's relinquishment of the shares to WC&P to hold as an accommodation for both parties would constitute a transfer to a "person designated by" Herbert as required under sections 8-321 and 8-313(1)(a).

* * * *

Thus concluding that the requisite elements for the creation of a security interest in the Class B shares were satisfied, I conclude that the proxy when granted was coupled with an interest in the stock and thus its stated irrevocability was a valid and enforceable term of the parties' agreement. Insofar as plaintiff's motion is premised on a different view, that motion must be denied.

III. The Proxy Is Irrevocable Irrespective of any Satisfaction of the Note

With respect to Ronald's claim that the Proxy will be revocable once the Note is paid in full, I conclude that Herbert Haft's interests in Dart other than as a person with a security interest in the transferred Class B shares, are sufficient to render specifically enforceable the contractual undertaking of irrevocability.[8]

1. The Applicable Statute:

[17-18] The Delaware General Corporation Law states that a proxy may be made irrevocable "if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power." 8 *Del. C.* §212(e)(1991). Most agency powers are, of course, terminable by the grantor of the power at will. Irrevocable powers or powers in which the holder has a property right are an exception. The *Restatement (Second) of Agency* formulation is conventional: an irrevocable power or "power given as security" is "a power . . . held for the benefit of the power holder . . . and given to secure the performance of a duty or to protect a title, . . . such power being given when the duty or title is created or given for consideration." *Restatement (Second) of Agency* §138(1957). Generally, of course, irrevocable powers arise in transactions in which the "agent" bargains for or requires the power as a means of protection of her own legally protectable interest.

In this case, Herbert Haft asserts that he required the irrevocable proxy in order to protect both his right to be paid the cash due on the Note and as a means to protect his interests in Dart, which included his interest as holder of Class A stock, and as the CEO of the company. It was of course obvious that if he were to sell his majority block of the Class B shares, without retaining (in effect) the vote, he would open

---

[8]Although Herbert Haft's security interest in the Class B shares in and of itself makes the Proxy irrevocable at this time, events occurring subsequent to the parties' cross motions for summary judgment make it prudent to address this issue. *See* note 1 above.

himself to a number of risks: such as the possibility of a merger, recapitalization, or other transaction that disadvantaged him as the holder of a security interest in the B stock, or more pointedly, the possibility of his removal as the firm's CEO by a board that would no longer have to look to him for reappointment. The vote offered no sure-fire protection against such steps, but it certainly offered substantial protection.

[19] Under the Delaware corporation law (§212(e)) an interest sufficient to support an irrevocable proxy must be either "an interest in the stock itself or an interest in the corporation generally." 8 *Del. C.* § 212(e) (1991). Do Herbert Haft's interests, other than as a secured creditor, qualify under the statute? As I now explain, in my opinion they do.

2. Relevant Legal Precedents

The predecessor of Section 212 was amended as part of the general revision of the Delaware General Corporation Law in 1967. The language in question ("an interest in the corporation generally") was introduced into our statute at that time. The apparent purpose for doing so was to erase the implication arising from dicta in a 1933 Master's Report, which had been confirmed by this court. The report was in the case of ***In re Chilson***, Del. Ch., 168 A. 82 (1933). The *Chilson* dicta was to the effect that in order to support irrevocability of a proxy, the holder had to have an interest in the stock itself. There was then and later a dearth of decided cases on this point and, as a consequence, *Chilson's* pronouncement commanded respect, despite its status as dicta. *See* Drexler, Black, & Sparks, DELAWARE CORPORATE LAW and PRACTICE at §25.09[2] (1993). This effect was, however, arguably dissipated by the enactment of new §212(e) in 1967, which made it very clear that other interests (interests other than in the stock itself) could legitimately be contractually protected by the grant of an irrevocable proxy.

Prior to the 1967 revision the question whether the interest of a CEO in his position was such an interest as, standing alone, would support the enforceability of the agreed-upon irrevocable proxy according to its terms had occasionally been addressed by courts in other jurisdictions. In ***Deibler v. Charles H. Elliot Co.***, Pa.Supr. 81 A.2d 557 (1951), the Pennsylvania Supreme Court, applying Delaware law, held that an irrevocable proxy given to the seller of corporate stock both to secure payment for the stock and to protect his on-going contract of employment with the corporation, remained irrevocable after the note had been paid. The court accepted the argument that the on-going employment contract constituted a sufficient interest to specifically

enforce the agreement made. A similar result had been reached by the Supreme Court of Michigan in 1947: *Ecclestone v. Indiatlantic, Inc.*, 29 N.W.2d 679 (1947).

3. Policy Considerations:

No Delaware court has been required to address this question under the language of amended Section 212. In now doing so, it is appropriate to acknowledge that the corporate law has tended to distrust and discourage the separation of the shareholder claim as equity investor (i.e., the right to enjoy distributions on stock if, as, and when declared) from the right to vote stock. For example there was for many years a rather clear rule against the sale of a corporate vote unattached to the sale of the underlying stock.[9] A powerful argument can be advanced that generally the congruence of the right to vote and the residual rights of ownership will tend towards efficient wealth production.[10]

[20] A proxy is, of course, a means temporarily to split the power to vote from the residual ownership claim of the stockholder. In the vast number of instances in which proxies to vote stock are used, however, this split occasions no significant divergence between the interests of the proxy holder and the holder of the residual corporate interest because the proxy is of relatively short duration and in all events is revocable unilaterally. Thus, in effect, the grant of the proxy represented a judgment (which may be enforced through revocation) that the holder of the proxy will exercise it in the economic interest of the residual owner. A potentially inefficient split between the interests of the voter and the interests of the residual owners may, however, develop when the proxy is irrevocable. Such a holder is free from the unilateral control of the grantor and may be expected to be inclined to exercise voting rights in a way that benefits himself. There is of course, as a general matter,

---

[9]*See Macht v. Merchants Mortgage & Credit Co.*, Del. Ch., 194 A. 19 (1937); *Hall v. John S. Isaacs & Sons Farms*, Del. Ch., 146 A.2d 602 (1958), aff'd, Del. Supr., 163 A.2d 288 (1960); *Chew v. Inverness Mgt. Corp.*, Del. Ch., 352 A.2d 426 (1976). More recently courts have recognized some circumstances in which there is neither fraud nor unfairness present in a transaction which may entail consideration for voting. *E.g. Schreiber v. Carney*, Del. Ch., 447 A.2d 17 (1982). We continue, however, to have in mind the problems that made the original prohibition useful. *See Commonwealth Assoc. v. Providence Health Care, Inc.*, Del. Ch., 641 A.2d 155, 157-58 (1993) (law will assume contract to give proxy where after record-date sale of stock occurs).

[10]*See* Robert C. Clark, *Vote Buying and Corporate Law*, 29 Case Western Res. L. Rev. 776 (1979); Frank Easterbrook & Daniel Fischel, *Voting in Corporate Law*, 26 J.L. & Econ. 395 (1983).

nothing legally suspect in contracting parties exercising contracted for rights in a self-interested manner.[11] Yet the exercise of voting control over corporations by persons whose interest in them is not chiefly or solely as a residual owner will create circumstances in which the corporation will be less than optimally efficient in the selection of risky investment projects.[12] (A simple, if gross, example: the holder of an irrevocable proxy with voting control might simply refuse to elect a board that will accept the best investment projects (those with the highest risk adjusted rate of return) unless some side payment to him is arranged). The special additional costs associated with such a divorce between ownership and voting (the costs being expressed either as an otherwise unnecessary expense or as the selection of non-optimizing investment projects) will of course tend to diminish as the voter's interest becomes aligned with the residual owners interest.

In this light, the dicta of ***In re Chilson*** may be thought to offer a means of limiting the agency costs that irrevocable proxies occasion. By recognizing only an interest in the stock itself as an interest that will support the irrevocability of a proxy, the rule of *Chilson* would eliminate a class of cases in which the incentives of the proxy holder to exploit the corporation would be greatest, that is, those in which she simply has no economic interest at all in the residual equity of the firm. Of course the *Chilson* rule does not entirely eliminate the inefficient incentive structure that the divorce of voting power and benefit occasions; the proxy voter/secured lender still is a creditor and thus may not be inclined to accept high-risk/high-reward projects, even if they have a positive risk-adjusted net present value.[13] But the *Chilson* rule would moderate the effect.

---

[11]I note that this statement is subject to qualification in at least three circumstances: (1) a contract between a fiduciary and the person or entity for whom she acts (the "trust" or "corporation" etc); (2) a contract between a fiduciary and a person who is an express beneficiary of the "trust" etc., if the contract relates to the business of the "trust" and (3) an implied obligation of good faith and fair dealing, which under certain circumstances will be found to impose a limitation on a arm's-length contracting party's ability to exercise legal rights in a way that deprives the other contracting party of the substance of the express bargain that the parties had reached. On the last see *Corbin on Contracts* § 570 (Cunningham & Jacobson Supp. 1994); *Katz v. Oak Indus. Inc.*, Del. Ch., 508 A.2d 873, 880 (1986).

[12]Alchian & Demsetz, *Production, Information Costs, and Economic Organizations*, 62 Am. Econ. R. 777 (1972); Michael Jensen & William Meckling, *Theory of the Firm, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

[13]The reasoning is well-known. I gave an example of the reasoning (from the converse perspective of the owner-voter) in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, Del. Ch., C.A. No. 12150, Allen C. (Dec. 30, 1991), Mem. Op. fn.55.

4. Fashioning a Rule of Judicial Decision:

[21] In the field of corporation law, courts have for centuries played and do still play an enormously important role in creating that law interstitially through the accretionary process of case by case rulings. Indeed the doctrine of fiduciary duty and the *ex post* protection against investor exploitation it offers, arguably provides an important support for the basic utility of the public corporation. When, in the absence of authoritative text or precedent, courts are modernly called upon to fashion corporate law rules interestitially, it is appropriate for the court, among other considerations, to consider the future effects generally of alternative rules and, in doing so, to consider especially the efficiency effects of those alternatives, to the extent they can reliably be detected. Thus, reasoning of the foregoing kind is not inappropriate to the institutional role of courts. But while not inappropriate, rarely will such reasoning directly produce an applicable rule or a ruling. To state what I would suppose is obvious, the corporate law, as applied in specific cases by courts, is institutionally a rich stew; the corporation law's underlying efficiency concerns are mediated through a body of authoritative rules, principles and practices to which courts owe loyalty. In this instance I confess to the view that a corporation law rule allowing for the specific enforceability of an irrevocable proxy that is coupled only with the holder's interest in maintaining a salaried office seems mischievous in terms of its possible efficiency effects.[14] But in light of the 1967 amendment to the Delaware statutory law, the existence of the ***Diebler*** and ***Ecclestone*** opinions,[15] and the absence of contrary precedent, I am

---

[14]One response to this might be to suggest that this tendency could be moderated by incentive compensation plans. Another response, which I raise but don't discuss, would be to assert that both parties may have understood (should have understood if they were alert) all of this at the outset. Therefore the price at which proxy was granted impounded a discount to account for the likelihood that the company would be managed less efficiently because of this structure. Thus on this view there is no fairness problem between the parties themselves in enforcing a contract granting an irrevocable proxy even though another arrangement (i.e., having residual owner vote) might now seem more likely to be efficient. Indeed, on this view, to fail to specifically enforce the contract would simply allow the buyer to have the property for which the proxy served as partial consideration at a discount price but deprive the seller of the consideration (proxy) for which he gave the discount.

[15]I note that the Restatement (Second) of Agency, § 138 comment b., in addressing the question, what sort of interest in the holder of a power would support the specific enforcement of an irrevocability term, states:

> On the other hand, if an agent has an interest in the subject matter, as where he engaged in a joint enterprise in which another supplies the subject matter, a power given him by the other to protect such interest is a power given as security [which may be made irrevocable].

required to express the opinion that such an interest -- the interest that Herbert Haft had and retains as the senior executive officer of Dart -- is sufficient under our law to render specifically enforceable the express contract for an irrevocable proxy. So concluding, I thus have no need to address the effect of his ownership of a block of non-voting Class A Dart stock. The record indicates that that stock is pledged to secure repayment of a now-defaulted loan, so that, as an interest supporting the irrevocability of the proxy, it involves complexities which need not be addressed in this opinion.

Plaintiff's motion for summary judgment will therefore be denied.

KOSTOLANY v. DAVIS

No. 13,299

Court of Chancery of the State of Delaware, New Castle

November 7, 1995

Plaintiff brought this derivative action as a minority stockholder of Perrier American Springwater Holdings, N.V. (PASH), a Dutch corporation, alleging breach of fiduciary duty by the majority shareholder of PASH, Nestlé Sources International, S.A., and the directors and chief executive officers of PASH's subsidiaries. Plaintiff alleged that the individual defendants breached their fiduciary duties because they failed to sue a subsidiary corporation for an alleged breach of its distribution agreement. Defendants filed a motion to dismiss asserting that the internal affairs doctrine requires the application of Dutch law, which recognizes no right to pursue a derivative action.

The court of chancery, per Vice-Chancellor Balick, held that (1) Dutch local law was applicable because Dutch law is not so inconsistent with Delaware's interest in protecting minority stockholders as to override the important policies promoted by the internal affairs doctrine, and (2) plaintiff's complaint must be dismissed because Dutch law does not

---

This comment would presumably reach one who provides management skill while another contributes capital.

recognize a stockholder's right to pursue a derivative action on behalf of a corporation.

1. Trial ⇐ 136(4)

The court's determination of foreign law is treated as a ruling on a question of law. DEL. CH. CT. R. 44.1.

2. Corporations ⇐ 640

Legal relations between a corporation and its stockholders, directors, and officers are governed by the law of the state of incorporation.

3. Commerce ⇐ 82.20
Corporations ⇐ 638

The federal commerce clause compels the use of the internal affairs doctrine except where the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce.

4. Corporations ⇐ 202, 207, 210

The internal affairs doctrine applies to the right of a stockholder to pursue a derivative action.

Charles F. Richards, Jr., Esquire, Thomas A. Beck, Esquire, and Scott R. Haiber, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Deborah E. Lans, Esquire, Malcolm I. Lewin, Esquire, and Nina J. Spiegel, Esquire, of Morrison Cohen Singer & Weinstein, New York, New York, of counsel, for plaintiff.

William O. Lamotte, III, Esquire, Richard L. Sutton, Esquire, and Michael L. Vild, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Ronald S. Rolfe, Esquire, and Colin A. Underwood, Esquire, of Cravath, Swaine & Moore, New York, New York, of counsel, for defendant Nestlé Sources International S.A.

Robert K. Payson, Esquire, of Potter, Anderson & Corroon, Wilmington, Delaware; and Gerald J. Fields, Esquire, and Raymond J. Soffientini, Esquire, of Battle Fowler, L.L.P., New York, New York, of counsel, for defendants Ronald V. Davis and Kim E. Jeffery.

Lawrence C. Ashby, Esquire, Amy A. Quinlan, Esquire, of Ashby & Geddes, Wilmington, Delaware, for nominal defendants Perrier American Springwater Holdings, N.V. and Perrier Group of America, Inc.

BALICK, *Vice-Chancellor*

Defendants move to dismiss the complaint in this stockholder derivative action for failure to state a claim upon which relief can be granted.

Plaintiff is a minority stockholder of Perrier American Springwater Holdings N.V. ("PASH"), a Dutch corporation. Plaintiff brings this action on behalf of nominal defendants, PASH, PASH's wholly owned Delaware subsidiary, Perrier Group of America, Inc. ("PGA"), and PGA's former wholly Delaware subsidiary, Great Waters of France, Inc. ("GWF").

Defendants are Nestlé Sources International S.A. ("NSI"), a French corporation formerly known as Source Perrier, Ronald V. Davis, and Kim E. Jeffery. The individual defendants were directors and chief executive officers of PGA and GWF at the time of the events alleged in the complaint. Source Perrier owned the majority of PASH stock and thus controlled the nominal defendants.

Source Perrier produced Perrier bottled water for worldwide distribution through a complicated chain of subsidiaries. PGA distributed the product in the United States through GWF. One Source Perrier subsidiary, Soveper, N.V., provided the product pursuant to a distribution agreement with GWF. Another Source Perrier subsidiary guaranteed Soveper's performance. The agreement provided for damages, including lost profits, if Soveper failed to fulfill its obligations under the distribution agreement.

In 1990, excessive levels of benzene were discovered in the water. Source Perrier undertook to recall and resupply the product. The complaint alleges that in resupplying its distributors Source Perrier discriminated against PGA and GWF because PASH, unlike other subsidiaries, was not wholly owned by Source Perrier. Plaintiff claims that Source Perrier did not adequately compensate PGA and GWF for their large drop in market share and resulting lost profits in excess of $120 million. The complaint alleges that the individual defendants breached their fiduciary duties as directors and chief executive officers of PGA and GWF by failing to sue for Soveper's alleged breach of the distribution agreement. According to the complaint, Source Perrier bought off directors and officers of PGA and GWF to the tune of at least $50 million by increasing their compensation and purchasing their stock

options. In sum, this is a derivative action alleging breach of fiduciary duty by the majority stockholder of PASH and by directors and chief executive officers of PASH's subsidiary, PGA, and PGA's subsidiary, GWF.

I

The parties present choice-of-law and foreign law issues. Defendants argue that the internal affairs doctrine calls for application of the law of the Netherlands, where PASH is incorporated, and that there is no right to pursue a derivative action under Dutch law. Plaintiff counters that France or Delaware has a more substantial relationship to plaintiff's claim and defendants' motion should be denied whether French, Delaware, or Dutch law applies.

The parties agreed to stay discovery until the motion to dismiss is decided. At the conclusion of briefing, plaintiff asked the court to defer deciding defendants' motion until plaintiff conducts discovery on the choice-of-law and foreign law issues. As explained below, the undisputed facts in the record compel the use of the internal affairs doctrine. There is therefore no point in permitting discovery of facts pertinent to the choice of law issues.

[1] The court's determination of foreign law is treated as a ruling on a question of law. Del. Ch. R. 44.1. The parties have filed expert affidavits on Dutch and French law. Although the court may consider testimony, the issues of foreign law have been adequately developed by affidavit and argument. There is therefore no need to cause additional expense and delay by deposing the experts or bringing them to Delaware for a hearing on foreign law.

II

[2-4] Legal relations between a corporation and its stockholders, directors, and officers are governed by the law of the state of incorporation. McDermott Inc. v. Lewis, Del.Supr., 531 A.2d 206 (1987). According to McDermott, the federal commerce clause compels the use of the internal affairs doctrine except in the rarest situations where the law of the state of incorporation is inconsistent with a national policy on foreign or interstate commerce. 531 A.2d at 217. The internal affairs doctrine applies to the right of a stockholder to pursue a derivative action. Levine v. Milton, Del.Ch., 219 A.2d 145 (1966). The Restatement explains the rationale for the doctrine thus:

> Application of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate and international systems, certainty, predictability and uniformity of result, protection of the justified expectations of the parties and ease in the application of the law to be applied. Usually, application of this law will also be supported by the factor looking toward implementation of the relevant policies of the state with the dominant interest in the decision of the particular issue.

Restatement (Second) of Conflict of Laws § 302 cmt. e (1971).

Plaintiff points out that the Restatement recognizes that there may be unusual cases where the law of some other state has a more significant relationship with respect to a particular issue. Restatement (Second) of Conflict of Laws § 302 (1971). However, a comment to § 302 explains that the law of the state of incorporation is applied "almost invariably" to determine issues involving matters that are peculiar to corporations, and that many factors and the force of precedent support that result except in the "extremely rare" situation where a contrary result is required by the overriding interest of another state. Restatement (Second) of Conflict of Laws § 302 cmt. g (1971).

Plaintiff argues against the use of Dutch law for essentially three reasons: PASH is a holding company having little relationship to the Netherlands; plaintiff's claim is based primarily on corporate conduct in France; and Delaware has a strong interest in protecting minority stockholders by means of derivative actions. Plaintiff repeatedly states that PASH is merely a "shell." However, plaintiff does not challenge the affidavit of PASH's Amsterdam lawyer confirming that PASH complies with the requirements of corporate existence under Dutch law.

Plaintiff's position is inconsistent with Delaware precedent. In Hausman v. Buckley, 299 F.2d 696 (2d Cir.), cert. denied, 369 U.S. 885 (1962), the court dismissed a derivative action on behalf of a Venezuelan corporation because Venezuelan law did not allow such an action without the approval of a majority of the stockholders. McDermott and Levine both cite Hausman with approval. McDermott involved a Delaware subsidiary of a Panamanian corporation. The court held that Delaware would apply Panamanian law permitting a subsidiary to vote the stock of a parent even though the Panamanian rule was inconsistent with a Delaware statute. Levine involved Panamanian corporations. The court was satisfied that the plaintiff's derivative action would have to be dismissed if such an action was not permitted under Panamanian law.

Plaintiff argues that Delaware's interest in protecting the right of a minority stockholder claiming mismanagement of a Delaware corporation to pursue a derivative action is so fundamental that this court should apply Delaware law. That argument was expressly rejected in Hausman and is inconsistent with Levine and McDermott. Delaware does have a strong interest in protecting minority stockholders of Delaware corporations. However, plaintiff is a stockholder of the Dutch parent, not of the Delaware subsidiaries. Moreover, a derivative action is not the only possible means of protecting minority rights. Plaintiff argues that Dutch law affords the essential equivalent of a derivative action. It follows that Dutch law cannot be so inconsistent with Delaware's interest in protecting minority stockholders as to override the important policies promoted by the internal affairs doctrine.

I therefore conclude that Dutch law applies.

III

Plaintiff argues that a Dutch court would view plaintiff's allegation as stating a tort claim and would apply the law of the place of the tort, France. However, under the internal affairs doctrine, this court does not look to Dutch choice-of-law rules but applies Dutch local law. Restatement (Second) of Conflict of Laws § 302 cmt. j (1971). Moreover, I am convinced by defendants' experts that a Dutch court would apply Dutch law to the issue presented. Having concluded that Dutch law governs, I need not consider the affidavits of experts on French law.

Defendants' experts on Dutch law cite authorities supporting their opinion that Dutch law does not recognize a stockholder's right to pursue a derivative action on behalf of a corporation. Plaintiff's expert does not dispute those authorities. Rather, he argues that Dutch courts may allow remedies that are analogous to a derivative action. He cites a couple of commentators on recent Dutch cases who say that in theory a stockholder could file a tort claim to compel a corporation to sue for damages. He also argues that the right to have a court appoint persons to inquire into the conduct of a corporation could in theory be used to force a corporation to sue for damages. Defendants' experts explain that those theories have never been accepted by a Dutch court. Moreover, even if it is assumed that those remedies might be allowed, they do not amount to a right to pursue a derivative action.

This court's duty is to apply existing, not to develop new, Dutch law. One can only conclude from the authorities cited that Dutch law does not recognize a stockholder's right to pursue a derivative action on

behalf of a corporation. It follows that plaintiff's complaint must be dismissed.

ORDER

For the reasons stated in the memorandum opinion filed with this order, it is ordered that defendants' motion to dismiss the complaint is granted.

IN RE MAXXAM, INC.

No. 12,111 (Consolidated)

NL INDUSTRIES, INC. v. MAXXAM, INC.

No. 12,353 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

June 21, 1995

Consolidated shareholders' derivative actions were brought on behalf of a corporation against the corporation's controlling stockholder and the individual members of the corporation's board of directors. Plaintiff charged that the defendants breached their fiduciary duties to the corporation and its shareholders by approving $25 million in non-recourse loans in 1987 and for purchasing a real estate development project in 1991. Defendants moved to dismiss on the ground that the claims arising out of the 1987 loans were barred by the statute of limitations.

The court of chancery, per Vice-Chancellor Jacobs, held that: (1) the statute of limitations is tolled in derivative actions charging actionable self-dealing or fraudulent concealment, until shareholders know or have reason to know facts constituting the alleged wrong; (2) the defendants failed to establish that the plaintiffs had actual or constructive notice of facts that would have stopped any tolling of the statute of limitations with respect to the 1987 loan agreement; (3) the complaint supports the plaintiffs' position that the disclosures relating to the 1987 loans concealed, rather than clearly disclosed, material facts relating to the

riskiness of the loan terms; and (4) the complaint contains allegations that, if proven, would be legally sufficient to invoke the doctrine of equitable tolling and fraudulent concealment. The defendants' motion to dismiss was denied.

1. Pretrial Procedure ⇐ 679

On motion to dismiss for failure to state a claim, the court must take all facts of the pleadings and reasonable inferences to be drawn therefrom as true, but neither inferences nor conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest are accepted as true. DEL. CH. CT. R. 12(b)(6).

2. Pretrial Procedure ⇐ 622

In order for a motion to dismiss to succeed, it must appear with a reasonable certainty that the plaintiff would not be entitled to relief sought under any set of facts which could be proven to support the action.

3. Limitation of Actions ⇐ 30

Three-year statute of limitations applies to shareholder derivative claims which seek recovery for money damages or other essentially legal relief. DEL. CODE ANN. tit. 10, § 8106 (1974 & Supp. 1994).

4. Limitation of Actions ⇐ 199(1)

Courts of equity normally do not apply statutes of limitations directly but, in appropriate circumstances, will apply the statute of limitations by analogy.

5. Limitation of Actions ⇐ 99(1), 100(7)

Under the doctrine of equitable tolling, the benefit of the statute of limitations will be denied to a fiduciary charged with unfair self-dealing.

6. Limitation of Actions ⇐ 104(1)

Fraudulent concealment of facts that are essential to the plaintiff's cause of action is an independent ground for tolling the statute of limitations.

7. Limitation of Actions ⇐ 100(1)

Under both fraudulent concealment and unfair self-dealing doctrines is the policy that a defendant, who possesses information critical to the existence of an actionable claim of wrongdoing and prevents the plaintiff from discovering that information in a timely fashion, should be denied the benefit of statute of limitations.

8. Limitation of Actions ⇐ 100(7), 104(1)

Statute of limitations will be tolled if fraudulent concealment or unfair self-dealing is found in a shareholder derivative action until such time as the plaintiff knows or has reason to know of the facts constituting the alleged wrong.

9. Limitation of Actions ⇐ 195(3)

Plaintiff who alleges fraudulent concealment or unfair self-dealing in a shareholder derivative action has the burden of pleading specific facts that, if true, would establish tolling of the statue of limitations.

10. Limitation of Actions ⇐ 99(1), 100(7)

In order to invoke the doctrine of equitable tolling, an abuse of the fiduciary relationship through actionable self-dealing must be claimed.

11. Limitation of Actions ⇐ 100(1), 104(1)

The standard for pleading fraudulent concealment is more stringent than that for equitable tolling.

12. Limitation of Actions ⇐ 95(1), 104(2)

Fraudulent concealment requires an affirmative act of concealment or misrepresentation, while equitable tolling does not.

13. Corporations ⇐ 310(1)

Stockholders are entitled to rely on the good faith of directors when they act with respect to the corporation's property or processes.

14. Limitation of Actions ⇐ 99(1), 104(1)

The concealment of the post-loan agreement facts is sufficient to toll the operation of the statute of limitations because their disclosure would have alerted the public shareholders to the possible unfairness of the loans.

Joseph A. Rosenthal, Esquire, of Rosenthal, Monhait, Gross & Goddess, Wilmington, Delaware; Joan Harnes, Esquire, of Silverman, Harnes & Harnes, New York, New York, of counsel; and Lowey, Dannenberg, Bemporad & Sellinger, New York, New York, of counsel, for shareholder plaintiffs.

Henry N. Herndon, Jr., Esquire, and Bruce C. Doeg, Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware; and Donald E. Scott, Esquire, of Bartlit, Beck, Herman, Palenchar & Scott, Denver, Colorado, of counsel, for plaintiff NL Industries, Inc., et al.

A. Gilchrist Sparks, III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; David C. McBride, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and Lawrence C. Ashby, Esquire, Stephen E. Jenkins, Esquire, and Richard D. Heins, Esquire, of Ashby & Geddes, Wilmington, Delaware, for defendants.

JACOBS, *Vice-Chancellor*

Pending is the defendants' motion to dismiss the complaint in these consolidated shareholder derivative actions brought on behalf of MAXXAM, Inc. ("MAXXAM") and its former wholly-owned subsidiary, MCO Properties, Inc. ("MCOP"), both Delaware corporations. The principal named defendants are MAXXAM and MCOP (as nominal defendants), certain of MAXXAM's directors, and MAXXAM's controlling stockholder, Federated Development Company ("Federated").

The plaintiffs' claims arise out of separate but related events that occurred in 1987 and 1991. In 1987, MCOP loaned Federated $25 million in connection with a Federated-owned resort real estate development project located in Rancho Mirage, California, known as the "Mirada" (the "1987 loans"). The 1987 loans were non-recourse, and were secured only by the real estate underlying the Mirada. Interest and principal on those loans were payable solely from the proceeds of Mirada lot sales, and interest was not required to be paid currently. In 1991, MAXXAM purchased the Mirada from Federated for consideration

totaling approximately $42 million, of which $32 million represented MAXXAM's forgiveness of the unpaid principal and accrued interest from the 1987 loans to Federated. The plaintiffs claim that the defendants breached their fiduciary duties to MAXXAM and its shareholders by approving both the 1987 loans and the 1991 Mirada purchase transaction.

Three of the individual defendants, William C. Leone, Stanley D. Rosenberg, and John M. Seidl (the "moving defendants") have moved, pursuant to Court of Chancery Rule 12(b)(6), to dismiss the claims arising out of the 1987 loans (the "1987 loan claims") on the ground that those claims are barred by the applicable statute of limitations. The remaining individual defendants join in that motion, which was argued on May 24, 1995. This is the Opinion of the Court on the defendants' motion to dismiss. For the reasons discussed below, that motion will be denied.

I. PROCEDURAL BACKGROUND

A comprehensive recital of the procedural background of these stockholder derivative actions appears in In Re MAXXAM, Inc./Federated Dev. Shareholders Litig., Del. Ch., C. A. Nos. 12111 and 12353, Jacobs, V.C. (Feb. 10, 1995) ("MAXXAM II"). An abbreviated account of that background is provided here only as needed to address the present motion.

The first derivative complaint was filed on May 28, 1991. Numerous other derivative actions were filed thereafter. On February 3, 1992, all shareholder actions were consolidated except the action filed by plaintiffs NL Industries, Inc., et al. ("NL") in Civil Action No. 12353. On February 28, 1992, the plaintiffs other than NL (the "shareholder plaintiffs") filed a consolidated complaint against MAXXAM, MCOP, Federated, and certain MAXXAM directors. That consolidated complaint did not attack the 1987 loans, but it did claim that Federated had breached its fiduciary duties to MAXXAM by mismanaging the development of the Mirada, and that the individual defendants had breached their fiduciary duties by approving the 1991 Mirada purchase. The first consolidated complaint prayed for rescission of the 1991 Mirada transaction and for an accounting by the individual defendants and Federated.

On January 22, 1993, the shareholder plaintiffs moved for leave to file a second amended complaint to add the 1987 loan claims. The defendants opposed the amendment on the ground that those claims were barred by the statute of limitations. The Court denied the motion to

amend, In re MAXXAM, Inc./Federated Dev. Shareholders Litig., Del. Ch., C. A. Nos. 12111 and 12353, Jacobs, V.C. (April 13, 1993) ("MAXXAM I"), but granted the plaintiffs leave to file a new amended complaint to plead facts that, if proved, would operate to toll the statute of limitations.

On April 22, 1993, the plaintiffs filed a consolidated third amended complaint (the "complaint") alleging facts that (plaintiffs argued) would operate to toll the statute of limitations. In June 1993, the defendants again moved to dismiss the 1987 loan claims as barred by the statute of limitations.

Before briefing on that dismissal motion was completed, the shareholder plaintiffs and the defendants entered into a settlement agreement. Those parties moved formally for approval of that agreement on July 7, 1994, and NL actively opposed the settlement. On February 10, 1995, this Court declined to approve the settlement, because its proponents had failed to carry their burden of persuading the Court that the settlement proposal was fair and reasonable. MAXXAM II, supra. Following that decision, the parties completed briefing on the dismissal motion that is now sub judice.

II. RELEVANT FACTS

What next follows are the relevant facts that are either (i) alleged in the consolidated third amended complaint, or (ii) contained in documents incorporated therein by reference or in certain MAXXAM public disclosures relied upon by defendants in their briefs.[1]

A. The 1987 Loan Agreements

MAXXAM (formerly known as MCO Holdings, Inc., or "MCO") and MCOP are Delaware corporations having their principal places of

---

[1]In their briefs in support of their dismissal motion, the defendants have relied upon several MAXXAM publicly-filed documents not specifically referred to in the complaint. Among those documents are excerpts from MAXXAM proxy statements, annual reports, and SEC filings, all collected at DX 1. The defendants' reliance upon these documents was not objected to, presumably because all parties recognize that the principal issues on this motion concern matters of disclosure to which those documents are critically relevant.

At oral argument, counsel for plaintiff NL relied upon a MAXXAM public document that was not referred to in the complaint or relied upon by the defendants in their briefs, namely, the SEC Form 10-Q for September 1987 of MCO Holdings, MAXXAM's predecessor-in-interest. Because the defendants did not object to counsel's reliance upon the September 1987 Form 10-Q, and because the defendants have relied upon other SEC filings of a similar character, that document may appropriately be considered on this motion as well.

business in Houston, Texas. Federated, a New York business trust, also has its principal place of business in Houston. At all relevant times Federated owned a controlling interest in MAXXAM, and defendant Charles E. Hurwitz ("Hurwitz"), members of his family, and family trusts owned 100% of Federated. Hurwitz was the Chairman of the Board and Chief Executive Officer of both Federated and MAXXAM. (Complaint at ¶¶ 2-3). MAXXAM's board of directors had eight members, which include Hurwitz and the other named individual defendants, viz., Barry Munitz, Ezra G. Levin, John M. Seidl, William C. Leone, and Stanley D. Rosenberg. (Complaint at ¶ 4).

Since the 1970s, Federated had owned a tract of unimproved land in Rancho Mirage, California, and an adjacent property in Cathedral City. Those two tracts would become known as the Mirada. Federated had a long-term plan to develop the Mirada into a luxury residential community consisting of villas, townhomes, estate lots, and a golf course. However, the Town of Rancho Mirage strongly opposed the development plan, as did some of the town's residents and certain environmental groups. Lawsuits aimed at halting the project were filed. In part because of that opposition, at the time of the August 1987 loan no villas or townhouses had been constructed, and no estate lots had been improved sufficiently to be offered for sale. (Complaint at ¶ 5).

Despite those circumstances, on August 27, 1987, MCOP and Federated entered into a two-part loan agreement pursuant to which MCOP advanced to Federated $20 million. Fifteen million of that amount was a five year term loan; the remaining five million was a revolving line of credit. The debt was nonrecourse, secured only by the Rancho Mirage real estate. The loan agreement provided for an interest rate of 12% on the term loan; however, interest was not required to be paid currently, and thus could be permitted to accrue. Importantly, the loan agreement also provided that principal and interest would be paid solely from the proceeds of the sale of Mirada real estate lots. Finally, the loan agreement entitled MAXXAM to receive 25% of net profits generated by the Mirada development project. (Complaint at ¶¶ 6-7, August 1987 Loan Agreement).

The proceeds of the $15 million term loan were then immediately paid to Hurwitz and Federated, and not used to develop the Mirada. Federated did use some of the $5 million credit line to finance the development of the Mirada, but plaintiffs allege that a portion of those monies were diverted to pay Hurwitz's personal entertainment expenses. Moreover, the proceeds of estate lot sales were not used to repay principal or interest on the outstanding loan balance, but instead were reloaned to Federated on an interest-free basis. The result was that

interest on the 1987 loans continued to accrue. (Complaint at ¶¶ 6-7, and ¶ 13.a.).

In November 1987, the defendants caused MCOP to enter into a second loan agreement with Federated under which MCOP would loan Federated up to $5 million of new money to construct a golf course on the Cathedral City parcel. The November loan also was non-recourse and secured by the land on which the golf course was to be built. At the time the second loan agreement was executed the Mirada project had no permit to construct the golf course, nor was a permit ever obtained. Pursuant to the settlement of a lawsuit brought to enjoin the construction of the Cathedral City golf course, most of the land securing that debt was ultimately donated to Cathedral City and Rancho Mirage in exchange for the right to develop other parts of the Mirada. (Complaint at ¶ 8).

In 1988, MCOP assigned all of its rights under the 1987 loans to MAXXAM.

B. Disclosures Concerning the 1987 Loans

Some terms of the August 27, 1987 loan agreement were disclosed in MCO Holdings' September 30, 1987 SEC Form 10-Q. That document disclosed (i) that the loans had been made to Federated and that Federated was MAXXAM's controlling stockholder, (ii) the amount of the loans, (iii) the rate of interest, (iv) the fact that the loans were secured by the Rancho Mirage real estate, and (v) MAXXAM's contingent interest in the net profits from the Mirada development project. That document did not, however, expressly disclose that the loans were non-recourse or that the loan agreements did not require that interest be paid currently. The September, 1987 Form 10-Q also represented that approximately $15 million had been advanced to Federated "in connection with the development of a real estate project in Rancho Mirage, California." In fact, however, the $15 million proceeds of the August, 1987 term loan had been paid to Federated and Hurwitz, and that fact was never publicly disclosed. (MCO Holdings, Inc. SEC Form 10-Q for Quarter Ended September 30, 1987).

MAXXAM's (MCO's) Form 10-K for 1987 did disclose that the loan agreements provided for up to $25 million to be loaned to Federated and that the debt was nonrecourse. However, that 1987 Form 10-K, and MAXXAM's (MCO's) Forms 10-K for 1988, 1989, and 1990, omitted the disclosure, previously made in the 1987 Form 10-Q, that the loans to Federated were made "in connection with the development of a real estate project in Rancho Mirage, California." (MCO Holdings, Inc. SEC Forms 10-K for Fiscal Years Ended Dec. 31, 1987, 1988, 1989 and 1990).

Although all of these Forms 10-K disclosed the amount of loan principal then outstanding, not until MAXXAM's Form 10-K for 1989 was filed in 1990 was it disclosed that interest had been accruing on the 1987 loans. That document disclosed that as of the end of fiscal year ("FYE") 1989, $5.5 million of interest had accrued, and MAXXAM's 1990 Form 10-K disclosed that as of FYE 1990, $8.1 million in interest had accrued. The 1990 Form 10-K also disclosed (for the first time) that $2.9 million of interest had accrued on the 1987 loans as of FYE 1988. (MCO Holdings, Inc. SEC Form 10-K for Fiscal Year Ended Dec. 31, 1987; MAXXAM, Inc. Forms 10-K for Fiscal Years Ended Dec. 31, 1988; 1989; and 1990).

On February 11, 1988, MAXXAM disseminated a proxy statement in connection with a proposed merger (the "1988 proxy statement"). The 1988 proxy statement disclosed the basic loan terms that had been previously disclosed in the 1987 Form 10-K. It also represented that the proceeds of the November 1987 loan ($5 million) were to be used "for acquisition costs and expenses related to the Cathedral City property and . . . to repay existing mortgage indebtedness secured by part of the Cathedral City property." Although that document discussed the August 1987 loan immediately thereafter and within the same paragraph, that discussion did not mention the intended use of, or the absence of any restrictions upon the use of, the proceeds of the $15 million loaned to Federated under the August 1987 loan agreement. (February 11, 1988 Proxy Statement, at 111).

To summarize: by May 28, 1988, three years before the first action was filed, the defendants had publicly disclosed the following information: (1) the total principal amount of the 1987 loans; (2) the fact that the loans were non-recourse, secured only by the Mirada real estate; (3) the fact that the loans were to Federated, MAXXAM's controlling stockholder; (4) the fact that MCOP would receive, in addition to interest on the loans, a contingent 25% in net profits from the project; and (5) the fact that interest and principal on the loans would be repaid solely from net proceeds from lot sales.

However, other significant information bearing on the fairness of the loan terms had not been disclosed as of May 28, 1988. The undisclosed information included (a) the absence of any restrictions on the use of the proceeds of the $15 million August, 1987 loan, and (b) that the $15 million had been paid to Hurwitz and Federated rather than being used to develop the Mirada, despite MCO's representation in its 1987 SEC Form 10-Q that the August 1987 loans had been made "in connection with" the development of the Mirada. The plaintiffs claim that they did not learn of that fact until 1992 during discovery in this

action. (Complaint at ¶ 13.b.). Also not disclosed was (c) the strong local opposition to the Mirada development, and the fact that no permit to construct a golf course had been secured. It is alleged that those facts also were not learned until discovery in this action. (Id. at ¶ 15.b.). Finally, the facts that (d) the loan agreement gave Federated the discretion to reinvest the lot sale proceeds rather than require it to use those proceeds to pay interest, and the fact that the significant interest had accrued and was accruing, were also not disclosed. As earlier noted, the public shareholders were not informed of the accrual of interest on the 1987 loans until 1990.[2]

III. THE CONTENTIONS

The gist of the plaintiffs' claim regarding the 1987 loans is that they were unfair to MAXXAM and constituted fraudulent self-dealing. The complaint does not allege that the loan terms were unfair per se. Rather, it claims that those terms were unfair because of the high degree of risk surrounding the Mirada project, which was the sole security for the 1987 loans and the only source for their repayment. The complaint alleges that the defendants intentionally concealed material facts concerning the high risk associated with the Mirada project, and that because of that concealment the plaintiffs did not become aware of the possible unfairness of the loans until 1991 or thereafter.[3]

In support of their motion the defendants contend that the three year statute of limitations found in 10 Del. C. § 8106 applies to the 1987 loan claims, that the operation of that statute was not tolled, and that by the time these actions were commenced the limitations period had expired. The defendants argue that "notice inquiry" is the standard that governs whether the plaintiffs had actual or constructive knowledge of the critical facts, and that no tolling occurred here because by May 1988 the plaintiffs had knowledge of facts that put them on constructive (if not

---

[2]Although the plaintiffs allege (at ¶¶ 14.b. and c.) that not until early 1991 did MAXXAM disclose the accrual of interest on the 1987 loans, in fact that information was disclosed in early 1990 on MAXXAM's 1989 Form 10-K. (DX 1).

[3]The facts allegedly concealed included (a) the local opposition to the Mirada project, (b) the project's slow rate of development (although subdivided in 1983, the Mirada was not yet sufficiently improved to enable Federated to sell one estate lot, townhome, or villa when the loans were made), (c) the payment of the $15 million term loan proceeds to Hurwitz and Federated rather than the proceeds being invested in the Mirada development project, (d) Federated's limited ability to repay interest on the loans, and (e) the fact that interest on the loans was allowed to accrue rather than be paid currently. Finally, the plaintiffs allege that none of these facts were discovered or became discoverable until 1991, and that many of them were not learned until 1992. (Complaint at ¶¶ 12-15).

actual) notice of any potential claim that the 1987 loans were unfair. Therefore, the defendants conclude, the claims arising out of the 1987 loans are time-barred. The defendants further contend that the plaintiffs' allegations regarding the improper use of the loan proceeds are insufficient to toll the statute, because they concern events that post-dated the loan agreements. Finally, the moving defendants argue that in all events, the statute is not tolled as to them because they are not charged with actionable self-dealing or fraudulent concealment, and because mere negligent non-disclosure is insufficient to toll the statute.

The plaintiffs respond that the complaint alleges the concealment of material facts that if known would have revealed the unfairness of the 1987 loans, and that the concealed facts did not come to light until after May 28, 1988. Therefore, plaintiffs conclude, the running of any period of limitations that would otherwise have applied to claims arising out of the 1987 loans was tolled until those facts were publicly disclosed, which did not occur until 1991 or thereafter.

* * *

[1-2] On a Rule 12(b)(6) motion to dismiss for failure to state a claim, "all facts of the pleadings and reasonable inferences to be drawn therefrom are accepted as true, but neither inferences nor conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest are accepted as true." Grobow v. Perot, Del. Supr., 539 A.2d 180, 187 n.6 (1988). For the motion to succeed, "it must appear with a reasonable certainty that a 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). These standards will govern the Court's evaluation of the parties' tolling arguments.

IV. TOLLING OF THE STATUTE OF LIMITATIONS

[3-4] 10 Del. C. § 8106 is a three-year statute of limitations that if applicable, would bar all shareholder derivative claims for money damages or other essentially legal relief arising out of the 1987 loans.[4]

---

[4]10 Del. C. § 8106 pertinently provides:

"No action ... to recover damages caused by an injury unaccompanied with force or resulting indirectly from the act of the defendant shall be brought after the expiration of 3 years from the accruing of the cause of such action ...."

Bokat v. Getty Oil Co., Del. Supr., 262 A.2d 246 (1970); Kahn v. Seaboard Corp., Del. Ch., 625 A.2d 269, 274 (1993). Courts of equity do not normally apply statutes of limitations directly, but in appropriate circumstances they will apply the statute of limitations by analogy. See Kahn v. Seaboard, at 276.

The first of these derivative actions was filed on May 28, 1991, more than three years after the 1987 loans were first disclosed. All parties agree that unless the statute of limitations was tolled, the claims for legal relief arising out of the 1987 loans would be time-barred. Thus, the core issue on this motion is whether the statute was tolled until at least May 28, 1988, i.e., three years before the first derivative action was filed.

[5-6] Two separate doctrines govern whether the operation of a statute of limitations will be tolled. The first is equitable tolling, which normally applies where a fiduciary is charged with unfair self-dealing. Bovay v. H.M. Byllesby & Co., Del. Supr., 38 A.2d 808 (1944); Kahn v. Seaboard, at 275-76. The second tolling doctrine is fraudulent concealment, with applies where a defendant is charged with having fraudulently concealed facts that are essential to the plaintiff's cause of action. Litman v. Prudential Bache Properties, Inc., Del. Ch., C.A. No. 12137, Chandler, V.C. (January 14, 1994). Mem. Op. at 8.

[7-9] Underlying both doctrines is the policy that a defendant should not be permitted to use the statute of limitations as a shield where the defendant possesses information critical to the existence of an actionable claim of wrongdoing and prevents the plaintiff from discovering that information in timely fashion. Id. at 5. If either doctrine is found to apply, the running of the statute of limitations is deemed to be tolled until such time as the plaintiffs knew or had reason to know of the facts constituting the alleged wrong. A plaintiff who contends that the limitations period is tolled under either doctrine has the burden of pleading specific facts that, if true, would establish tolling. In re USA Cafes, L.P. Litig., Del. Ch., Cons. C.A. No. 11146, Allen, C. (Jan. 21, 1993) Mem. Op. at 5; Litman, supra, at 8.

[10] To invoke the doctrine of equitable tolling, an abuse of the fiduciary relationship through actionable self-dealing must be claimed. See Kahn v. Seaboard, 625 A.2d at 275-76. Here the complaint alleges that because defendant Hurwitz controlled Federated, which in turn controlled MAXXAM, he stood on both sides of the 1987 loan

---

Here, the plaintiffs seek both damages and equitable rescission of the 1987 loans. (Complaint at ¶ 22). Therefore, the discussion that follows is limited to claims for legal relief in connection with the 1987 loan claims.

transactions. (Complaint at ¶¶ 3, 10-11). The complaint further alleges that (1) a majority of the other individual defendants were either personally interested in the loan transactions or were beholden to Hurwitz (Id. at ¶¶ 4, 21), (2) Hurwitz and Federated profited from the 1987 loans by off-loading onto MAXXAM's public shareholders the lion's share of the risk associated with the Mirada's development on terms that were unfair to MAXXAM (Id. at ¶¶ 5-11, 17-19), and (3) MAXXAM's public shareholders were kept ignorant of facts, of which the defendants had knowledge, that would have alerted plaintiffs to the possibility that the loans were unfair, until after the limitations period had expired. Thus, facts sufficient to invoke the doctrine of equitable tolling have been averred.

[11-12] The standard for pleading fraudulent concealment is more stringent than that for equitable tolling. Fraudulent concealment requires an affirmative act of concealment or misrepresentation, while equitable tolling does not. The complaint here alleges that the director defendants, who were fiduciaries, affirmatively concealed facts that would have alerted MAXXAM shareholders to the high degree of risk that caused the loans to be substantively unfair. (Complaint at ¶¶ 12-15). The complaint alleges that because of that concealment the plaintiffs did not learn of the facts indicating the substantive unfairness of the loans until after the limitations period had expired. (Id. at ¶ 16). Thus, the complaint pleads facts that, if proven, would be legally sufficient to invoke the tolling doctrine of fraudulent concealment.

V. THE DEFENDANTS' ANTI-TOLLING ARGUMENTS

The defendants proffer four reasons why the Court should, nonetheless, conclude that the statute of limitations was not tolled. First, they argue that the pleaded facts demonstrate that by February 1988 at the latest, the plaintiffs knew of facts sufficient to put them on notice of any possible unfairness in the 1987 loans. Second, defendants point out that the 1987 loans were challenged in three complaints filed in 1991, before this action was consolidated. That fact, defendants argue, establishes that the plaintiffs were on notice of all essential information before May 1988. Third, the defendants argue that the plaintiffs' tolling theory improperly relies upon events relating to the post-1987 administration of the loans rather than upon the loan terms themselves. Finally, the moving defendants contend that in all events the tolling principle does not apply specifically to them. These arguments are addressed seriatim.

A.

The defendants first argue that under Kahn v. Seaboard Corp., supra, the standard governing whether the statute of limitations was equitably tolled is "inquiry notice," under which standard the statute will not be tolled once the plaintiffs become aware of facts sufficient to put them on notice of a possible fairness claim. Relying upon In re USA Cafes, L.P. Litig., supra, the defendants contend that the plaintiffs, once on notice of the loans' possible unfairness, were then obliged to take timely action to preserve their rights, including conducting whatever investigation was needed to uncover additional information about the loans. The defendants argue that the February 1988 proxy statement publicly disclosed facts sufficient to put the plaintiffs on inquiry notice of any possible claim that the 1987 loans were unfair, specifically (i) the loans' self-dealing and non-recourse nature, (ii) the fact that interest was not required to be paid currently, and (iii) the absence of any restriction upon the use of the proceeds of the $15 million August term loan. Because the disclosure of those facts constituted inquiry notice (so the argument goes) the statute of limitations began to run from the time that disclosure was made in February 1988.

The flaw in that argument is that it misapprehends the nature of the plaintiffs' 1987 loan claims. The thrust of the complaint is not that the loan terms were unfair, in and of themselves, but, rather, that those terms were unfair because of the high degree of risk surrounding the Mirada project. Those risks, it is claimed, made it unfair to MAXXAM for the loans to be non-recourse and for interest to be allowed to accrue, as opposed to requiring that it be paid currently. As a result of the concealment of those facts, the public shareholders were kept ignorant of the risk associated with the Mirada project until after the limitations period had expired.

The plaintiffs specifically allege that (a) the 1988 proxy statement did not clearly disclose that there were no restrictions on the use of the proceeds from the $15 million term loan and that the loan agreement did not require that interest be paid currently, and (b) a reasonable shareholder could have concluded from the disclosures that were made that the August 1987 term loan proceeds could be devoted only to Mirada-related uses, which is the normal practice in development and construction loans. (Complaint at ¶ 13.a.). Finally, the plaintiffs allege that (c) because the defendants concealed the fact that no Mirada lot sales had taken place, and did not disclose the fact that substantial interest had accrued until 1990, the unfairness of the loan term requiring interest to

be paid only from the proceeds of Mirada lot sales could not have become evident until then.

[13] In my view, the complaint supports the plaintiffs' position that the disclosures relating to the 1987 loans obfuscated and concealed, rather than clearly disclosed, material facts relating to the riskiness of the loan terms.[5] What facts were disclosed before May, 1988 did not, in these circumstances, impose upon the plaintiffs a duty to make further inquiry or conduct an independent investigation. Until told of facts suggesting the contrary, the plaintiffs were entitled to assume that the defendants had been and were acting in good faith:

> Given the fiduciary duties that the law imposes upon the relationship among those serving as corporate directors, stockholders are entitled to rely on the good faith of the directors when they act with respect to the corporation's property or processes. . . .
>
> Since trust and good faith are the essence of this relationship, it would be corrosive and contradictory for the law to punish reasonable reliance on that good faith by applying the statute of limitations woodenly or automatically to alleged self-interested violations of trust.

---

[5]Although MCO's 1987 SEC Form 10-Q stated that the August 1987 loans were made "in connection with" the development of the Mirada, in fact, the proceeds from the $15 million dollar term loan were immediately paid over to Hurwitz and Federated. However, the 1988 proxy statement did not affirmatively disclose that the use of proceeds from the August 1987 term loan was restricted. On that subject the proxy statement was silent. It did state, however, that the proceeds of the November 1987 loans were "to be used for acquisition costs and for expenses related to the Cathedral City property and . . . to repay existing mortgage indebtedness secured by part of the Cathedral City property." (1988 Proxy Statement at 111).

The defendants argue that because the 1988 proxy statement affirmatively disclosed the existence and nature of restrictions on the use of the November 1987 loans, by negative implication a reasonable shareholder reading that document should have concluded that the $15 million August term loan was not so restricted. The defendants also argue that the disclosures regarding interest payments made it clear the loan agreements permitted interest to accrue. I disagree. The treatment of these material facts in the 1988 proxy statement was ambiguous, incomplete and at best misleading. Such partial disclosure was not sufficient to meet the defendants' fiduciary obligations under Delaware law to disclose fully and unambiguously that there were no restrictions on the use of the $15 million proceeds of the August, 1987 term loan and that interest was not required to be paid currently, even if there were available proceeds from lot sales. See Arnold v. Society for Sav. Bancorp, Inc., Del. Supr., 650 A.2d 1270, 1280 (holding that once partial disclosure is embarked upon, accurate, full, and fair disclosure is required).

625 A.2d at 275. To credit the defendants' anti-tolling argument would seriously diminish the stockholders' entitlement to rely on the good faith of their corporate fiduciaries, and create the precise corrosive effect that the Chancellor in Kahn v. Seaboard Corp. quite properly held must be avoided.

B.

The defendants next argue that the allegations in three of the original derivative complaints filed in 1991[6] establish beyond question that the information publicly available by February 1988, put the plaintiffs on notice of any potential claims that the 1987 loans were unfair. That is because (it is argued) all three complaints attacked the 1987 loans, and one complaint (in Progressive United Corp. v. MAXXAM, Inc., et al., C.A. No. 12111) did so based solely upon the terms of the loans as described in the 1988 proxy statement. That argument is without merit.

The inference the defendants ask this Court to draw from the Kahn and Kassoway complaints is incorrect. Those two complaints did attack the fairness of the 1987 loans, but the most that can be inferred from that fact is that at some point before the complaints were filed in 1991, the plaintiffs became aware of facts that gave them reason to believe that the loans were unfair to MAXXAM. However, the defendants do not identify precisely when the plaintiffs learned those facts. More to the point, the defendants have not shown that the plaintiffs knew or should have known of those facts before May 1988.

Nor was the Progressive United complaint based "solely on the terms of the loans as set forth" in the 1988 proxy statement, as defendants argue. On the contrary, that complaint pertinently alleged that:

> The loan of MCOP's funds under the Loan Agreements, and the cancellation of the debt in exchange for the real estate described in paragraphs 22 and 23 above, constitutes a breach of fiduciary duties to the public shareholders of the Company and a waste of the Company's and MCOP's assets.

---

[6]Kahn v. Federated Dev. Co., et. al., C.A. No. 12373, Kassoway v. MAXXAM, Inc. et. al., C.A. No. 12377, and Progressive United Corp. v. MAXXAM, Inc., et al., C.A. No. 12111.

(Progressive United Complaint at ¶ 24) (emphasis added). Thus, the 1987 loan claim in the Progressive United complaint rested, at least in part, upon the fact that Federated's accrued debt from the 1987 loans was being canceled as part of the

[start - revised page - June 22, 1995]

consideration paid by MAXXAM in its 1991 purchase of the Mirada.[7] Therefore, the defendants' second argument fails to establish that the plaintiffs were on notice of facts that would have stopped any tolling of the statute of limitations with respect to the 1987 loan claims.

C.

[14] The defendants next contend that the plaintiffs' allegations concerning the "administration of the loans" (e.g., the accrual of interest and the failure to invest the proceeds of the term loan in the Mirada) are insufficient to toll the statute, because those allegations rest upon events that post-dated the 1987 loan agreements. Some of the events alleged did post-date the loan agreements. But the gist of the plaintiffs' claim is that material facts relating to the riskiness of the loans were known at the time the loans were made, but were concealed. Those concealed facts, discussed in detail above, are sufficient to toll the operation of the statute, independent of any post-loan agreement developments. The concealment of those post-loan agreement facts is significant because their disclosure would also have alerted the public shareholders to the possible unfairness of the loans.

4.

Finally, the moving defendants contend that in all events, the statute is not tolled as to them because they are not charged with actionable self-dealing, no

[end - revised page - June 22, 1995]

[7]Indeed, at oral argument plaintiffs' counsel identified the public disclosure of that fact (in April 1991) as the "key event" that first alerted them to the possibility that the loans were unfair to MAXXAM. (Oral Argt. Tr. at 81-82).

allegations of fraudulent concealment are made against them, and at most they are charged with negligent disclosure, which is insufficient to toll the statute.

That contention also misses the mark. The defendants' argument that the statute will be tolled only as to defendants who are themselves charged with actionable self-dealing, and the defendants' remaining arguments, overlook the plaintiffs' claim that all defendants participated in the concealment of the material information upon which the tolling contention is based. (Complaint at ¶ 12). See, e.g., Laventhol, Krekstein, Horwath & Horwath v. Tuckman, Del. Supr., 372 A.2d 168, 170 (1976) (holding that the statute of limitations is tolled as to claims against certified public accountants alleged to have conspired with corporate fiduciaries to defraud shareholders). Finally, the complaint's concealment allegations go far beyond claiming negligent non-disclosure. Those allegations, if proved, would constitute fraudulent concealment. (See id. at ¶¶ 13-15 and pp. 13-14, supra.).

* * *

For the foregoing reasons, the defendants' motion to dismiss the claims based upon the 1987 loans as barred by the statute of limitations is denied. IT IS SO ORDERED.

MOORE BUSINESS FORMS, INC.
v. CORDANT HOLDINGS CORP.

No. 13,911

Court of Chancery of the State of Delaware, New Castle

November 2, 1995

Plaintiff, a preferred stockholder of defendant corporation, brought this action against the corporate issuer, its directors, and the issuer's wholly owned subsidiary. Plaintiff filed a motion for judgment on the pleadings alleging breach of fiduciary duty, constructive fraud, and breach of contract. Plaintiff contends that the defendants (1) improperly concealed their intention to terminate their alliance; (2) unfairly excluded

plaintiff from participating in the valuation process; and (3) as a result, improperly selected a flawed valuation process that grossly undervalued the preferred stock. Defendant filed a motion to dismiss for failure to state a claim or, alternatively, for summary judgment.

The court of chancery, per Vice-Chancellor Jacobs, concluded that the plaintiff's allegation that Cordant Holdings breached its contract by failing to repurchase plaintiff's stock promptly after giving notice of the termination of the deal raised a litigable issue of fact. The defendants' summary judgment motion was granted to all other claims raised in the plaintiff's complaint. The plaintiff's motion for judgment on the pleadings was denied.

1. Pretrial Procedure ⇐ 622, 624

A motion to dismiss for failure to state a claim will be granted where the moving party can demonstrate that the plaintiff would not be entitled to relief under any set of facts supporting the plaintiff's claim. DEL. CH. CT. R. 12(b)(6).

2. Pretrial Procedure ⇐ 622, 624

Reasonable inferences or conclusions of law in the complaint will be accepted if they are supported by specific allegations of fact.

3. Corporations ⇐ 307

The relationship between a corporation and its preferred stockholders is primarily contractual in nature, involving rights and obligations created contractually by the certificate of designation.

4. Corporations ⇐ 307

The fiduciary duties directors owe to preferred stockholders are consistent with the duties owed to common stockholders and the corporation itself.

5. Corporations ⇐ 307, 317, 320

Disputes that relate to obligations expressly treated and rights that are created by contract will be governed by contract principles.

6. Pleading ⇐ 331, 333(4), 337(2), 337(3)

To survive a motion to dismiss, a complaint stating a claim for breach of contract must identify a contractual obligation, whether express or implied, a breach of that obligation, and resulting harm. DEL. CH. CT. R. 12(b)(6).

7. Contracts ⇐ 168

To state a claim for breach of an implied covenant of good faith and fair dealing, a plaintiff must identify a specific implied contractual obligation.

8. Contracts ⇐ 168

Implied contractual obligations are terms that clearly would have been included in the contract had the parties negotiated with respect to them.

9. Contracts ⇐ 168

Courts will not readily imply a contractual obligation where the contract expressly addresses the subject of the alleged wrong, yet does not provide for the obligation that is claimed to arise by implication.

10. Estoppel ⇐ 52, 54, 55, 58

To survive a motion to dismiss, an equitable estoppel claim must allege inequitable conduct by the defendant, such as an act or omission, that led the plaintiff to change its position, in justifiable reliance on that conduct, to its detriment.

11. Estoppel ⇐ 52(4), 52.15

A characterization of the plaintiff's state of mind is necessary to support the justifiable reliance element of an equitable estoppel claim.

12. Pleading ⇐ 343

A motion for judgment on the pleadings will be denied where the facts alleged in the pleadings are inconsistent with the movant's factual allegations. DEL. CH. CT. R. 12(c).

Richard D. Allen, Esquire, and Kurt M. Heyman, Esquire, of Morris, Nichols, Arsht & Tunnel, Wilmington, Delaware; and Stephen S. Rosenthal, Esquire, and Jeffery A. Tomasevich, Esquire, of Morrison & Foerster, Washington, D.C., of counsel, for plaintiff.

Henry N. Herndon, Jr., Esquire, and Joseph C. Schoell, Esquire, of Morris, James, Hitchens & Williams, Wilmington, Delaware; Joseph M. Hassett, Esquire, John C. Keeney, Jr., Esquire, and David G. Leitch, Esquire, of Hogan & Hartson L.L.P., Washington, D.C.; and Stephannie Wood, Esquire, corporate counsel, Cordant, Inc., for defendants.

JACOBS, *Vice-Chancellor*

Pending are two motions in this action brought by a preferred stockholder against the corporate issuer, its directors, and the issuer's wholly owned subsidiary. The first motion is to dismiss this action under Rule 12(b)(6) for failure to state a claim or, alternatively, for summary judgment. The movants are the corporate defendants, Cordant Holdings Corporation ("Holdings"), and its wholly owned subsidiary, Cordant, Inc. (Cordant").[1] The second motion is by the plaintiff, Moore Business Forms, Inc. ("Moore"), for judgment on the pleadings. This is the Opinion of the Court on these motions.

I. THE FACTS[2]

The dispute arises out of the defendants' effort to terminate a business relationship that Holdings, Cordant and Moore formed in early 1990. That relationship involved Moore's participation in the financing of an employee buy-out of Cordant by Holdings. In that transaction, Moore acquired for $11 million all of the outstanding shares of the Series B Noncumulative Convertible Redeemable Preferred Stock (the "Preferred Stock") of Holdings. (Complaint at ¶¶ 12-16). As part of the transaction, Cordant, Holdings and Moore entered into a business development

[1]The individual directors of Holdings -- Messrs. Peter P. Kusek, C. Kenneth Michlovitz, Kenneth A. Casazza, Gilbert F. Decker and Robert M. Jeffers -- have joined in the corporate defendants' motion, and also have moved to dismiss for lack of personal jurisdiction.

[2]The facts are drawn from the complaint. For purposes of a Rule 12(b)(6) motion, the well pleaded facts and reasonable inferences derived from the complaint are accepted by the Court as true, Good v. Getty Oil Co., Del. Ch., 518 A.2d 973, 975 (1986); Delaware State Troopers Lodge v. O'Rourke, Del. Ch., 403 A.2d 1109, 1110 (1979). Documents incorporated by reference into the complaint may also be considered on a motion to dismiss. Lewis v. Straetz, Del. Ch., C.A. No. 7859, Hartnett, V.C. (Feb. 12, 1986), Slip Op. at 6-10.

arrangement, called the "Strategic Alliance," the terms of which were embodied in a March 23, 1990 Purchase Agreement among Cordant, Holdings and Moore (the "Purchase Agreement"). (Complaint at ¶ 14).

Moore is a manufacturer and supplier of business forms and related systems. Cordant is a provider of computer and communication systems integration services. The Strategic Alliance contemplated that Moore and Cordant would work together to identify and develop business opportunities and afford each other a first right of refusal with respect to certain client requirements. (Complaint at ¶ 18). The Strategic Alliance would last a minimum of four and a quarter years, i.e., until June 30, 1994. (Complaint at ¶ 19). After that, the parties would be entitled to terminate the Strategic Alliance in accordance with the terms of the Purchase Agreement. (Complaint at ¶¶ 20-21).

Under the Purchase Agreement, the Preferred Stock becomes convertible into Holdings common stock in specified circumstances. The Preferred Stock also becomes callable by Holdings at fair market value if Holdings or Cordant decide to terminate the Strategic Alliance. (Complaint at ¶¶ 16, 20). All Preferred Stock that is not either converted or repurchased by December 31, 2004 must be redeemed at par value. (Complaint at 16). As the holder of all of the outstanding Preferred Stock, Moore was entitled to designate a director to serve on the boards of directors of both Holdings and Cordant. Moore appointed Mr. Ronald D. Rogers ("Rogers") as its representative on those boards. (Complaint at 17).

Under Section VII.F. of the Purchase Agreement, if Holdings or Cordant decide to terminate the Strategic Alliance, Holdings must repurchase all of the outstanding Preferred Stock. Holdings and Cordant are entitled to terminate the Strategic Alliance on 60 days notice to Moore. In that event, Section VII.F. requires that:

> . . . promptly upon giving of such notice . . . [Holdings] shall repurchase all of the [Preferred Stock] . . . owned by Moore . . . for cash at a price equal to . . . the per share value set forth in a fair market value appraisal of the common stock of [Holdings], made as of the end of [Holding's] most recent fiscal quarter, by an accounting firm selected from among those firms formerly known as "the big eight" or their successors by a majority of the directors of [Holdings] other than directors who are executives of [Holdings] or affiliated with Moore, provided that the accounting firm selected will not be one which has audited the financial statements of either Moore or [Holdings] for

> the most recent three (3) years then ended, . . . Moore hereby irrevocably agrres [sic] to the repurchase by [Holdings] provided for by this Section F., subject only to the conditions set forth in this Section F.

Purchase Agreement, Section VII.F.

If, on the other hand, Moore elects to terminate the Strategic Alliance, then Holdings loses its right to repurchase the Preferred Stock and Moore retains its Preferred Stock investment. Section IX.E. of the Purchase Agreement permits Moore to terminate the Strategic Alliance upon 60 days notice, and "[u]pon such termination, . . . [the provisions of the Purchase Agreement entitling Holdings to repurchase the Preferred Stock] shall also terminate and be of no further force or effect."

This action arises out of Holdings' election to terminate the Strategic Alliance and repurchase Moore's Preferred Stock. That dispute was triggered by the events now described.

On February 23, 1994, Holdings' board of directors met to decide upon certain stock options and bonus stock to be awarded to key employees. (Complaint at ¶ 26). In that connection, the board considered a valuation of Holdings as at December 31, 1993 that KPMG Peat Marwick ("KPMG") had previously prepared. (Id.). KPMG had valued the Preferred Stock at between $4.27 million and $4.72 million, assuming that the Preferred Stock was not converted to Holdings common stock; and at between $4.36 million and $4.84 million, assuming that there was conversion (Complaint at ¶ 25).

That same day, Messrs. Jeffers and Decker (two directors of Holdings who were neither executives of Cordant nor affiliated with Moore) decided to engage KPMG to conduct a fair market value appraisal of Holdings as at March 31, 1994. (Complaint ¶ 31). The complaint alleges that Jeffers and Decker advised Kusek, in a March 8, 1994 memorandum, that they had selected KPMG "for purposes of purchasing the [Holdings] preferred and/or common stock owned by Moore."[3]

---

[3]The complaint quotes only that specific excerpt from the March 8, 1994 memorandum, thereby implying that Holdings had already formed an intention to purchase the Preferred Stock. However, the implication is misleading because the quoted excerpt is incomplete. The complete quote is that Decker and Jeffers selected KPMG "for purposes of purchasing the [Holdings] preferred and/or common stock owned by Moore . . . in the event that Cordant at any time in the future terminates [the Strategic Alliance]." (March 8, 1994 Memorandum from Jeffers and Decker to Kusek, incorporated by reference in ¶ 31 of the Complaint; emphasis added). Under Section VII.F. of the Purchase Agreement, a valuation of Holdings as of March 31, 1994 could not be used to repurchase the Preferred Stock, because (i) Holdings and Cordant may not terminate the Strategic Alliance until after the quarter ending June 30, 1994

(Complaint at ¶¶ 31-32). Soon thereafter, Holdings and Cordant entered into negotiations to obtain a commitment from Chase Manhattan Bank of Maryland to finance a potential repurchase of the Preferred Stock by Holdings. (Complaint at ¶ 33).

The defendants did not disclose these actions to Moore. (Complaint ¶¶ 31, 32, 35). Specifically, they did not reveal to Rogers (Moore's representative on the Holdings and Cordant boards) that they had engaged KPMG to value Holdings or that they had taken steps to obtain bank financing for the Preferred Stock repurchase. Nor did they furnish Rogers the March 31, 1994 valuation after it was received from KPMG. (Id.). The plaintiff alleges that in a May 9, 1994 meeting among representatives of Holdings and Moore's corporate parent, Mr. Kusek (Holdings' Board Chairman and Chief Executive Officer) remained silent about those actions, and affirmatively misrepresented that the defendants wanted to make the Strategic Alliance work and had no plans to terminate it. (Complaint at ¶¶ 36-39).

The Holdings board met on May 17, 1994. At that meeting, the directors (a) reviewed the KPMG valuation as of March 31, 1994, (b) voted to authorize Holdings' officers to terminate the Strategic Alliance after June 30, 1994, and (c) voted to obtain a valuation of Holdings as at June 30, 1994 for purposes of repurchasing the Preferred Stock in accordance with Section VII.F. of the Purchase Agreement.[4] (Complaint at ¶ 50). The board determined that Holdings and Cordant would not disclose their intention to terminate the Strategic Alliance until after certain current contract negotiations with Moore had been completed and approval from the United States Air Force regarding a substantial contract had been obtained. (Complaint at ¶¶ 48-49).

After the May 17, 1994 board meeting, the defendants continued to conceal their decision and the steps they had taken to terminate the Strategic Alliance. Two months later, in a telephone conversation, Mr. Reto Braun, the President of Moore's corporate parent, and Mr. Kusek discussed the Strategic Alliance and ways to improve relations among Holdings, Cordant and Moore. (Complaint at ¶ 51). They also exchanged letters on that subject on July 19 and August 2, 1994. (Complaint at ¶¶ 53-54). Although Mr. Kusek knew of KPMG's ongoing valuation of Holdings, he did not disclose the actions Holdings and

---

and (ii) the repurchase of the Preferred Stock must be at a value determined by a fair market appraisal of Holdings "made as of the end of [Holdings'] most recent fiscal quarter." Thus, the earliest possible valuation date for purposes of repurchasing the Preferred Stock was June 30, 1994.

[4]Rogers was excluded from the discussions on this subject.

Cordant had taken to value Holdings or to terminate the Strategic Alliance. (Complaint at ¶¶ 52, 54, 56). However, in his August 2, 1994 letter, Kusek did tell Braun of his perception of a "worsening business relationship." He also communicated his belief that Cordant and Moore "should separate that business relationship from [their] equity relationship [and that] an appropriate business relationship can be implemented without an equity relationship but an equity position by a strategic investor should only exist in support of a solid, mutually-beneficial, business relationship." (August 2, 1994, Kusek letter at 3, incorporated by reference in ¶ 54 of the Complaint).

On August 11, 1994, KPMG submitted its valuation of Holdings as at June 30, 1994. (Complaint at ¶ 55). KPMG had valued the Preferred Stock at $4.62 million assuming no conversion into Holdings common stock, and at $4.48 million assuming conversion. (Complaint at ¶¶ 57, 61-62). On August 30, 1994, Cordant and Holdings formally notified Moore of their decision to terminate the Strategic Alliance, and disclosed KPMG's prior retention of Holdings common stock and its $4.48 million valuation of the Preferred Stock as at June 30, 1994. (Complaint at ¶ 61). Cordant and Holdings advised Moore that Holdings was prepared to repurchase the Preferred Stock for $4.48 million. (Id.).

One week later, on September 8, 1994, Mr. Kusek wrote a letter to Moore on Cordant stationery, enclosing a Cordant check for $4.48 million. (Complaint at ¶ 68). On September 20, 1994, Moore returned the check to Mr. Kusek, taking the position that the Preferred Stock had been undervalued in a flawed process that violated the requirements of the Purchase Agreement. (Id.). Moore also contended that the manner in which Cordant had attempted to repurchase the Preferred Stock violated both the Purchase Agreement and the rights of Moore's designee to the Holdings board of directors. (Id.).

On December 5, 1994, Moore, contending that Cordant and Holdings had never validly terminated the Strategic Alliance, advised the defendants that it (Moore) had decided to terminate the Strategic Alliance pursuant to Section IX.E of the Purchase Agreement. (Complaint at ¶ 70). Moore takes the position that its termination of the Strategic Alliance extinguished Holdings' repurchase option and that as a consequence, Moore continues to own the Preferred Stock.

II. CONTENTIONS OF THE PARTIES

Moore argues that the defendants (a) improperly concealed their intention to terminate the Strategic Alliance, (b) improperly selected KPMG to value the Preferred Stock, (c) unfairly excluded Moore from

participating in the valuation process; and (d) as a result, improperly selected a flawed valuation methodology that grossly undervalued the Preferred Stock.

That conduct is claimed, in Count I, to constitute a breach by the individual defendants of their duties of loyalty, good faith and fair dealing owed to Moore. Moore further claims that Cordant aided and abetted the individual defendants in that breach of fiduciary duty; and alleges in Count IV that the defendants' conduct amounted to constructive fraud.

In Count II, Moore claims that Holdings' and Cordant's conduct also constituted a breach of their contract with Moore. Specifically, Moore alleges Holdings and Cordant breached the express provision of Section VII.F. of the Purchase Agreement that required a "fair market value appraisal" of Holdings to determine the Preferred Stock repurchase price. Moore also contends that the manner in which Holdings and Cordant conducted the valuation process constituted a breach of their implied covenant of good faith and fair dealing.

Finally Moore claims, in Count III, that the defendants' concealment of and affirmative misrepresentation regarding their intention to terminate the Strategic Alliance, estops them from proceeding to terminate the Strategic Alliance and repurchase the Preferred Stock.

Moore claims that as a result of the alleged wrongdoing it suffered three harms. First, Moore asserts that because it was misled into believing that Holdings and Cordant did not intend to terminate the Strategic Alliance, it (Moore) continued to treat Holdings and Cordant preferentially in business dealings. Next, Moore claims that the defendants' concealment of their plans to terminate the Strategic Alliance excluded Moore from participating in the Preferred Stock valuation process. Third, Moore contends that the defendants' conduct caused it to refrain from exercising its own termination rights, which, if done, would have extinguished Holdings' option to repurchase Moore's Preferred Stock.

The defendants contend that Moore has failed to state an actionable claim, because (a) the duties owed by the defendants to Moore were contractual, not fiduciary, (b) the complaint does not state an actionable breach of any duty expressed in the Purchase Agreement or arising from the implied covenant of good faith and fair dealing, (c) no equitable estoppel claim is pleaded because the complaint fails (i) to identify any duty of disclosure owed by defendants, other than the 60 day notice period required by the Purchase Agreement; and (ii) fails adequately to plead that the defendants made affirmative misrepresentations upon which Moore justifiably relied.

* * *

I conclude, for the reasons next discussed, that the defendants' Rule 12(b)(6) motion to dismiss should be granted, except insofar as Count II claims that Holdings breached its contract by failing to tender payment for the Preferred Stock promptly after giving notice of the termination of the Strategic Alliance. The plaintiff's motion for judgment on the pleadings on that claim will be denied, because the defendants' averment that Holdings promptly tendered payment through its agent, Cordant, raises a litigable issue of fact.

Finally, because the plaintiff has not yet had an opportunity to conduct discovery, Chancery Rule 56(f) precludes granting the defendants' motion for summary judgment. Therefore, this Opinion addresses solely the defendants' Rule 12(b)(6) motion (including the defendants' challenges to in personam jurisdiction) and the plaintiff's motion for judgment on the pleadings.

III. THE DEFENDANTS' MOTION TO DISMISS

[1-2] A Rule 12(b)(6) motion to dismiss will not be granted except where, based on the allegations of the complaint and the documents incorporated therein by reference, "it appears with reasonable certainty that, under any set of facts which could be proven to support the claim, plaintiffs would not be entitled to relief." In re Tri-Star Pictures, Inc. Litigation, Del. Supr., 634 A.2d 319, 326 (1993). Reasonable inferences or conclusions of law in the complaint will be accepted if they are supported by specific allegations of fact. Id. Each Count of the complaint is evaluated in light of this standard.

A. The Fiduciary Duty Claim

[3-4] Count I claims a breach of fiduciary duties owed by a corporation's directors to a class of preferred stockholders. The rights of preferred stockholders are, in certain respects, both equitable and contractual. The relationship between a corporation and its preferred stockholders is "primarily . . . contractual in nature," involving "rights and obligations created contractually by the certificate of designation." HB Korenvaes Investments, L.P. v. Marriott Corp., Del. Ch., C.A. No. 12922, Allen, C. (June 9, 1993), Mem. Op. at 9. However, in limited circumstances fiduciary duties may be owed to preferred stockholders as well. A corporation's directors "are fiduciaries for the [p]referred stockholders, whose interests they have a duty to safeguard, consistent with the

fiduciary duties owed by those directors to [the corporation's] other shareholders and to [the corporation] itself." Eisenberg v. Chicago Milwaukee Corp., Del. Ch., 537 A.2d 1051, 1062 (1987).

[5] Whether or not a given claim asserted by preferred stockholders is governed by contract or fiduciary principles depends on whether the dispute arises from rights and obligations created by contract or from "a right or obligation that is not by virtue of a preference but is shared equally with the common." Jedwab v. MGM Grand Hotels, Inc., Del. Ch., 509 A.2d 584, 594 (1986). Determinations of this kind are highly fact-specific and contextual and do not easily lend themselves to a "bright line" rule. See, HB Korenvaes Investments, L.P., supra, at 9-11. What can be said, however, is that disputes that relate to obligations "expressly treated and rights [that are] created" by contract will be governed by contract principles. Id. at 13.

Moore claims that the individual defendants' conduct constituted a breach of their fiduciary duties of loyalty, good faith and fair dealing, but Moore provides no support for that assertion. Indeed, in advancing this position, Moore attempts to downplay its status as a preferred stockholder and to portray itself as a common shareholder, by referring to itself throughout Count I as a "minority shareholder." That characterization is inaccurate. Although the Holdings Preferred Stock is convertible into common shares in specified circumstances, nowhere is it alleged that that stock has been converted. Moore's rights flow from its status as a Preferred, not a common, stockholder.

The plaintiff's fiduciary duty argument boils down to an assertion that the claimed rights that are the subject of Count I -- specifically, Moore's right to a fair market valuation of the corporation and to a proper determination of the Preferred Stock repurchase price -- are common to all shareholders. But that is not so: the duties sought to be enforced have a clearly contractual source. This dispute among these parties relates to an event specifically anticipated and expressly provided for in their contract. The Purchase Agreement created, and Holdings issued, a class of stock having unique attributes designed to facilitate a smooth severance of Holdings' relationship with Moore if Holdings became dissatisfied with the Strategic Alliance. In that context the parties contractually created specific procedural guidelines for the valuation and repurchase of the Preferred Stock. What Moore challenges here is the manner in which those procedures were implemented.

The rights Moore seeks to have vindicated are contractual, not fiduciary, in nature. For that reason, Moore's claim for breach of fiduciary duty, as alleged, is legally deficient. Because no cognizable breach of fiduciary duty is stated, Moore's claim in Count I that Cordant

aided and abetted the individual defendants' breach of fiduciary duties must be dismissed as well.

B. The Constructive Fraud Claim

Count IV is a claim for constructive fraud. At oral argument Moore's counsel conceded that that claim is essentially a breach of fiduciary duty claim in a different form, that is substantively indistinguishable from the claims alleged in Count I. (Oral Argument, TR., 5/19/95 at 101). Because Count I is dismissible, so, too, is Count IV.

C. The Contract Claims

[6] At the heart of Moore's case are its contract claims. To survive a motion to dismiss, a complaint stating a claim for breach of contract must identify a contractual obligation, whether express or implied, a breach of that obligation by the defendant, and resulting damage to the plaintiff. Ch. Ct. R. 12(b)(6); See, Goodrich v. E.F. Hutton Group, Inc., Del. Ch., 542 A.2d 1200, 1203-4 (1988); Wright & Miller, Federal Practice and Procedure: Civil 2d § 1235. Moore alleges, in Count II, that Holdings and Cordant breached an express provision of the Purchase Agreement as well as an implied covenant of good faith and fair dealing. Those claims are now addressed.

1. Express Contract Claim

Moore claims that Holdings and Cordant breached, in two distinct ways, Section VII.F. of the Purchase Agreement, which requires a "fair market value" appraisal of the Preferred Stock. First, Moore challenges the valuation process, claiming that KPMG conducted an inadequate inquiry and investigation. Second, Moore challenges the result of that process, claiming that KPMG's valuation did not yield a "fair market value" as the Purchase Agreement required. I conclude that the complaint fails to state an actionable breach of contract claim.

To ensure an adequate valuation inquiry and investigation, the process created by the Purchase Agreement relies upon the independence and professional competence of a "big eight" accounting firm. Section VII.F. requires Holdings to repurchase the Preferred Stock "at a price equal to . . . the per share value set forth in a fair market value appraisal of the common stock of [Holdings]." It also requires that the appraisal be "[1] made as of the end of [Holdings'] most recent fiscal quarter, [2]

by an accounting firm selected from among those firms formerly known as 'the big eight' or their successor by [3] a majority of the directors of [Holdings] other than directors who are executives of [Holdings] or affiliated with Moore. The foregoing is made subject to the proviso that ". . . the accounting firm selected will not be one which has audited the financial statements of either Moore or [Holdings] for the most recent three (3) years then ended . . . ."

Moore does not allege that Holdings or Cordant failed to comply with any of those express provisions. Nor does it cite any other provision of the Agreement that creates a contractual duty to conduct the valuation inquiry in a particular manner. For these reasons Moore's claim of inadequate inquiry and investigation is legally insufficient.

In the alternative, Moore argues that even if Holdings and Cordant fully complied with the foregoing procedural requirements, the averment that the valuation process did not yield "fair market value" suffices to state a claim for breach of the Purchase Agreement. However, Moore alleges no facts that support this claim. All the Purchase Agreement requires is that the repurchase price be equal to the ". . . value set forth in a fair market value appraisal . . . made . . . by an accounting firm selected from among those firms formerly known as 'the big eight' . . ." That is, the parties, mindful that the "fair market value" of a closely held company is a matter over which reasonable minds might disagree, contractually agreed that the "fair market value" repurchase price would be what the selected "big eight" accounting firm determines it to be. The complaint does not allege that the fair market valuation of Holdings was performed by someone other than a "big eight" accounting firm.

In support of its position, Moore argues that the term "fair market value" in the Purchase Agreement was intended to incorporate the "fair value" standard employed in Delaware's appraisal statute, 8 Del. C. § 262(a). According to Moore, § 262(a) requires a determination of a corporation's intrinsic or fair value as a going concern. Moore asserts that KPMG's valuation of the Preferred Stock violated Section VII.F. of the Purchase Agreement (as thus interpreted), because the valuation improperly included a discount to reflect the fact that the Preferred Stock is illiquid and does not represent a controlling interest.

The premise of that argument is wrong. Nothing in the Purchase Agreement supports a conclusion that the contracting parties intended for "fair market value" to mean "fair value" within the meaning of 8 Del. C. § 262(a). Because it rests upon an invalid premise, this claim is also legally insufficient.

2. Implied Contract Claim

Because Moore has failed to state a cognizable claim that Holdings or Cordant breached an express provision of the Purchase Agreement, for Count II to survive a motion to dismiss, it must allege an actionable breach of an implied contractual term. However, no such claim is alleged either.

In Count II, Moore contends that the manner in which Holdings and Cordant "initiated, controlled and directed" the valuation of the Preferred Stock constituted a breach of an implied covenant of good faith and fair dealing owed by Holdings and Cordant.

[7-9] To state a claim for breach of an implied covenant of good faith and fair dealing, a plaintiff must identify a specific implied contractual obligation. Goodrich, 542 A.2d at 1204. The cardinal guiding principle in adjudicating a contract claim is to give effect to the intention of the contracting parties. E.I. du Pont de Nemours v. Shell Oil Co., Del. Supr., 498 A.2d 1108, 1113 (1985). Thus, implied contractual obligations are terms that "clearly would have been included [in the contract] had the parties negotiated with respect to them." Price Organization, Inc. v. Universal Computer Consulting, Inc., Del. Ch., C.A. No. 12505, Allen, C. (Oct. 1, 1993), Mem. Op. at 16 (citing Katz v. Oak Industries, Del. Ch., 508 A.2d 873, 880 (1986)). By parity of reasoning, "courts will not readily imply a contractual obligation where the contract expressly addresses the subject of the alleged wrong," yet does not provide for the obligation that is claimed to arise by implication. Abex, Inc. v. Koll Real Estate Group, Inc., Del. Ch., C.A. No. 13462, Jacobs, V.C. (Dec. 22, 1994), Slip Op. at 22.

Moore complains that Holdings and Cordant acted in bad faith by hiring KPMG to value the Preferred Stock, because KPMG had previously valued Holdings in connection with stock option and bonus plans. Moore also claims that it should have been given notice when the defendants decided to conduct a valuation of the Preferred Stock and/or when their boards of directors decided to terminate the Strategic Alliance. Finally, Moore claims that the defendants were obligated to afford Moore the opportunity to provide KPMG with information that Moore considered pertinent to the valuation of Holdings.

The problem with these claims is that the obligations that Moore urges the Court to recognize (by implication) flow from matters expressly addressed by the Purchase Agreement. The conditions to which the Preferred Stock repurchase is made subject are limited to those expressly set forth in Section VII.F. That Section (i) imposes criteria to governing the selection of an accounting firm to conduct the valuation of the

Preferred Stock; (ii) establishes a 60 day notice period for the orderly termination of the Strategic Alliance, and (iii) rather than include Moore in the valuation process, specifically permits Holdings to repurchase the Preferred Stock without any notice to or involvement of Moore.[5]

Contrary to the duties Moore claims it is owed by virtue of the Purchase Agreement, Section VII.F. does not require that Holdings and Cordant give notice of their intention to terminate the Strategic Alliance within a period of time after that intention is formed. It merely imposes a 60 day period between the date that Holdings and Cordant announce their decision to terminate the Strategic Alliance, and the date upon which the termination of that Alliance becomes effective. Nor does Section VII.F. require notice to Moore before Holdings may exercise its right to repurchase the Preferred Stock after giving notice of the termination of the Strategic Alliance. All that Section requires is that Holdings repurchase the Preferred Stock, "promptly upon giving of such notice. . . ." (emphasis added). Thus, the "implied" duties Moore seeks to enforce are inconsistent with the scheme of express duties created by Section VII.F. Moore cannot, therefore, validly claim that the conduct complained of violated an implied covenant of good faith and fair dealing owed by Holdings and Cordant.

For these reasons, Count II must fail as a matter of law.

D. The Equitable Estoppel Claim

[10-11] Count III alleges equitable estoppel. To survive a Rule 12(b)(6) motion to dismiss, an equitable estoppel claim must allege inequitable conduct by the defendant that led the plaintiff to change its position, in justifiable reliance on that conduct, to its detriment. Wilson v. American Ins. Co., Del. Supr., 209 A.2d 902, 903-4 (1965). The defendants' conduct may be either an affirmative act or a failure to act when duty required. Welshire, Inc. v. Harbison, Del. Ch., 88 A.2d 121, 125 (1952), aff'd, Del. Supr., 91 A.2d 404 (1952). Some description of the plaintiff's state of mind is necessary to satisfy the requirement that the plaintiff's reliance be justifiable. Burge v. Fidelity Bond and Mortg. Co., Del. Supr., 648 A.2d 414, 420 (1994).

Here, Moore alleges that it relied to its detriment upon the defendants' omissions to disclose facts and affirmative misrepresentations concerning the status of the Strategic Alliance. With respect to the

---

[5]The 60 day notice period required by Section VII.F. applies only to the termination of the Strategic Alliance. In contrast, Section VII.F. requires that Holdings repurchase the Preferred Stock "promptly upon giving of such notice . . . ." (emphasis added)

alleged omissions, the plaintiff claims that the defendants had a duty, arising from their contractual and fiduciary relationships with Moore, to disclose their intention to terminate the Strategic Alliance. I conclude, for the reasons previously stated in my discussion of Counts I and II, that the defendants owed no disclosure duty beyond the 60 day notice requirement prescribed by the Purchase Agreement. Thus, insofar as the claim for equitable estoppel rests upon a disclosure omission, it must fail.

Moore's "affirmative misrepresentation" estoppel claim rests solely upon the allegation that on May 9, 1994, Mr. Kusek ". . . affirmatively misrepresented Defendants' position by stating that they had no plans to terminate [the Strategic Alliance] . . ." (Complaint, ¶ 39). However, nowhere does Moore specifically allege that the defendants had decided to terminate the Strategic Alliance before Kusek made that statement. Moore asks the Court to infer that intent from its use of the word "misrepresented" in Paragraph 39 of the complaint.[6]

Given the alleged sequence of events leading to the termination of the Strategic Alliance, in my view no reasonable inference can be drawn that Holdings had decided to terminate the Strategic Alliance by May 9, 1994. Nowhere does the complaint straightforwardly allege that Holdings had already formed an intention to terminate the Strategic Alliance by that date. All the complaint specifically avers is that on May 17, 1994, the Holdings board met and voted to terminate the Strategic Alliance, and to authorize its officers to obtain a valuation of Holdings as at June 30, 1994 and effect the termination of the Strategic Alliance. (Complaint, Section F). For the Court to infer that Holdings had decided to terminate the Strategic Alliance by May 9, 1994, it must have a pleaded basis also to infer that (a) a majority of the individual members of Holdings' board had formed the intention to terminate the Strategic Alliance before they met and voted at the May 17, 1994 board meeting, and (b) despite having formed that intention, those directors refrained from recording their decision or authorizing Holdings' officers to act on that decision until the May 17, 1994 meeting. That is too much water for a single word ("misrepresented") to carry uphill.

To support the conclusory allegation that Kusek's May 9, 1994 statement was a misrepresentation, some minimal factual averments are needed. Here, the only reasonable inference that can be drawn from the

---

[6]Moore alleges that "[w]hen asked by Braun at this [May 9] meeting whether, in light of the difficulties the companies were having, Holdings and Cordant wanted to terminate the Strategic Alliance, Defendant Kusek affirmatively misrepresented Defendants' position by stating that they had no plans to terminate it, but rather that Holdings and Cordant wanted to make the Strategic Alliance work." (Complaint, ¶ 39) (emphasis added).

complaint is that the Holdings board was actively exploring the possibility of terminating the Strategic Alliance, but did not decide to do that until its members collectively voted at the May 17, 1994 meeting. In short, Moore's allegation of an affirmative misrepresentation is not well pleaded. I therefore need not consider whether Moore has successfully pleaded the other elements essential to a claim of equitable estoppel. Because Count III fails to allege an actionable omission or affirmative misrepresentation by the defendants, it does not state an a valid claim for equitable estoppel.

As analyzed thus far, Counts I through IV state no actionable claim. However, Moore has stated a cognizable contract claim that is the subject of its motion for judgment on the pleadings. Moore alleges that Holdings breached the Purchase Agreement by failing to "repurchase Moore's stock . . . within sixty days of Holdings' and Cordant's notice to Moore" of the termination of the Strategic Alliance. (Complaint ¶ 69). That allegation states a claim sufficient to survive a motion to dismiss. However, it cannot be the basis for judgment on the pleadings, because, as set forth in Part IV below, the pleadings disclose a litigable dispute.

IV. THE PLAINTIFF'S MOTION FOR JUDGMENT ON THE PLEADINGS

Moore's final claim is that even if Holdings and Cordant did legally terminate the Strategic Alliance, Holdings did not validly repurchase the Preferred Stock in accordance with the Purchase Agreement, because payment for the stock was tendered in the form of a Cordant check accompanied by a letter on Cordant stationery, rather than by a check of Holdings, which was the only party contractually entitled to purchase the Preferred Stock. Therefore, Moore argues, Holdings did not validly repurchase the Preferred Stock and as a consequence, Moore continues to own the Preferred Stock as a matter of law.

[12] The pleadings are not sufficient to warrant judgment in Moore's favor, because the defendants have alleged in their Answer that "Holdings handles its financial and other transactions through Cordant." (Answer ¶ 68). That allegation raises the possibility that Cordant was acting as Holdings' agent. Because the pleadings allege a factual scenario inconsistent with Moore's version of the facts, that precludes judgment on the pleadings in Moore's favor. Ch. Ct. R. 12(c); Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P., Del. Supr., 624 A.2d 1199, 1205 (1993). As previously noted, however, this claim is sufficient to survive the defendants' motion to dismiss.

V. CONCLUSION

For the foregoing reasons, (a) the defendants' motion for summary judgment and the plaintiff's motion for judgment on the pleadings are denied; (b) the defendants' motion to dismiss pursuant to Rule 12(b)(6) is granted, except with respect to Moore's claim (against Holdings) that Holdings did not repurchase the Preferred Stock in accordance with Section VII.F. of the Purchase Agreement. As to that claim, the motion is denied.[7] **IT IS SO ORDERED.**

NEBEL v. SOUTHWEST BANCORP, INC.

No. 13,618

Court of Chancery of the State of Delaware, New Castle

July 5, 1995

Plaintiffs, minority shareholders of M.C. Bancorporation, challenged the merger of the corporation into its 91.68% stockholder parent, Southwest Bancorp, Inc. In this cash-out merger, the plaintiffs did not seek appraisal of the value of their shares but instead sought compensatory and/or rescissory damages. The plaintiffs allege that appraisal was not an appropriate remedy since the directors: (1) violated their duty of fair dealing in fixing the merger price unilaterally without the use of a special committee of independent directors, and without input from the minority shareholders; (2) breached their duty of fair dealing by fixing a merger price without regard to whether it was a fair price; and (3) violated their duty of disclosure by misstating information and omitting to disclose information material to the stockholders' decision to accept the merger consideration or demand an appraisal.

The court of chancery, per Vice-Chancellor Jacobs, granted the defendants' motion to dismiss in part and denied it in part. In so holding, the court stated that there is no requirement for a board of directors to obtain input from a special committee or the minority stockholders when

---

[7]These rulings render moot the individual defendants' motion to dismiss on jurisdictional grounds, for which reason, those grounds are not addressed.

setting a merger price. In addition, the fair dealing claims only challenge the fairness of the price and can therefore adequately be addressed in an appraisal. The court found that the directors violated their duty of disclosure, but the statutory violation did not justify rescissory damages. The court held that the appropriate remedy for the directors' violation of their duty to disclose would be to permit the plaintiffs to commence an appraisal proceeding or to pursue a "quasi-appraisal" remedy.

1. Corporations ⇐ 584

Where a merger eliminates the minority for cash and the dispute is essentially one of value, appraisal is the exclusive remedy.

2. Corporations ⇐ 581, 584

The appraisal remedy is commonly exclusive in "short-form" mergers since the purpose of the short-merger statute is to provide a method for a parent corporation that owns ninety percent or more of a subsidiary's stock, to eliminate the minority stockholders' interest by unilateral act of the parent corporation's board of directors. DEL. CODE ANN. tit. 8, § 253 (1991).

3. Corporations ⇐ 320, 584

Appraisal will not be adequate where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved because they present issues which an appraisal cannot address.

4. Corporations ⇐ 320, 584

Disclosure-based claims based upon fraud or breach of the fiduciary duty of disclosure are claims that appraisal cannot adequately address, because misdisclosures or nondisclosures of material facts may warrant injunctive relief which would prevent a merger from taking place.

5. Corporations ⇐ 320, 584

Where the challenged merger has already occurred, disclosure claims might warrant rescission of the merger.

6. Corporations ⇐ 584

Where a challenged merger has already occurred, disclosure claims may warrant a recovery of the monetary equivalent of rescission where rescission is impractical or other circumstances warrant.

7. Corporations ⇐ 584

Disclosure-based claims are beyond the capability of appraisal to resolve, because the remedies appropriate to such claims would be inconsistent with the relief available in a statutory appraisal.

8. Corporations ⇐ 182.4(2), 310(1), 584

Certain types of unfair dealing, although not involving fraud or deception, may be so egregious as to make it inequitable to relegate the minority shareholders to the appraisal remedy, even though the unfair dealing impacts only the merger price.

9. Corporations ⇐ 584
Pleading ⇐ 8(3)

Courts are not bound by, and may look behind, any conclusory allegations or characterizations of the complaint to determine whether the unfair dealing claims are truly of that egregious character, or whether they are simply claims that question judgmental factors of valuation.

10. Corporations ⇐ 182.3, 585

There is no requirement under section 253 for directors to obtain input from minority stockholders or to form a committee of independent directors when fixing a merger price. DEL. CODE ANN. tit. 8, § 253 (1991).

11. Corporations ⇐ 581

The purpose of section 253 is to provide a mechanism to enable a ninety percent majority stockholder to effectuate a merger unilaterally. DEL. CODE ANN. tit. 8, § 253 (1991).

12. Corporations ⇐ 182.3, 584

The board of directors has a duty to disclose all facts material to the minority stockholders' decision whether to accept a short-form merger consideration or seek an appraisal.

13. Corporations ⇐ 519(1), 584

The burden of demonstrating materiality rests with the plaintiffs.

14. Statutes ⇐ 181(2)

Delaware law requires that substantive statutory mandates be strictly observed, and any nonobservance will give rise to an appropriate remedy.

15. Corporations ⇐ 320(12)

To be entitled to pursue rescissory damages, the plaintiffs must allege facts that, if true, would justify invalidating the merger.

Josy W. Ingersoll, Esquire, Bruce L. Silverstein, Esquire, and Martin S. Lessner, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and Thomas E. Chomicz, Esquire, Quinton F. Seamons, Esquire, and William T. McCormick, Esquire, of Wilson & McIlvaine, Chicago, Illinois, of counsel, for plaintiffs.

Wayne J. Carey, Esquire, and Ronald J. Brown, Jr., Esquire, of Prickett, Jones, Elliot, Kristol & Schnee, Wilmington, Delaware; and Frederick V. Lochbihler, Esquire, and David S. Barritt, Esquire, of Chapman & Cutler, Chicago, Illinois, of counsel, for defendants.

JACOBS, *Vice-Chancellor*

In this class action, certain minority shareholders of M.C. Bancorporation, a Delaware corporation ("Bancorporation"), challenge the merger of Bancorporation into its 91.68% stockholder-parent, Southwest Bancorp, Inc. ("Southwest") on November 17, 1993. The named defendants are Southwest and its directors as of the merger date. Because the merger was a "short form," "cash-out" merger effected pursuant to 8 Del. C. § 253, appraisal rights were available to the minority stockholders who held the remaining 8.32% interest in Bancorporation. Some of those

shareholders elected appraisal; the plaintiffs, however, did not. One plaintiff (Mr. Rudolph) tendered his shares, accepted the merger price, and thereafter brought this action.

The defendants have moved to dismiss the amended complaint ("complaint") on the grounds that (i) its allegations fail to state claims upon which relief can be granted and (ii) to the extent the complaint does allege cognizable claims, appraisal is the exclusive remedy.

This is the opinion of the Court on the defendants' motion to dismiss.

I. PERTINENT FACTS

The pertinent facts are based solely upon the well-pleaded allegations of the complaint and documents incorporated therein by reference. The complaint alleges three categories of fiduciary duty violations: (1) "fair dealing" claims in connection with the fixing of the merger price, (2) claims alleging the unfairness of the merger price, and (3) claims of misdisclosure of, or omissions to disclose, material facts in the Notice of Merger and Information Circular ("Notice") sent to Bancorporation's shareholders following the merger.[1]

In the merger, each share of Bancorporation's common stock was converted into a right to receive $41 cash, subject to the minority shareholders' entitlement to seek appraisal. The alleged fair dealing violations are based on claims that the merger price was unilaterally fixed by the defendants without the use of a special committee of independent directors, and without input from the minority shareholders or anyone authorized to represent the minority's interests. The claim that the $41 price was substantively unfair rests upon the allegation that that price was fixed without regard to whether it was a "fair price." In that connection, the plaintiffs claim that the fair value of Bancorporation's shares far exceeded the $41 merger price (Compl. at ¶ 12), and that in fixing the merger price, the defendants' only concern was to pay the "fair market value" of the shares, which value improperly included a minority discount and/or a discount for lack of marketability.

As for the disclosure claims, the complaint alleges that the defendants "misstated information and omitted to disclose information material to the stockholders' decision to accept the merger consideration or demand an appraisal." (Id.) Specifically the complaint alleges that:

---

[1]The Notice is attached as an exhibit to the complaint, and is incorporated therein by reference.