5. Standard of Review for Pre-Suit Demand in a Derivative Action

[6] Having found Plaintiffs claims to be derivative actions, I must now address the issue of pre-suit demand. Delaware law requires a stockholder to exhaust any intra-company remedies before bringing an action in the Court of Chancery. ***Rothenberg v. Santa Fe Pac. Corp.***, Del. Ch., C.A. No. 11749, Jacobs, V.C. (Sept. 5, 1995) Mem. op. at 6. The proper avenue is for that stockholder to make a pre-suit demand on the Board to redress the wrong about which that stockholder complains. ***Id.*** To assert a derivative claim, a plaintiff-stockholder must either (1) show it has made a demand on the corporation's board of directors, or (2) plead facts showing such a demand would have been futile. ***Aronson v. Lewis***, Del. Supr., 473 A.2d 805, 816 (1984). The relevant Board of Directors is the body in existence at the time a plaintiff filed the complaint. ***Rales v. Blasband***, Del. Supr., 634 A.2d 927, 933-34 (1993).[5]

Plaintiff asserts here any pre-suit demand to the Board existing as of the date of filing would be futile and therefore the requirement should be excused.

[7] In ***Aronson***, the Supreme Court of Delaware articulated the standard for determining whether a plaintiff has properly plead sufficient facts to establish demand on the board would be futile: "whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." 473 A.2d at 814. Plaintiff's interpretation of Vice-Chancellor Chandler's reasoning in ***Katell v. Morgan Stanley Group, Inc.***, Del. Ch., C.A. No. 12343. Chandler, V.C. (Jan. 14, 1993), suggests he need only demonstrate the lack of independence of two directors. While Vice-Chancellor Chandler's reasoning is unquestionably clear and correct, ***Katell*** is distinguishable from the facts of this case.[6] I apply the

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[5]Here, then, the relevant Board of Directors is the Board in existence at the time Plaintiff filed his Complaint - October 17, 1994.

[6]In ***Katell v. Morgan Stanley Group, Inc.***, Del. Ch., C.A. No. 12343, Chandler, V.C. (Jan. 14, 1993) Mem. op. at 12, this Court excused demand where one of two partners was disinterested or independent. Vice-Chancellor Chandler found the Board was not sufficiently disinterested and excused the plaintiff's failure to make a demand on the board of directors. In that case, however, Vice-Chancellor Chandler qualified his decision to apply this standard. ***Id.*** He explained,

> I adopt [the approach stating 'a majority consisting of disinterested directors' must approve a transaction to be presumed disinterested'], considering that the supposedly independent partner is unable to act on

standard Delaware courts have consistently applied: a plaintiff has the burden to allege particularized facts sufficient to establish a reasonable doubt a *majority* of the directors had a disqualifying self-interest. *See, e.g., Levine v. Smith*, Del. Supr., 591 A.2d 194, 205 (1991); *Rothenberg*, C.A. No. 11749, Mem. op. at 8 (*citing Levine v. Smith*, Del. Supr., 591 A.2d 194, 205 (1991)). Delaware courts will excuse a failure to make such a demand if a majority of the board was interested or lacked independence to review the derivative claim. *Rales*, 634 A.2d at 933-34.

The factual scenario set forth in the pleadings creates an atypical, if not unique, situation. The majority of the Board in power when it decided to follow through with the contested transactions no longer constituted the "majority" at the time Plaintiff should have made a pre-suit demand (October 17, 1994). Interestingly, however, two members of the five person Board still held their seats at the time for pre-suit demand and had participated as the "special committee" in approving the challenged transactions. Both of their votes would be required to constitute a majority decision on any pre-suit demand. *Harris v. Carter*, Del. Ch. 582 A.2d 222, 230 (1990).

As the Supreme Court stated in *Rales*, "a court should not apply the *Aronson* test for demand futility where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit." 634 A.2d at 933; *See also Harris*, 582 A.2d at 230.

At the time the challenged transactions took place, the Empire Board consisted of five directors. Three - M. Halperin, B. Halperin, and Minkin - later resigned. However, at the time Plaintiff filed suit, October 17, 1994, the Halperins were neither on the Board nor held a majority of the shares. Geller had supplanted the Halperins as controlling shareholder. Two new directors replaced three of those in power at the time of the challenged transactions and two remained.[7] Therefore, the Board of October 17, 1994 neither fits neatly into the scenario contemplated by *Aronson* nor *Rales*. Nonetheless, I must conclude the *Aronson* test applies here because Swersky and Derman are two members of the Board upon which Plaintiff should have made demand, and they

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> claims made upon the general partners without the agreement of the interested one."

There could only be a majority if *both* partners voted together. Otherwise, there would be deadlock. There are no such limitations on the Directors here. There is a Board of Directors consisting of four individuals. Moreover, *Katell* was a partnership situation which, although similar, is not identical to the corporate setting present here.

[7]The "new" Board consists of Geller, Smollar, Swersky, and Dermian.

are also two directors who participated in the decision making processes leading to the challenged transactions.

A. The Interested Director

A court will consider a director interested if "he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders." ***Aronson***, 473 A.2d at 812. A director may also be interested if a corporate decision will have a materially detrimental effect on a director but not on the corporation and stockholders. ***Rales,*** 634 A.2d at 936. According to Vice-Chancellor Jacobs, ". . . the complaint must establish a reasonable doubt that any conflicting interest was material." ***Rothenberg***, C.A. No. 11749, Mem. op. at 9 (***citing Cede & Co. v. Technicolor, Inc.***, Del. Supr., 634 A.2d 345, 363 (1993)). This Court must consider facts plead bearing on the significance of the alleged conflicting financial interests in question. ***Id.***

B. The Independent Director

A court will consider a director "independent" if that director bases a decision "on the corporate merits of the subject before the board rather than extraneous considerations or influences. ***Aronson***, 473 A.2d at 816. Stock ownership alone, even a majority interest, is insufficient proof of "domination or control" over a board of directors. ***Id.*** at 815 (***citing Kaplan v. Centex Corp.***, Del. Ch., 284 A.2d 119, 123 (1971)). Ownership must be coupled with facts showing directors are beholden to the controlling person through personal or other relationships. ***Id.*** (***citing Mayer v. Adams***, Del. Ch., 167 A.2d 729, 732, ***aff'd***, Del. Supr., 174 A.2d 313 (1961)). It is not enough for a plaintiff to charge that those controlling the outcome of a corporate election nominated or elected a director. ***Aronson***, 473 A.2d at 816. That is the usual process by which a person becomes a director. ***Id.*** While it is correct Justice Moore added in ***Aronson***, ". . . the plaintiff need only allege specific facts; he need not plead evidence." 473 A.2d at 816, nonetheless conclusory allegations cannot be confused with specific facts.

C. Disinterest and Independence of the Empire Board of Directors

Here, Plaintiff's pleadings are demonstrably insufficient in fact. One can only conclude it appears to a reasonable certainty his charge of control to the point of domination on the facts plead would not entitle

him to relief. Whether one adopts Vice-Chancellor Chandler's approach that a majority of disinterested directors must remain intact after a plaintiff's attack, or whether that plaintiff must successfully defeat an actual arithmetic majority, the result is the same. Plaintiff has the burden to establish successfully at least two of the four directors of Empire would lack independence to review his demand in order to establish no majority of the Board would be available to act.

The relevant date is October 17, 1994, the date Plaintiff filed this suit. At that time, the Empire Board of Directors consisted of Geller, Swersky, Derman, and Smollar.

Certainly, I must agree Geller had an interest in the transactions about which Plaintiff complains. He did receive a personal, financial benefit from a transaction in which the stockholders did not share equally. *See Aronson*, 473 A.2d at 812. He was interested in the redemption transaction. Geller would likely not agree to sue any members of the Halperin Group or himself. It would have potentially significant adverse financial consequences on him or Empire.

Assuming the plead facts are true, I cannot, however, draw any reasonable inference leading to the conclusion the Halperins exerted undue influence over Swersky and Derman *after* the Halperins relinquished their majority interest. *See Rales*, 634 A.2d at 933-34. The pleadings indicate no other means by which the Halperins could control Swersky and Derman before or after October 17, 1994. *See supra*, Section 4. In fact, the Halperins had no voting power related to the shares they still owned. They had transferred voting power to Geller pursuant to the deal they had struck earlier for the transfer of control of previously Halperin-owned stock to Geller.

[8] Plaintiff does not allege particularized facts suggesting Swersky and Derman appeared on both sides of any challenged transaction nor engaged in self-dealing.

> the mere threat of personal liability for approving [the] questioned transaction[s] standing alone, is insufficient to challenge either the independence or disinterestedness of directors . . . .

Aronson, 473 A.2d at 815. "What, in the end, is relevant is. . . whether the present board is or is not disabled from exercising its right and duty to control corporate litigation." *Harris*, 582 A.2d at 230. I conclude the Plaintiff's pleading lacks particularized facts creating a reasonable doubt Smollar, Swersky, and Derman - a majority of the Empire Board of Directors who would review the presuit demand - were disinterested and

independent. I cannot, therefore conclude Plaintiff's demand would have been futile.

D. The Valid Exercise of Business Judgment

While the factual scenario, as noted above fits neither ***Rales*** nor ***Aronson***, a review of Plaintiffs pleadings as to each challenged transaction results in the conclusion Plaintiff fails to allege facts creating a reasonable doubt the challenged transactions were the product of a valid exercise of business judgment. Plaintiff's expressed concerns about demand futility focus on Swersky's and Derman's participation in each of the decisions approving the challenged transactions. If Plaintiff were to prevail on his complaints of corporate waste, Swersky and Derman then may be liable. They would, Plaintiff infers, have little interest in acting on Plaintiff's demand for action, and their votes would be required as of October 17, 1994 to gain a majority for a decision. Allegations of this kind standing alone are conclusory. ***See Aronson***, 473 A.2d at 805.

There is no allegation of fact challenging the procedures the Board used in approving the contested transactions.

Conclusory allegations corporate waste resulted are insufficient to support a theory any one or all of the transactions (seen as a seamless web of a conspiracy to benefit the Halperins) were egregious or even unreasonable in that no rational basis supported them. The facts, as to each transaction standing alone, create no suspicion the ". . . decision is so extreme or curious. . . to justify future inquiry and judicial review." ***Kahn v. Tremont Corp.***, Del. Ch., C.A. No. 12339, Allen, C. (Apr. 22, 1994) Mem. op. at 16. In fact, on their face, the transactions, even as Plaintiff alleges, are entirely consistent with a carefully orchestrated scheme to: (a) remove old, tired management, quietly yet effectively; and, (b) encourage new aggressive management with reasonable financial incentives and opportunity for adequate control.

Defendants are entitled to a presumption the business judgment rule applies with regard to the challenged transactions. Plaintiff has failed to plead with particularity facts demonstrating a violation of due care in Board approval of the challenged transactions. First, the Empire Loan was not an egregious Board action - Halco returned the payments in full with interest. Second, the pleadings do not indicate the Halco loan would bring harm to the corporation, nor do they indicate it was a product of a violation of the Board's fiduciary responsibilities. Third, the retirement package, although arguably palatable enough for M. Halperin, is not inconsistent with other retirement arrangements in the corporate world and falls far short of shocking a rational conscience. Fourth, the

redemption transaction allowed fresh leadership to take the Empire helm which could produce new direction for the company, and potentially benefit, its shareholders. In short, Plaintiff's allegations are vague, at best, and they clearly do not rebut the presumption of the application of the business judgment rule.

Therefore, assuming *Aronson* indeed should apply to the facts of this case, I must conclude pre-suit demand cannot be excused for the reasons stated above. Defendants' Motions to Dismiss the derivative claims for failure to make pre-suit demand must be granted.

E. This Court Does Not Have Personal Jurisdiction Over Geller

Even if, as Plaintiff complains, Geller's "fundamental involvement and participation in the wrongs complained of in the Complaint" make him a "necessary and proper party," he did not serve as a director at those times of alleged wrongdoing. Plaintiff claims this Court has personal jurisdiction over Geller under Delaware's Consent Statute, 10 Del.C. § 3114. This section provides a non-resident director of a Delaware corporation concedes to jurisdiction in any action on behalf of a Delaware corporation where "such director, trustee or member is a necessary or proper party, or in any action or proceeding against such director, trustee or member for violation of his duty in such capacity." § 3114(a).

Geller alleges "[he] was not an officer, director or controlling shareholder of Empire at the time of *any* of the challenged transactions (i.e. the loans, the award of the retirement package, the charitable contribution and the redemption of the Halperin Group's stock)." I agree. Plaintiff's pleadings indicate he did not become Chairman, and a director, until the close of the redemption action on September 30, 1994. The statute clearly explains if directors, trustees or members of a Delaware corporation commit a violation of duty in their respective capacities, that individual assents to jurisdiction in any action on behalf of the Delaware corporation with which they are associated.

Plaintiff relies on *In re USACafes, L.P. Litig.*, Del. Ch., 600 A.2d 43 (1991), to support his claim of personal jurisdiction over Geller. Plaintiff claims Geller need only be a "necessary or proper party" to this litigation for this Court to have personal jurisdiction over him. This is an incomplete statement. Chancellor Allen, in *In re USACafes*, explained, "Because the first clause of Section 3114 is susceptible to unconstitutional application, this court in *Hana Ranch* construed the word 'or' to mean 'and,' in effect reading this clause out of the statute.

(citations omitted)." 600 A.2d at 53. In ***Hana Ranch v. Lent***, Chancellor Marvel addressed the "necessary or proper party" clause:

> ... it is the rights, duties, and obligations which have to do with the services as a director of a Delaware corporation which make a director subject to personal service in Delaware under the terms of 10 Del.C. § 3114 and **not simply that he or she may be both a proper party as well as a director**. (emphasis added).

Del. Ch., 424 A.2d 28, 30 (1980). According to Chancellor Marvel's reasoning, Plaintiff's argument Geller was a "necessary and proper party" is insufficient to establish personal jurisdiction over him. He must also be a director, trustee or member who violates his duty in whichever capacity he serves at the time of the alleged wrongful act. This Court does not have personal jurisdiction over Geller. Geller's Motion to Dismiss for lack of personal jurisdiction must be granted.

CONCLUSION

Plaintiff's Complaint consists of three derivative claims, and one individual claim for the breach of duty of candor. I dismiss the derivative claim for Plaintiff's failure to make a pre-suit demand. After considering the facts underlying the breach of duty of candor claim in the light most favorable to Plaintiff, I find to a reasonably certainty Plaintiff would not be entitled to relief under any set of facts which could be susceptible to proof at a later date. ***See James River-Pennington Inc.***, C.A. No. 13870, Mem. op. at 9. This Court lacks personal jurisdiction over Defendant Geller. Accordingly, I grant Defendants' respective Motions to Dismiss. A separate order will follow reflecting this decision.

ORDER

For the reasons set forth in the Court's Memorandum Opinion dated February 5, 1996:

1. Defendants, Maurice A. Halperin, Barry S. Halperin, Carol A. Minkin and Halco Industries, Inc.'s Motion to Dismiss pursuant to Chancery Court Rule 23.1 is granted; and,

2. Defendant Steven Geller's Motion to Dismiss pursuant to Rule 12(b)(2) and 12(b)(6) is granted.

3. Defendants Jeffrey R. Swersky and Carl Derman's Motion to Dismiss is granted.

IT IS SO ORDERED this 5th day of February, 1996.

LEE v. ENGLE

No. 13,323

FRANK v. ENGLE

No. 13,284

Court of Chancery of the State of Delaware, New Castle

December 15, 1995

Plaintiffs brought a motion to compel production of documents they had requested in the course of a shareholder derivative suit and class action. Defendants refused to produce the documents asserting that the attorney-client privilege, work product doctrine, and accountant-client privilege protected these documents. Plaintiffs sought injunctive, declarative, and monetary relief.

The court of chancery, per Vice-Chancellor Steele, granted in part plaintiff's motion to compel production of documents and ordered that defendant produce all documents that the plaintiffs requested excluding the preliminary drafts of board meeting documents and the publicly-filed documents they withheld. The court found that these documents were properly protected by the attorney-client privilege.

1. Witnesses ⟹ 198(1)

The purpose of the attorney-client privilege is to foster the confidence of the client and enable the client to communicate without fear in order to seek legal advice.

2. Witnesses ⟹ 200

The attorney-client privilege protects legal advice, as opposed to business or personal advice.

3. Witnesses ⚷ 200

The attorney-client privilege only protects advice which a person gives within a professional legal capacity.

4. Witnesses ⚷ 199(2)

Absent some special cause, the attorney-client privilege does not protect a corporation's attorney's communications to the client corporation which relate to a subject of a later suit.

5. Pretrial Procedure ⚷ 34

Parties cannot discover attorney-client confidential communications automatically in shareholder derivative suits.

6. Witnesses ⚷ 222

A suing shareholder may overcome corporate claims of attorney-client privilege only if he or she shows "good cause" motivates the discovery.

7. Witnesses ⚷ 222

A corporation is not barred from asserting the attorney-client privilege merely because those demanding information enjoy the status of stockholders. Where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.

8. Witnesses ⚷ 223

Three factors are of paramount importance to consider when determining whether the requisite good cause is present precluding the invocation of privilege: (1) the nature of the shareholders' claim and whether it is obviously colorable, (2) the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources, and (3) the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing.

9. Corporations ⟹ 202, 320(4)

A minority shareholder brings a shareholder derivative action to enforce a corporate cause of action against officers, directors, and third parties.

10. Principal and Agent ⟹ 1

A fiduciary owes an obligation of complete candor and openness to its beneficiary.

11. Corporations ⟹ 307

A corporation and its directors are fiduciaries.

12. Witnesses ⟹ 204(2)

The work product doctrine only applies to materials an attorney assembled and brought into being in anticipation of litigation.

13. Witnesses ⟹ 217

The work product doctrine protects the privacy of lawyers in the task of preparing their clients' cases for trial.

14. Witnesses ⟹ 217

The work product doctrine protects factual material gathered in preparation of a case and specifically shelters opinion work product which includes attorney's mental impressions, conclusions, opinions, and legal theories.

15. Witnesses ⟹ 198(2), 204(2)

The work product doctrine is broader than the attorney-client privilege which protects only communications between the attorney and client.

16. Witnesses ⟹ 198(2), 204(2)

The work product doctrine consists of factual information and opinion information.

17. Witnesses ⚷ 198(2), 204(2)

Factual or ordinary work product includes written statements and all other trial preparation material not involving an attorney's thought processes.

18. Pretrial Procedure ⚷ 404

The party seeking discovery must show substantial need and inability to obtain the substantial equivalent without undue hardship.

19. Pretrial Procedure ⚷ 358

Even if a party sufficiently demonstrates his or her need to obtain the draft work product, the work product doctrine protects the opinion work product.

20. Pretrial Procedure ⚷ 358

Opinion work includes attorney's mental impressions, conclusions, opinions, and legal theories.

21. Pretrial Procedure ⚷ 358

Where the plaintiff has available to it publicly-filed documents, preliminary drafts of such documents are the proper subject of a claim of privilege and thus need not be produced.

22. Witnesses ⚷ 219(3)

A party may only compel production of opinion work product when a party puts that privileged information directly at issue.

23. Witnesses ⚷ 219(3)

Where there is no indication whether the party seeking the protection of the work product doctrine put opinion work at issue, the attorney-client privilege shields the draft documents which were intended for public disclosure.

24. Witnesses ⟹ 196(2)

Delaware does not recognize the accountant-client privilege nor do the federal courts.

25. Actions ⟹ 17

A court should weigh four factors when determining whether it should apply law other than that of the forum state: (1) the number and nature of the contacts that the forum state has with the parties and the transaction involved, (2) the relative materiality of the evidence that is sought to be excluded, (3) the kind of privilege involved, and (4) fairness to the parties. RESTATEMENT (SECOND) OF CONFLICTS § 139(2), cmt. d (1971 & Supp. 1989).

Kevin Gross, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; and Robert D. Goldberg, Esquire, of Biggs & Battaglia, Wilmington, Delaware, for plaintiffs.

Stephen Lowey, Esquire, Sherrie Brown, Esquire, of Lowey, Dannenberg, Bemporad & Selinger, P.C., New York, New York, of counsel; and Lawrence A. Sucharow, Esquire, Linda P. Nussbaum, Esquire, Barbara Hart, Esquire, of Goodkind Labaton Rudoff & Sucharow, New York, New York, of counsel, for Robert A. Lee, as owner of account Guarantee Trustee and Trust FBO Robert Alton Lee.

Michael Fuchs, Esquire, and Roy Jacobs, Esquire, of Wolf Popper Ross Wolf & Jones, New York, New York, of counsel, for John C. Boland.

Clark W. Furlow, Esquire, Joanne Marie H. Shalk, Esquire, of Smith Katzenstein & Furlow, Wilmington, Delaware; and Zwerling, Schachter & Zwerling, New York, New York, of counsel, for defendant Sunstates Corporation.

Jesse A. Finkelstein, Esquire, Matthew J. Ferretti, Esquire, and Lisa A. Schmidt, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for individual defendants.

Michael D. Goldman, Esquire, Stephen C. Norman, Esquire, Kevin R. Shannon, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendants Hickory Furniture Company, Telco Capital Corporation, and RDIS Corporation.

STEELE, *Vice-Chancellor*

CONTENTIONS OF PARTIES

On March 10, 1995, Plaintiffs brought a Motion to Compel Production of Documents they requested in the course of a shareholder derivative suit and class action. Defendants refused to produce the requested documents. Defendants assert the attorney-client privilege, work product doctrine, and accountant-client privilege protect these documents. This is the opinion deciding that motion to compel.

FINDINGS OF FACT

Plaintiff, Richard N. Frank, filed a shareholders' derivative suit and class action ("the Frank Action") on December 8, 1993 against Clyde Wm. Engle ("Engle"), William D. Schubert, Robert J. Spiller, Jr., Howard Friedman, Lee N. Mortenson, Harold Sampson (collectively "the Individual Defendants"), Hickory Furniture Company ("Hickory"), Telco Capital Corporation ("Telco"), and Acton (now Sunstates) Corporation ("Sunstates" or "the Company"). The Frank Action alleges breaches of fiduciary duty, waste of corporate assets, failure to pay dividends on $3.75 cumulative Preferred Stock, and violation of the duty of disclosure with regard to the December 3, 1993 proxy statement. The Frank Action seeks injunctive, declaratory, and monetary relief.

Plaintiffs, Robert A. Lee, John C. Boland, Jeremiah O'Connor, and Harry Lewis filed a shareholders' derivative action ("the Lee Action") against the Individual Defendants, Hickory, Telco, and RDIS Corporation ("RDIS"), naming Sunstates as a nominal defendant. Engle is Chairman of the Board and Chief Executive Officer of Sunstates. The Lee Action alleges waste and breach of fiduciary duty. It also seeks declaratory and monetary relief. Plaintiffs in the Lee Action served a request for production of documents on February 2, 1994.

Sometime thereafter, the parties entered into a confidentiality stipulation and agreed to arrange discovery in both the Frank and Lee actions. Defendants have produced nearly 30,000 pages of documents to Plaintiffs. On August 19, 1994, Defendants provided Plaintiffs with a detailed privilege list. This list identified all documents which Defendants withheld or produced in redacted form on the basis of privilege. The list provided the date, author, recipient, copy, summary description, and privilege Defendants asserted. Defendants have refused

to produce 731 documents based on attorney-client, accountant-client, and work product privilege.

On October 12, 1994, Plaintiffs responded with a letter voicing objections to the privilege list. The Individual Defendants responded to these objections in a letter dated December 2, 1994. Plaintiffs filed a motion to compel production of documents on March 10, 1995. The motion seeks production of every document Defendants withheld on the basis of privilege.

CONCLUSIONS OF LAW

1. Attorney-Client and Work Product Privilege

[1-3] The attorney-client privilege is "to foster the confidence of the client and enable [him] to communicate without fear in order to seek legal advice." *Valente v. Pepsico, Inc.*, 68 F.R.D. 361, 367-68 (D. Del. 1975). The attorney-client privilege protects legal advice, as opposed to business or personal advice. *Securities and Exch. Comm. v. Gulf & Western Indus., Inc.*, 518 F. Supp. 675, 681 (D.D.C. 1981). This privilege only protects advice which a person gives within "a professional legal capacity." *In re Sealed Case*, 737 F.2d 94, 99 (D.C. Cir. 1984).
[4-5] Plaintiffs urge this Court to apply the *Valente* standard for attorney-client privilege protection. Absent some special cause, the attorney-client privilege does not protect a corporation's attorney's communications to the client corporation which relate to the subject of a latter suit. *Valente*, 68 F.R.D. at 367; *see also Deutsch v. Cogan*, Del. Ch., 580 A.2d 100, 104-05 (1990). This Court has been reluctant to apply *Valente* broadly. *See Gioia v. Texas Air Corp.*, Del. Ch., C.A. No. 9500, Allen, C. (Mar. 3, 1988) Mem. op. at 6; *In the Matter of Heizer Corp.*, Del. Ch., C.A. No. 7949, Berger, V.C. (Nov. 9, 1987); *Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc.*, Del. Ch., C.A. No. 8853, Jacobs, V.C. (Jun. 19, 1987) Mem. op. at 7; *Tabas v. Bowden*, Del. Ch., C.A. No. 6619, Hartnett, V.C. (Feb. 16, 1982) Mem. op. at 6. In *Deutsch*, this Court announced parties could not discover attorney-client confidential communications automatically in shareholder derivative suits. 580 A.2d at 106.
[6-7] Although not a binding case, this Court adopted and consistently has followed *Garner v. Wolfinbarger* as opposed to *Valente*.[1] *Garner v.*

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[1]Even though *Valente* and *Garner* are facially at odds, Vice-Chancellor Hartnett harmonized the two in *Deutsch v. Cogan*, Del. Ch., 580 A.2d 100, 106 (1990). The Vice-Chancellor explained,

Wolfinbarger, 430 F.2d 1093 (5th. Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *see* ***Deutsch***, 580 A.2d at 106; ***Matter of Heizer Corp.***, C.A. No. 7949; ***Sealy Mattress Co. of N.J.***, C.A. No. 8853 at 7; ***Tabas***, C.A. No. 6619 at 6. Under ***Garner***, a suing shareholder may overcome corporate claims of attorney-client privilege only if he or she shows "good cause" motivates the discovery. 430 F.2d at 1103. According to the ***Garner*** court,

> The attorney-client privilege still has viability for the corporate client. The corporation is not barred from asserting it merely because those demanding information enjoy the status of stockholders. But where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders *to show cause* why it should not be invoked in the particular instance. (emphasis added).

Garner, 430 F.2d at 1103-04. This Court will not diverge from this established line of reasoning. The ***Garner*** analysis is appropriate.[2]

[8] In ***Sealy Mattress Co.***, Vice-Chancellor Jacobs noted three factors of paramount importance to consider when determining whether the requisite good cause if present precluding invocation of the privilege:

> (i) 'the nature of the shareholders' claim and whether it is obviously colorable;' (2) 'the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources;' (3) 'the extent to which the communication is identified versus the extent to

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In ***Garner*** the court was not faced with a clear conflict of interest on the part of the attorneys as existed in ***Valente***. The ***Valente*** court therefore may have just been applying the ***Garner*** balancing test to a clear conflict of interest and thereby arrived at the conclusion that the plaintiff had shown good cause.

[2]Although I cannot embrace Plaintiffs' ***Valente*** argument which would automatically make the attorney-client privilege unavailable to directors, I agree directors owe a strict fiduciary duty to shareholders. They are responsible to minority shareholders. ***Valente v. Pepsi Co., Inc.***, 68 F.D.R. 361 (1975). This responsibility does not apply *per se*, thereby superseding the burden ***Garner*** attaches to discovery. **Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).**

which the shareholders are blindly fishing.' C.A. No. 8853, at 7 (citing *Garner*, 430 F.2d at 1104).

Defendants attempt to use the attorney-client privilege to insulate specific documents — the ones which Secretary and Vice President Leonard authorized or received ("the Leonard documents"). True, Leonard is an attorney. True, Leonard could use both confidentiality protections *if* he were acting as legal counsel to Sunstates. However, Leonard did *not* act in the capacity of Sunstates' in-house counsel. The record does not indicate Leonard prepared or reviewed meeting minutes or documents as an *attorney*. There was no attorney-client relationship between Leonard and Sunstates. Therefore, Leonard cannot avail himself of the protection associated with the attorney-client privilege or the work product doctrine. Accordingly, the attorney-client privilege cannot shield production of the Leonard documents.

[9] Assuming *arguendo*, Leonard acted in the attorney-client capacity, applying the *Garner* criteria to the facts here, I find Plaintiffs have shown good cause necessitating production of certain withheld documents. First, Plaintiffs are minority shareholders of Sunstates seeking information related to transactions they challenge as breaches of fiduciary responsibility. They clearly have the right to bring a shareholder derivative action under Delaware law. *See Kramer v. Western Pac. Indus., Inc.*, Del. Supr., 546 A.2d 348, 351 (1988). A minority shareholder brings a shareholder derivative action "to enforce a *corporate* cause of action against officers, directors, and third parties." Dennis J. Block, Nancy E. Barton, and Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, (Fourth ed. 1993), p. 709 (citing *Kamen v. Kemper Fin. Servs., Inc.*, 111 S. Ct. 1711, 1716 (1991) (emphasis in original, and quoting *Ross v. Bernhard*, 396 U.S. 531, 534 (1970))). The fact the Frank action and the Lee Action have progressed this far indicates viability. Otherwise, they may not have survived a motion to dismiss had one been presented. Plaintiffs' suit is, therefore, a "colorable claim."

Second, after careful scrutiny of the record, I find Plaintiffs have genuine cause for seeking production of the documents in question. It is both necessary and desirable for the plaintiff-shareholders to have the information. The withheld documents may lead to the discovery of information relevant to the transactions Plaintiffs contest as breaches of fiduciary duty. Furthermore, these documents may be the best evidence of the facts they contain which otherwise would be unavailable from any other practical source. The only *possible* alternative to this information

may be an avoidable, unnecessarily cumbersome and expensive route of deposing in detail the individual directors.

Third, the record does not leave me with the impression Plaintiffs' request for document production constitutes a blind "fishing expedition." The record indicates Plaintiffs' desired documents are related to pursuit of their claims, even if they ultimately prove unsuccessful.

[10-11] Furthermore, a fiduciary owes an obligation of complete candor and openness to its beneficiary. *See, e.g.*, ***Riggs Nat'l Bank of Washington, D.C. v. Zimmer***, Del. Ch., 355 A.2d 709 (1976). A corporation and its directors are fiduciaries. ***Valente***, 68 F.R.D. at 367-68. The Board of Directors, as fiduciaries, owe Frank, a stockholder, complete candor and openness.

[12-14] Alternatively, Defendants attempt to shield documents which Leonard prepared or reviewed behind the work product doctrine. The work product doctrine only applies to materials an attorney assembled and brought into being in anticipation of litigation. ***United States v. El Paso Co.***, 682 F.2d 530, 542 (5th Cir. 1982), *cert. denied*, 466 U.S. 944 (1984). The work product doctrine protects "'the privacy of lawyers in their work and encourages ... freedom ... from interference in the task of preparing their clients' cases for trial.'" ***E.I. DuPont de Nemours & Co. v. Admiral Ins. Co.***, Del. Super., C.A. No. 89C-AU-99, Steele, J. (Dec. 23, 1992) Mem. op. at 6 (citing ***Riggs Nat'l Bank of Washington, D.C. v. Zimmer***, Del. Ch., 355 A.2d 709, 715 (1976)), *interlocutory appeal denied*, Del. Super., 622 A.2d 1095 (1993). "It protects factual material gathered in preparation of a case and specifically shelters 'opinion' work product which includes attorneys' mental impressions, conclusions, opinion, and legal theories." ***Id.*** (citing ***Hickman v. Taylor***, 329 U.S. 495, 510-11 (1947).

[15-16] The work product doctrine is broader than the attorney-client privilege which protects only communications between the attorney and client. ***Id.*** at 7 (citing ***In re Grand Jury Proceedings***, 604 F.2d 798, 801 (3d. Cir. 1979)). The work product doctrine consists of "factual" information and "opinion" information. ***Id.***

[17-20] Factual or "ordinary" work product includes "written witness statements and all other trial preparation material not involving an attorney's thought processes...." 4 James W. Moore, et al., ***Moore's Federal Practice*** ¶ 26.15[3.-2], at 26-316 (2d ed. 1994). The party seeking discovery must show substantial need and inability to obtain the substantial equivalent without undue hardship. ***E.I. DuPont de Nemours & Co.***, C.A. No. 89C-AU-99 at 7-8. Even if a party sufficiently demonstrates his or her need to obtain the draft work product, the work product doctrine protects "opinion" work product. ***Id.*** at 7. Opinion

work includes "attorneys' mental impressions, conclusions, opinions, and legal theories." *Id.* (citing *Hickman*, 329 U.S. at 510-11). The policy behind this theory encourages lawyers to maintain their freedom to express and to record mental impressions and opinions for the benefit of their clients without fear of their impressions and opinions being used against their clients. *Id.* at 8.

The work product doctrine cannot shield the Leonard documents from production. The record shows no evidence Leonard interacted with Sunstates as an attorney until after this litigation began. By Defendants' own admission, the word "Counsel" does not appear in Leonard's title. Therefore, Leonard could not have been an attorney assembling and bringing into being materials in anticipation of litigation. Although he had his legal degree, his relationship with Sunstates did not relate to delivery of legal services.

Plaintiffs urge the above privilege protections do not apply to documents intended for public disclosure. *See In re Micropro Sec. Litig.*, [1988-89 Transfer Binder] *Fed. Sec. L. Rep.* (CCH) ¶ 93,986 (N.D. Cal. 1988). According to Plaintiffs, "handwritten notations on preliminary drafts are generally for the purpose of conveying factual data, not seeking legal advice." Their insistence seems consistent with the *Micropro Sec.* court who wrote,

> [T]hese communications, consisting as they do of factual information, do not call for a legal opinion or analysis. Such a communication does not constitute legal advice or a request for legal advice. Rather, the purpose of the communication is to furnish the information necessary to compile the offering materials required by the federal securities laws. Thus, the principle purpose for making the communication is not to secure legal advice but to secure what is essentially a business service (that, is to compile business data for disclosure in order to comply with the requirements of the federal securities laws). In receiving this information, the attorney herein were essentially serving as a conduit for factual data, and were not acting primarily as lawyers. *Hercules, Inc. v. Exxon Corp.*, 434 F.Supp. 136, 147 (D.Del. 1977); *Hewlett Packard Co. v. Bausch & Lomb, Inc.*, 116 F.R.D. 533, 542 (N.D. Cal. 1987).

MicroPro, at 90,593. The *MicroPro* court also emphasized,

> the information given the [attorney] was to assist in preparing such prospectus which was to be published to others and was not intended to be kept in confidence. That is the critical circumstance, to wit, the absence of any intent that the information was to be kept in confidence. (citation omitted).

Id.

[21] Although ***MicroPro*** is compelling, it is not binding on this Court. Chancellor Allen articulated this Court's position on the issue of producing draft documents in ***Jedwab v. MGM Grand Hotels, Inc.***, Del. Ch., C.A. No. 8077, Allen, C. (Mar. 20, 1986) Mem. op. at 6-7. Defendants, following the Chancellor's reasoning, argue the attorney-client privilege and work product doctrine protect the preliminary drafts of the board meeting documents and the publicly-filed documents they withheld. I agree.

In ***Jedwab***, this Court held preliminary drafts of documents a company later files with the Securities and Exchange Commission "are the proper subject of a claim of privilege and thus need not be produced." ***Id.*** at 6. Chancellor Allen based his decision on the fact that a plaintiff has available to it the publicly-filed documents. ***Id.*** Chancellor Allen wrote,

> [T]he only information available from prior drafts relates to matters appearing in prior drafts that were deleted, augmented or otherwise modified in the final product. ... [S]uch modifications are made as a result of communications between a client or its representatives and lawyers. Thus, new information disclosed from comparing drafts of SEC filings with the filed documents themselves necessarily relates to and may inferentially disclose communications between a client and its lawyers charged with preparing the final documents. Communications of this kind are clearly made "for the purpose of facilitating the rendition of professional legal services" and lie at the heart of the confidential communications that the lawyer-client privilege seeks to protect.
>
> ... [W]here... the document itself is prepared by a lawyer in a setting in which it is intended to remain confidential until a final version is deemed appropriate for public disclosure and where the only pertinence of the document to the

> discovery process is the inferential disclosure of the communication from a client to its lawyer, it strikes me that the underlying policies of the lawyer-client privilege are properly implicated and that discovery of such a document would inappropriately permit access by third parties to privileged communications.

Id. at 6-7.

Similarly, the work product doctrine protects the draft documents from production. Chancery Court Rule 26(b)(3) specifies,

> [A] party may obtain discovery of [relevant] documents and tangible things ... prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative... only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the Court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

Ch. Ct. R. 26(b)(3).

[22-23] Here, the draft documents consist of both factual and opinion work product. As for the factual ones, Plaintiffs have not sufficiently shown why they would be unable to discover the same information without undue hardship. Our Courts have held a party may only compel production of opinion work product when a party puts that privileged information directly "at issue." ***E.I. DuPont de Nemours & Co.***, C.A. No. 89C-AU-99 at 7-8. At this time, the record does not indicate whether the party seeking the protection of the work product doctrine put opinion work, in fact, "in issue." A more careful analysis is unnecessary in any event. The attorney-client privilege shields the draft documents which Defendants intended for public disclosure. Defendants properly withheld the draft documents from Plaintiffs' scrutiny.

2. Accountant-Client Privilege

[24] Finally, I turn to Plaintiff's request for the 110 documents which Defendants claim the Illinois Accountant-Client privilege protects. Delaware does not recognize the accountant-client privilege; nor do the Federal Courts. ***State of Del. v. Wright***, Del. Super., C.A. No. K94-02-0196I-0201I, Goldstein, J. (Jul. 20, 1994) (citing ***U.S. v. Arthur Young & Co.***, 464 U.S. 805, 817 (1984), ***Couch v. United States***, 409 U.S. 322, 335 (1973)).

Nevertheless, Defendants argue this Court should apply Illinois law which does recognize the accountant-client privilege, because "[Illinois] is the state with the most significant relationship to the communications in issue." I disagree.

[25] According to the **Restatement of Conflicts,**[3] a court should weigh four factors when determining whether it should apply law other than that of the forum state: (1) the number and nature of the contacts that the forum state has with the parties and the transaction involved; (2) the relative materiality of the evidence that is sought to be excluded; (3) the kind of privilege involved; and (4) fairness to the parties. ***Restatement (Second) of Conflicts***, § 139(2), Comment. Applying these factors to the factual record, I find Delaware law applies.

First, Sunstates is a Delaware corporation. Incorporation in Delaware constitutes a knowing and voluntary request for the widely recognized benefits and advantages flowing from the application of Delaware general corporate law to the governance of the incorporator's business entity. Sunstates' principal place of business is in North Carolina, not in Illinois. Apparently, Illinois's only connection with Sunstates is that Illinois accountants originally generated or received the documents Defendants attempt to protect behind the accountant-client privilege. However, as Plaintiffs highlight in their **Reply Memorandum in Support of Plaintiffs' Motion to Compel the Production of Documents**, Sunstates' 1990 and 1991 Annual Reports state Ernst & Young, Raleigh, North Carolina are actually Sunstates' accountants. The Company's 1993 and 1994 SEC filings list Greensboro, North Carolina accountants as Sunstates accountants.[4] It seems, second only to Delaware, North Carolina, not Illinois, has the most significant relationship to the communications which Defendants claim the

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[3]Delaware follows the Restatement's choice of law principles and the Restatement's "most significant relationship" test. ***Certain Underwriters at Lloyd's, London and London Market Insurance Cos.***, Del. Supr., 1994 LEXIS 355, Veasey, C.J. (Nov. 10, 1994) Slip op. (citing ***Oliver B. Cannon & Son v. Dorr-Oliver, Inc.***, Del. Supr., 394 A.2d 1160, 1166 (1978).

[4]Not surprisingly, an entity called "Sunstates" would necessarily be hard pressed to identify with Illinois.

accountant-client privilege protects.[5] That circumstance is irrelevant, however. Delaware has the most significant contacts with the Sunstates documents in question. Second, Defendants have not refuted Plaintiffs' argument these documents are material to Plaintiffs' case. I see no reason why they are not material. Third, while I can readily understand why some find the accountant-client privilege an important one, it is not the determining factor. Fourth, I see no reason why it is unfair to apply the law of the forum state — Delaware — here. If Sunstates did not intend to abide by Delaware law and anticipate Delaware law governing the conduct of its affairs, the Company would have incorporated elsewhere.

After weighing the evidence and applying it to the Restatement's four criteria, Delaware, not Illinois, is the state with the most significant relationship to the communications for which Defendants assert the accountant-client privilege. Since Delaware law recognizes no such privilege, there is no need to decide whether the privilege inures solely to the accountant or otherwise.

Accordingly, I grant in part and deny in part Plaintiffs' Motion to Compel Production of Documents. Plaintiffs are entitled to production of all documents they have specified in their **Motion to Compel Production of Documents** *excluding* the drafts of documents the Company intended for public disclosure. A separate order will follow reflecting this opinion.

ORDER

For the reasons set forth in the Court's Memorandum Opinion dated December 15, 1995:

This Court grants in part and denies in part Plaintiffs' Motion to Compel the Production of Documents —

Defendants are to produce, at their own expense, those documents Plaintiffs demanded as part of its request for documents *excluding* the preliminary drafts of the board meeting documents and the publicly-filed documents they withheld.

Defendants are to produce these documents within seven working days of receipt of this order.

IT IS SO ORDERED this 15th day of December, 1995.

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[5]North Carolina does not recognize the accountant-client privilege. *State v. Agnew*, 241 S.E.2d 684, 692 (N.C. 1978), *cert. denied, Agnew v. N.C.*, 439 U.S. 830 (1978).

LOUDON v. ARCHER-DANIELS-MIDLAND CO.

No. 14,638

Court of Chancery of the State of Delaware, New Castle

February 20, 1996

The plaintiff, an Archer-Daniels-Midland shareholder, brought an action under sections 225 and 227 to overturn the October 19, 1995 unopposed re-election of Archer-Daniels-Midland's seventeen member board of directors. In addition, plaintiff charged defendants with breach of fiduciary duties and duty of disclosure claims, asserting that the board of directors failed to disclose material facts in its reelection proxy statement, including failure to disclose alleged wrongdoing.

The court of chancery, per Vice-Chancellor Jacobs, dismissed the complaint for failure to state a claim, holding that section 225 cannot serve as a mechanism to overturn an otherwise valid election of a board of directors. The court dismissed the breach of duty to disclose claims, based on plaintiff's failure to assert specific facts in support of its claims, and on the principle that directors are not required to disclose any alleged wrongdoing in proxy statements, where such wrongdoing has not been judicially determined and disclosure would amount to "self-flagellation," which is not required under the law.

1. Pretrial Procedure ⚿ 683

On a motion to dismiss pursuant to Rule 12(b)(6), the moving party bears the burden of demonstrating that, assuming all of the factual allegations of the complaint are true, the complaint fails to state a claim upon which relief could be granted. DEL. CH. CT. R. 12(b)(6).

2. Pretrial Procedure ⚿ 679

The court will draw all reasonable inferences from the well-pleaded factual allegations of the complaint. However, the court will not accept as true conclusions of fact that are unsupported by specific factual allegations. DEL. CH. CT. R. 23.1.

3. Corporations ⟹ 283

Section 225, as the statutory equivalent of a common law *quo warranto* action, empowers the court to review and determine the validity of any election of any director or officer of any corporation organized under the general corporation law of Delaware. DEL. CODE ANN. tit. 8, § 225 (1995).

4. Corporations ⟹ 283(3)

Section 225 has a limited purpose, which is to resolve uncertainty as to the corporation's *de jure* directors by determining the validity of their contested election, and cannot be used as a vehicle to overturn an uncontested or unchallenged election based on alleged proxy disclosure violations. DEL. CODE ANN. tit. 8, § 225 (1995).

5. Corporations ⟹ 194

Corporate fiduciaries have a duty to disclose all material facts when seeking shareholder action.

6. Corporations ⟹ 194, 198(4)

A fact is material if there is a substantial likelihood that its disclosure would have assumed actual significance in the deliberations of the reasonable shareholder or would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

7. Corporations ⟹ 198(4), 310(1)

Directors have no duty to disclose speculative or contingent information, nor do they have a duty to engage in self-flagellation by confessing mismanagement or wrongdoing or by admitting to a breach of fiduciary duty before it is properly determined in a court of law.

8. Corporations ⟹ 320(7)

Plaintiff has the burden to plead specific facts sufficient to state an actionable disclosure claim.

9. Corporations ⚷ 198(4), 310(1)

Directors have no duty to disclose facts that would amount to a confession of wrongdoing on their part; such disclosure ignores the principle that directors are not required to engage in self-flagellation.

10. Corporations ⚷ 198(4), 310(1)

For reasons of practicality, under Delaware law, directors are not required to admit wrongdoing before it is properly determined in a court of law.

11. Corporations ⚷ 320(7)

A blanket allegation that the corporation should have disclosed the factual basis for its public denial of wrongdoing states no cognizable claim. To state a claim, the complaint must identify the specific material undisclosed facts that form the basis of the claimed violation of the directors' duty.

12. Corporations ⚷ 198(4), 310(1)

Requiring directors to disclose suspicions of wrongdoing allegedly held by a former director would effectively require directors to assume and disclose the validity of those suspicions in advance of any court determination that the suspicions were factually founded. Such disclosure would place directors in the untenable position that the rule against self-flagellation was designed to avoid.

13. Corporations ⚷ 194, 320(7)

Directors have no generalized duty to disclose the details of a special committee's ongoing work in response to a wide-ranging criminal investigation. Directors' duty is to disclose only those facts material to the shareholder action they are seeking. Non-disclosure claims must provide some basis for a court to infer that the alleged omissions were material.

14. Corporations ⟹ 198(4), 310(1)

Directors have no duty to disclose the personal opinions of a director, where those opinions are not material to the re-election of the incumbent nominees to the board.

15. Corporations ⟹ 320(7)

Where a complaint fails to identify specific material facts that were wrongfully omitted in corporation's proxy statement, it fails to state a legally cognizable claim for a breach of the directors' duty of disclosure.

William Prickett, Esquire, Ronald A. Brown, Jr., Esquire, and John E. Tracey, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Arthur T. Susman, Esquire, Terrence Beuhler, Esquire, and Robert E. Williams, Esquire, of Susman, Buehler & Watkins, Chicago, Illinois, of counsel, for plaintiff.

R. Franklin Balotti, Esquire, and Todd C. Schlitz, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Aubrey M. Daniel, III, Esquire, Nancy F. Lesser, Esquire, and George A. Borden, Esquire, of Williams & Connolly, Washington, D.C., of counsel, for defendant Archer-Daniels-Midland Company.

Lawrence C. Ashby, Esquire, and Amy A. Quinlan, Esquire, of Ashby & Geddes, Wilmington, Delaware, for director defendants.

JACOBS, *Vice-Chancellor*

In this individual and class action against Archer-Daniels-Midland Company ("ADM") and its directors, the plaintiff, an ADM shareholder, seeks to overturn the October 19, 1995 unopposed re-election of ADM's seventeen member Board of Directors. The plaintiff claims that the individual defendants breached their fiduciary duties by failing to disclose certain material facts in the company's proxy statement. He asks this Court to set aside the October 19, 1995 election pursuant to both its general equity powers and to 8 Del. C. §§ 225 and 227.[1] ADM moved

[1] 8 Del. C. § 225 confers authority upon this Court to determine the validity of an election or designation of directors in a summary proceeding. 8 Del. C. § 227 empowers this Court to order a new election in connection with a § 225 proceeding. An action pursuant to these statutory provisions is referred to herein as a "Section 225 proceeding."

to dismiss the complaint, pursuant to Court of Chancery Rule 12(b)(6), and the individual defendants joined in ADM's motion. This is the Opinion of the Court, following briefing and oral argument, on the defendants' dismissal motion.

I. PERTINENT FACTS[2]

ADM's business is that of procuring, transporting, storing, processing, and merchandising agricultural commodities and products. ADM's board of directors, all of whom are named as defendants, are Dwayne O. Andreas, Michael D. Andreas, Lowell W. Andreas, Martin L. Andreas, Ralph Bruce, John H. Daniels, H.D. Hale, John K. Vanier, M. Brian Mulroney, Marguaritta Rockefeller, James R. Randall, O. Glenn Webb, F. Ross Johnson, Shreve M. Archer, Jr., Ray A. Goldberg, Robert S. Strauss, and Gaylord O. Coan. ADM's Chairman of the Board and Chief Executive Officer is Dwayne Andreas; its President is James Randall.

On June 28, 1995, ADM announced that it and certain ADM senior executives were the subject of a federal criminal investigation of possible anti-trust violations. Later, in early July, it was revealed that Mark E. Whitacre ("Whitacre"), the then-president of ADM's BioProducts Division, had been cooperating in the investigation, which was being conducted by the Federal Bureau of Investigation ("FBI"). Mr. Whitacre reportedly had enabled the FBI to obtain secret tape recordings (including video tapes) of hundreds of meetings attended by senior executives and other employees of ADM. No criminal charges have yet been brought in connection with these events.

On July 19, 1995, ADM announced in a press release that it had formed a litigation committee (the "special committee") to direct the corporation's response to both the government investigation and to the many civil suits filed after the revelation of possible ADM anti-trust violations. The July 19, 1995 press release also stated that Gaylord Coan ("Coan") had been elected to the ADM board, although it did not disclose that Coan had succeeded Howard Buffet ("Buffet"), an officer and director who resigned from the board in early July 1995. The plaintiff alleges that the press release failed to disclose that Buffet had resigned because he would not participate in Dwayne Andreas' plans to

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[2]For purposes of a motion to dismiss, the well-pleaded factual allegations of the complaint are taken as true. In re Tri-Star Pictures, Inc., Litig., Del. Supr., 634 A.2d 319, 326 (1993).

"stonewall" ADM's stockholders about the government probe and related civil litigation.

On August 7, 1995, ADM fired Whitacre, claiming that Whitacre had stolen at least $2.5 million from ADM "at a time when he was acting as an undercover agent of the United States government" (Complaint at ¶ 11). This allegedly was done despite Whitacre's claim that those payments were part of a pattern of illicit bonuses approved by senior ADM officials, including director James Randall.

On September 13, 1995, director F. Ross Johnson ("Johnson") spoke at Emory University's Business School and made certain remarks about Whitacre, his work for the FBI, and his alleged thefts.

That same day, ADM issued a proxy statement in connection with its upcoming annual meeting, at which an unopposed slate of incumbent directors were being proposed for re-election. The proxy materials disclosed, in pertinent part, that (i) ADM was being investigated for possible federal anti-trust violations, (ii) ADM and certain of its directors and officers were named defendants in several class action suits arising out of the anti-trust investigation, (iii) certain ADM directors and officers were named defendants in derivative actions alleging breaches of fiduciary duty and waste of corporate assets, and that (iv) a litigation committee had been appointed to oversee ADM's response to the anti-trust investigation and the related civil litigation. (ADM Proxy Statement, September 13, 1995, at 7; ADM 1995 Annual Report, at 35).[3]

On October 19, 1995, ADM held its annual stockholders meeting. The complaint alleges that Dwayne Andreas presided over that meeting in an autocratic manner, responded to critical questions of one stockholder by ordering that his microphone be shut off, and summarily adjourned the meeting before allowing stockholders (who had queued up at the microphone) to pose their questions. Despite that acrimony, all of the individual defendants were re-elected to the ADM board at the annual meeting.

II. THE PARTIES' CONTENTIONS

The plaintiff requests the Court to: (a) invalidate ADM's October 19, 1995 election, (b) enjoin the individual defendants from

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[3]In evaluating the legal sufficiency of the plaintiff's complaint, this Court may consult the proxy statement, as a document incorporated by reference into the complaint, for the limited purpose of establishing what was disclosed to shareholders. In re Santa Fe Pacific Corp. Shareholder Litig., Del. Supr., ___ A.2d ___, No. 224, 23, 1995, Veasey, C.J. (Nov. 22, 1995).

taking action outside of ADM's ordinary course of business, (c) require corrective disclosure, and (d) establish a procedure for nominating candidates to stand for board election. Plaintiff also seeks damages for the disclosure violations and an award of costs and attorney's fees. Count I of the complaint seeks that relief on the ground that the individual defendants breached their fiduciary duties of disclosure and loyalty by concealing and misstating facts material to the shareholders' decision to re-elect the individual defendants to ADM's board. Count II alleges the identical fiduciary duty claims, but seeks relief pursuant to Section 225.

On this dismissal motion the defendants contend that this is not a proper Section 225 action. In addition and alternatively, the defendants argue that the complaint must be dismissed because it fails to identify any specific material fact that was either misstated or omitted in the proxy materials.[4]

[1-2] On a motion to dismiss pursuant to Rule 12(b)(6), the moving party bears the burden of demonstrating that, assuming all of the factual allegations of the complaint are true, the complaint fails to state a claim upon which relief could be granted. Rabkin v. Philip A. Hunt Chem. Corp., Del. Supr., 498 A.2d 1099, 1104 (1985). In applying this standard, the Court will draw all reasonable inferences from the well-pleaded factual allegations of the complaint; however, the Court will not accept as true conclusions of fact that are unsupported by specific factual allegations. Grobow v. Perot, Del. Supr., 539 A.2d 180, 187 n.6 (1988).

I conclude, for the reasons discussed below, that both Counts of the complaint must be dismissed for failure to state a claim.

III. THE SECTION 225 CLAIM

[3] The defendants first argue that this is not a proper Section 225 action. 8 Del. C. § 225 provides stockholders with a means to obtain judicial review of elections of directors. 8 Del. C. § 225(a). The authority conferred by that provision is broad. Kahn Bros. & Co., Inc. v. Fischbach Corp., Del. Ch., C.A. No. 8987, Allen, C. (Nov. 15, 1988). As the statutory equivalent of a common law quo warranto action, § 225 empowers the Court to "hear and determine the validity of any election of any director or officer of any corporation organized under the General

[4]The defendants also contend that even if the proxy materials did misrepresent or omit a material fact, the plaintiff's objection to the proxy materials is untimely and should be barred by laches. Because the complaint will be dismissed for failure to state a claim, the Court does not reach the laches defense.

Corporation Law of this state . . . ." Fleer v. Frank H. Fleer Corp., Del. Ch., 125 A. 411, 415 (1924); Kahn Bros. & Co., Inc., Mem. Op. at 9-11. [4] However, the summary mechanism of § 225 has a limited purpose, which is to "prevent a corporation from being immobilized by controversies as to who are its proper officers or directors." Bossier v. Connell, Del. Ch., C.A. No. 8624, Ltr. Op. at 5, Hartnett, V.C. (Oct. 7, 1986). Accordingly, only those issues that must be "decide[d] in order to determine the validity of ... [an] election or designation" are appropriately subject to review in a Section 225 proceeding. Kahn Bros. & Co., Inc., Mem. Op. at 12.

The plaintiff here has invoked § 225 as a vehicle to overturn an otherwise valid election based on alleged omissions in proxy solicitation materials. However, the purpose of § 225 -- to resolve uncertainty as to the corporation's de jure directors by determining the validity of their contested election[5] -- is not implicated here. The incumbent directors ran unopposed and their election went unchallenged. Most important, this action was not brought to resolve any uncertainty as to who constitutes ADM's lawful directors, or to determine the validity of their election. Rather, its purpose was to challenge the validity of ADM's proxy disclosures. Even if the plaintiff were to prevail in his disclosure claims, in no circumstances would the result be an adjudication of who constitutes ADM's lawful board, which is what § 225 is all about.

Accordingly, the Section 225 claim will be dismissed. The Court now turns to the plaintiff's disclosure claims.

IV. THE DUTY OF DISCLOSURE CLAIM

A. Preliminary

[5-6] Corporate fiduciaries have a duty to disclose all material facts when seeking shareholder action.[6] Stroud v. Grace, Del. Supr., 606 A.2d 75,

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[5]The first sentence of § 225 states: "Upon application of any stockholder or director, or any officer whose title to office is contested . . . the Court of Chancery may hear and determine the validity of any election of any director . . . or officer of any corporation . . . and the right of any person to hold such office . . . ." (emphasis added). By its terms, the statute indicates that § 225 is intended for situations involving a contested election. While the term "contested" may not invariably require opposing director slates (Kahn Bros. & Co., Inc., Mem. Op. at 9-11), it does require, at a minimum, that the events surrounding the election involve objective uncertainty as to the identity of the de jure board (and/or officers), which can only be resolved judicially.

[6]Although the plaintiff alleges that the directors breached their duty of disclosure by "failing to disclose and misstating the material facts ..." (Complaint at ¶ 17, emphasis added), not a single misstatement is identified in the complaint. Accordingly, this Opinion addresses

85 (1992). A fact is material if there is a substantial likelihood that its disclosure "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944 (1985) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). In the context of a shareholder vote, material facts are those which, "under all the circumstances, ... would have assumed actual significance in the deliberations of the reasonable shareholder." Arnold v. Soc'y for Sav. Bancorp, Inc., Del. Supr., 650 A.2d 1270, 1277 (1994). (quoting TSC Indus., Inc., 426 U.S. at 449).

[7] Although determinations of materiality are by their nature highly contextual, certain guidelines have evolved from our case law. Directors have no duty to disclose speculative or contingent information. Arnold, 650 A.2d at 1280. Nor have they a duty to engage in "self-flagellation" (Stroud, 606 A.2d at 84, n.1) by "confess[ing] mismanagement or wrongdoing," or by admitting to a breach of fiduciary duty "before it [is] properly determined in a court of law..." Weinberger v. United Fin. Corp. of Cal., Del. Ch., C.A. No. 5915, Mem. Op. at 24, Hartnett, V.C. (Oct. 13, 1983). See also, In re Rexene Corp. Shareholder Litig., Del. Ch., C.A. No. 10897, Ltr. Op. at 9, Berger, V.C. (May 8, 1991).

The defendants contend that the complaint is deficient because it either fails to identify any specific facts that ought to have been disclosed, or it posits that the directors were required to disclose speculative information or engage in self-flagellation. The plaintiff's response is that he is not required to identify each and every omission or misstatement in the proxy materials at the pleading stage. He argues that the burden rests upon the directors to prove that they discharged their disclosure obligations. He further contends that the directors are not immunized from those duties because the disclosure of material facts may turn out to indicate their complicity in wrongdoing.

[8] The plaintiff's concept of his pleading burden is erroneous. To be sure, in some limited circumstances (e.g., where defendant directors rely upon a ratifying shareholder vote as an affirmative defense), the board will be required to demonstrate adequate disclosure in the proxy solicitation (Braunshweiger v. American Home Shield Corp., Del. Ch., C.A. No. 10755, Allen, C. (Jan. 7, 1991)). But, that is not the normal rule, and no such special circumstances are present in this case. In this action the plaintiff has the burden to plead specific facts sufficient to state

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only the claimed breaches of the duty of disclosure resulting from omissions in ADM's proxy materials.

an actionable disclosure claim.[7] Grobow, 539 A.2d at 187 n.6; In re Tri-Star Pictures, Inc. Litig., 634 A.2d at 326.

[9] Also flawed is the plaintiff's argument that the directors are obligated to disclose facts that would amount to a confession of wrongdoing on their part. As set forth more fully below, to require such facts to be disclosed ignores the principle that directors are not required to engage in self-flagellation. Kahn v. Lynch Communication Systems, Del. Supr., ___ A.2d ___, No. 169, 30, 1995, Walsh, J. (Nov. 22, 1995).

For these and the additional reasons now discussed, none of the disclosure claims alleged in the complaint is legally sufficient.

B. Disclosures Concerning Alleged Anti-trust Violations

The plaintiff first claims that the defendants did not disclose material information concerning Michael Andreas' involvement in alleged anti-trust violations, including whether Mr. Andreas was captured on videotape conspiring to fix prices, production volumes, and market share goals with officials from other companies.

These allegations fail because they identify no material undisclosed fact. Rather, the plaintiff merely poses a question -- whether there exists an FBI recording of Michael Andreas committing a violation of anti-trust law -- and then claims that the answer to that question was a fact requiring disclosure. But presently the answer to that question is unknown, because it is the subject of the ongoing grand jury investigation. It therefore was sufficient for ADM's proxy materials to disclose to shareholders that "[t]he Company ... is the subject of a grand jury investigation into possible violations of federal anti-trust laws and possible related crimes in the food additives industry." (ADM 1995 Annual Report, at 35). That statement accurately -- and adequately -- described the status of the matter at that time.

[10] Moreover, Delaware law would not require this "fact" to be disclosed at a stage when Michael Andreas has not been accused of any violation. For reasons of practicality, under Delaware law, directors are not required to admit wrongdoing before it [is] properly determined in a court of law . . ." Weinberger, Mem. Op. at 24.

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[7]The plaintiff does not escape that pleading burden by supplying only a few examples of a larger category of material omissions and misstatements in ADM's proxy materials (i.e. "[t]he material omissions and misstatement of material facts include, but are not limited to, the following ..." Complaint at ¶ 17; see also Complaint at ¶¶ 17(b) and 17(c)). To the extent that the complaint does not identify specific allegedly material omissions or misstatements, it cannot survive a motion to dismiss. In re Dataproducts Corp. Shareholders Litig., Del. Ch., C.A. No. 11164, Mem. Op. at 6, Jacobs, V.C. (Aug. 22, 1991).

This claim must therefore be dismissed.

C. Disclosures Concerning Illicit Bonus Payments

The plaintiff next alleges that the proxy materials wrongfully omitted to disclose (i) facts relating to whether Randall and other ADM officials had approved the payment of illicit bonuses to ADM officers, and (ii) the factual basis for ADM's public position that Whitacre's allegations concerning the payment of illicit bonuses were "completely false."

[11] As with the claim just discussed, the claimed failure to disclose "whether James R. Randall and other ADM officials approved ... the payment of bonuses to ADM officers ... through the use of false invoices..." (Complaint at ¶ 17(e) emphasis added) is an effort to transmute an open question into an established fact. It also amounts to a demand for an admission of wrongdoing. Directors are not obligated to reveal the entire factual basis of their corporation's public announcements. A blanket allegation that the corporation should have disclosed the "factual basis" for its public denial of wrongdoing, states no cognizable claim. To state a claim, the complaint must, at the very least, identify the specific material undisclosed facts that form the basis of the claimed violation of the directors' disclosure duty. See, Margolies v. Pope & Talbot, Inc., Del. Ch., C.A. No. 8244, Mem. Op. at 23, Hartnett, V.C. (Dec. 23, 1986).

Accordingly, this claim will be dismissed as well.

D. Disclosures Concerning Mr. Buffet's Resignation and Mr. Coan's Election

Next, the plaintiff alleges that ADM's shareholders should have been informed that Howard Buffet had resigned from ADM's board because he refused to participate in Dwayne Andreas' plan to conceal material information from ADM's shareholders. The plaintiff also attacks the proxy statement for failing to disclose the "material facts" relating to the election of Gaylord Coan.

For purposes of this motion, the allegation that Buffet resigned to avoid participating in a plan to conceal material information is assumed to be true. Even so, the claim is insufficient as a matter of law. The directors had no obligation to disclose this "reason" for Buffet's resignation in the proxy statement. Such a rule, if validated, would effectively require directors to publicly announce that they intend to violate their fiduciary disclosure obligations. That would be self-

flagellation, only in a different form.[8] Weinberger, Mem. Op. at 24 (directors are not required to speculate as to alleged improper motives). [12] The plaintiff counters that the reason for Buffet's resignation is a fact, not an admission of wrongdoing. The argument is nonresponsive. ADM's directors would have been required to report Buffet's resignation only if it were material to a reasonable shareholder deciding whether or not to re-elect the incumbent board. The complaint alleges that Buffet's resignation would have been material, i.e., would have assumed actual significance in the shareholder's deliberations, because the resignation was linked to "plans to stonewall ADM's stockholders." If that argument were given the force of law, it would require a board to disclose that the resigning director suspected that other directors intended to conceal material information from shareholders. In effect, the directors would be required to assume, and then disclose, the validity of Buffet's suspicion in advance of any Court determination of whether that suspicion was factually founded. That would place directors in the "untenable position" that the rule against director self-flagellation is intended to avoid. See, Warner Communications, 581 F.Supp. at 1490.

Similarly deficient is the companion claim that the material facts relating to Mr. Coan's election to the board were not disclosed. Again, the plaintiff fails to specify any specific fact that he claims should have been disclosed. Margolies, Mem. Op. at 23. In his brief, the plaintiff tries to remedy the deficiency by contending that Coan was elected by "directors who are the subject of pending derivative actions." (Plaintiff's Answering Brief at 14). Even if that fact had been alleged in the complaint, the claim would still fail. The proxy materials disclosed that ADM faces derivative actions arising from the federal anti-trust investigation and from the alleged "breach by the individual defendants (including all director nominees except Mr. Coan) of their fiduciary duties to the Company and waste of corporate assets". (Proxy Statement at 7). From that information a reasonable shareholder could conclude that the directors named as defendants in these derivative suits were the same directors who elected Mr. Coan. See, Seibert v. Harper & Row, Publishers, Inc., Del. Ch., C.A. No. 6639, Mem. Op. at 14-15, Berger, V.C. (Dec. 5, 1984).

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[8]Validating plaintiff's claim would also impose upon directors a burden more onerous than that imposed by federal securities laws. Under Section 14(a) of the Securities Exchange Act of 1934, the SEC requires registrants to disclose a director's resignation, and the reasons therefor, only if the resignation was "because of a disagreement with the registrant on any matter relating to the registrant's operation, policies or practices, and if the director has furnished the registrant with a letter describing such disagreement and requesting that the matter be disclosed ...." 17 C.F.R. § 240.14a-101, Item 7(g) (emphasis added).

E. Disclosures Concerning the Special Committee

The plaintiff next alleges that the proxy materials omitted to disclose material facts about the special committee, specifically (i) how its members and co-chairs were selected; (ii) the special committee's actions and plans; (iii) its authority and intentions to hire independent counsel, accountants and other experts; and (iv) the details concerning the committee's response to derivative suits pending against ADM, including the results of the committee's investigations and why the committee moved to dismiss the claims for failure to make a demand on the board. [13] As with the other claims, the complaint fails to identify any specific fact that should have been disclosed. The proxy statement did disclose the existence of the special committee, its composition and its mission. Directors have no generalized duty to disclose the details of a special committee's ongoing work in response to a wide-ranging criminal investigation. Their duty is to disclose only those facts material to the shareholder action they are seeking. Without identification or particularization of the omitted facts that form the basis of the claim, the Court cannot ascertain whether the withheld information would be material to a shareholder deciding whether or not to re-elect the board. "Non-disclosure claims must provide some basis for a court to infer that the alleged omissions were material." In re Santa Fe Pacific Corp. Shareholders Litig., Del. Supr., No. 224, 12 (1995) (citing In re Wheelabrator Technologies, Inc. Shareholder Litig., Del. Ch., C.A. No. 11495, Mem. Op. at 6 n. 7, Jacobs, V.C. (Sept. 1, 1992).

F. Disclosures Concerning the Views of F. Ross Johnson

Next, the plaintiff claims that the directors failed to disclose that F. Ross Johnson had expressed the following views at Emory University Business School: (i) the FBI is comprised of "scumbags" "who like to extort"; (ii) if ADM's board "had had some good checks and balances in there, [it] might have found some smoke"; and (iii) director Mulroney had to be "maneuvered" into serving as co-chair of the special committee. (Complaint, ¶ 17(a)).

The plaintiff argues that Johnson's low regard of the FBI and its tactics was a material fact requiring disclosure in the proxy materials. The plaintiff's apparent materiality theory is that in the view of a reasonable stockholder, Johnson's opinion of the FBI might indicate his likely response to the FBI investigation of ADM and, therefore, might be a fact of significance relating to his fitness for re-election to ADM's board.

This attempt to link a director's present personal opinions with shareholder expectations about the director's future actions is misguided. In this case the connection is so speculative as to provide no limiting principle to guide fiduciaries attempting to comply with their disclosure obligations. Persons nominated to serve on a corporate board are normally required to present a summary of their qualifications to serve on a board, as well as facts relating to any actual or potential conflict of interest. The plaintiff provides no legal authority or reasoned argument to support his apparent position that nominees must also issue a manifesto of their personal views or otherwise indicate their intentions as to how they will exercise their independent business judgment in the future once elected.

[14] The plaintiff contends that Johnson's views are material. He relies heavily upon this Court's findings that the opinions of two of the directors in Gilmartin v. Adobe Resources Corp., Del. Ch., C.A. No. 12467, Mem. Op. at 20, Jacobs, V.C. (Apr. 6, 1992) were material and should have been disclosed. In Adobe the company had failed to inform its shareholders that its chief executive officer and its chief operating officer (both of whom were directors) were opposed to the very merger the shareholders were being asked to approve. Thus, the undisclosed information in Adobe did not represent a mere personal opinion that had some arguable potential to influence the directors' future business decisions. Rather, it involved facts that directly concerned the matter upon which shareholder approval was being sought. Id. at 20-21. That is not the case here. Johnson's opinion regarding the FBI does not directly concern the re-election of the incumbent nominees to the ADM board. It is not, therefore, an opinion that the ADM directors had a duty to disclose.

The plaintiff next argues that Johnson's belief that, if ADM's board "had some good checks and balances in there, [it] might have found some smoke," was material and should have been disclosed. The plaintiff mischaracterizes Johnson's remarks. Johnson was commenting on the possibility that ADM might have benefitted from a system of "checks and balances," and he concluded his comment by saying that "[but] you don't get checks and balances when people are going to forge things at a senior level." This implies that Whitacre's alleged embezzlement could not have been prevented even if additional security measures had been taken by the board. The "Court is hardly bound to accept as true a demonstrable mischaracterization and the erroneous allegation that flows from it." In re Wheelabrator Technologies, Inc. Shareholders Litig., Del. Ch., Consol. C.A. No. 11495, Mem. Op. at 7, Jacobs, V.C. (Sept. 1, 1992). Viewed

in its proper context, Johnson's opinion was not material to shareholders' deciding to re-elect the incumbent board.

Finally, the plaintiff argues that Johnson's opinion that Mr. Mulroney had initially resisted the idea of becoming co-chair of the special committee, was a fact that was material to shareholders deciding whether to re-elect the incumbent board. But the plaintiff does not cogently explain why. The Court is not required to conjure up ways that Mr. Mulroney's hesitation might conceivably bear on the shareholders' decision to re-elect the incumbent board. It is the plaintiff who must provide some basis for finding that an omitted fact was material to the shareholder action being sought. In re Santa Fe Pacific Corp. Shareholder Litig., Del. Supr., No. 224, 12 (1995). That the plaintiff has failed to do.

G. Failure to Respond to Questions at the Annual Meeting

The complaint alleges that "[t]he board . . . breached its fiduciary duty of disclosure by failing to answer stockholders' questions at the annual meeting." (Complaint ¶ 18). That also fails to state a duty-of-disclosure violation. The plaintiffs have not shown that the directors have a specific legal duty to answer every question put to them by shareholders at an annual meeting, though courtesy and prudence indicate that they should do that where possible. Moreover, the complaint fails to identify any specific fact that was misstated or omitted, including the questions that the board supposedly was required to answer. This allegation must also be dismissed for failure to state a claim.

H. Disclosures Concerning the Directors' Conflicts of Interest and Lack of Independence

Finally, the complaint contains the broad, unspecific allegation that "[t]he proxy statement failed to disclose all of the material facts concerning the board's conflicts of interest and lack of independence," (Complaint ¶ 17 (f)). Again, it does not plead any specific facts that were not disclosed.

[15] The defendants argue that the Court should reject these conclusory allegations. I agree. Because the complaint fails to identify specific material facts that were wrongfully omitted in ADM's proxy statement, it fails to state a legally cognizable claim for a breach of the directors' duty of disclosure. See, Margolies, Mem. Op. at 23.

V. CONCLUSION

For the foregoing reasons, defendants' motion to dismiss the complaint is granted. **IT IS SO ORDERED.**

McALLISTER v. KALLOP

No. 12,856

Court of Chancery of the State of Delaware, New Castle

July 28, 1995

Plaintiff, a minority shareholder, sought to enforce a letter agreement in which the majority shareholder promised to give, transfer, and deliver one share of stock back to the corporation, so that both shareholders would have an equal stake in the business. In addition, plaintiff claimed that defendants breached their fiduciary duties by misleading plaintiff into believing each shareholder had equal ownership. Defendants argued the letter agreement should not be enforced due to laches, waiver, and estoppel. Defendants also argued that they committed no affirmative acts to mislead plaintiff.

The court of chancery, per Vice-Chancellor Chandler, held that the signed letter agreement operated as a valid transfer of one share of stock, leaving both stockholders with equal shares. The court further found that none of the defendants breached their fiduciary duties to plaintiff.

1. Contracts ⟹ 51, 52

Consideration can consist of either a benefit to the promisor or a detriment to the promisee.

2. Contracts ⟹ 50

A fundamental element of consideration is that the parties bargain for it.

3. Contracts ⚷ 50

A party offers consideration to induce a promise from the other party.

4. Contracts ⚷ 79

Past consideration will not create an enforceable promise.

5. Gifts ⚷ 4, 11

A promise to make a gift is not legally binding until the gift is completed. A gift becomes legally valid where there is donative intent, delivery, and acceptance.

6. Corporations ⚷ 114
Securities Regulation ⚷ 263

The two requirements for completing a transfer of a certificated share of stock are indorsement and delivery. DEL. CODE ANN. tit. 6, § 8-308 (1991 & Supp. 1994).

7. Corporations ⚷ 114, 124

Indorsement of a certificate can be accomplished by either signing the certificate or an assignment or transfer of a security on a separate document. DEL. CODE ANN. tit. 6, § 8-308 (1991 & Supp. 1994).

8. Corporations ⚷ 114

An indorsement of a certificated security does not constitute a transfer until delivery of the certificated security on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificated security. DEL. CODE ANN. tit. 6, § 8-309 (1991 & Supp. 1994).

9. Corporations ⚷ 114

Transfer of a certificated security occurs when the purchaser or a person designated by him acquires possession of the certificated security. DEL. CODE ANN. tit. 6, § 8-313(a) (1991 & Supp. 1994).

10. Corporations ⟹ 114

A signed letter from a stockholder indicating that he gives, transfers, and delivers one share of stock to the company satisfies the indorsement requirement for a valid transfer of stock, under article 8 of the Delaware Code.

11. Corporations ⟹ 114
Gifts ⟹ 17

For the purposes of article 8, delivery is a voluntary transfer of possession. DEL. CODE ANN. tit. 6, § 1-201(14) (1991 & Supp. 1994).

12. Corporations ⟹ 114
Gifts ⟹ 17, 18(2)

Where a stockholder places an unsigned stock certificate in the company safe, the delivery requirement for a valid transfer of stock is not satisfied.

13. Gifts ⟹ 22, 29
Corporations ⟹ 114

Constructive or symbolic delivery can satisfy the common law delivery requirement and also the requirement of delivery for stock transfer purposes under article 8 of the Delaware Code.

14. Gifts ⟹ 22, 29
Corporations ⟹ 114, 118

Constructive delivery is permitted when actual transfer of physical possession of a certificate is impractical.

15. Gifts ⟹ 22

Delivery must be as perfect as the circumstances reasonably permit.

16. Gifts ⟹ 21
Bills and Notes ⟹ 209

Where a bank must retain possession of a stock certificate to maintain its security interest in the stock, transfer of a security to a

purchaser occurs at the time the bank acknowledges that it holds the security for the purchaser. DEL. CODE ANN. tit. 6, § 8-313(1)(e) (1991 & Supp. 1994).

17. Gifts ⚷ 22
Bills and Notes ⚷ 209

Constructive delivery requires an unmistakable intention to transfer title without transferring possession of the certificate to the transferee. However, intent alone is insufficient to constitute constructive delivery.

18. Gifts ⚷ 22, 29

The most important requirement of constructive delivery is that it must proceed to a point of no return.

19. Gifts ⚷ 29
Corporations ⚷ 129

Failure to record a transfer of stock does not affect the validity of a stock transfer between the parties to a transaction.

20. Gifts ⚷ 22, 29
Corporations ⚷ 114, 118

A letter agreement to deliver a share of stock to the company may serve as an adequate proxy for transfer of physical possession of the stock certificate.

21. Gifts ⚷ 17

Under the common law of gifts, delivery serves three important requirements. First, it makes significance of the act vivid and concrete to the donor. Second, the act of manual transfer is unequivocal to the actual witnesses to the transaction. Third, the fact of delivery gives the donee the prima facie evidence of the alleged gift.

22. Gifts ⚷ 29
Corporations ⚷ 129

Recording the transfer can satisfy the requirement of constructive delivery and may even be necessary for a constructive delivery in some

circumstances. However, failure to record a transfer in the corporate records does not preclude constructive delivery.

23. Equity ⟹ 67

A party asserting laches must demonstrate a detrimental change of position.

24. Contracts ⟹ 262
Gifts ⟹ 41

Waiver requires a voluntary relinquishment of a known right.

25. Estoppel ⟹ 55, 56

A party claiming estoppel must show that he reasonably relied on another party's conduct and suffered a detrimental change of position as a result of that conduct.

26. Contracts ⟹ 95(1)

Economic duress occurs where a party is deprived of his free will as a result of a threat to his business interests.

27. Contracts ⟹ 95(1)

Economic duress can invalidate an otherwise valid contract.

28. Contracts ⟹ 95(1)

The threat that creates the duress must be wrongful, but it does not have to be unlawful.

29. Corporations ⟹ 310(1)
Contracts ⟹ 121

To the extent that a contract, or a portion of a contract, limits a director's exercise of his fiduciary duties, it is unenforceable.

30. Corporations ⚷ 307, 310(1)

Directors and officers owe stockholders fiduciary obligations of care and loyalty.

31. Corporations ⚷ 195

No stockholder meeting with a quorum has been held when the stockholders have actually deadlocked on an issue or failed to elect directors. DEL. CODE ANN. tit. 8, § 226(a)(1) (1991 & Supp. 1994).

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Samuel A. Nolen, Esquire, and Robert J. Stearn, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Clinton B. Fisher, Esquire, and Steven R. Schoenfeld, Esquire, of Haythe & Curley, New York, New York, of counsel, for defendants William M. Kallop and Lawrence Chan.

CHANDLER, *Vice-Chancellor*

This lawsuit concerns one share of stock of McAllister Towing and Transportation Company, Inc. ("MT & T"), a holding company whose subsidiaries conduct tugboat and oil operations worldwide. Brian A. McAllister ("Brian") and William M. Kallop ("Kallop"), the only stockholders of MT & T, ask this Court to resolve whether Kallop owns one share more than Brian. This case was tried before the Court beginning on September 19, 1994, and concluding on October 5, 1994. This is the opinion of the Court after trial.

I. BACKGROUND FACTS

Although MT & T currently has only two stockholders, the story of MT & T is not one about the efforts of two men working as partners to build a successful company. MT & T was formed in 1969 by Brian, his brother Anthony McAllister ("Tony") and his cousins Neill McAllister ("Neill") and James McAllister ("James"), as a vehicle for the acquisition of their fathers' tugboat company. Before MT & T's acquisition of the tugboat company, Kallop and Bruce McAllister ("Bruce"), another of Brian's brothers, became stockholders in MT & T. The six stockholders

never worked well together. Over the course of twelve years, Bruce, Neill, James and Tony sold their shares back to the company, leaving only Kallop and Brian as stockholders of MT & T.

In contrast to the earlier era of constant bickering, Kallop and Brian worked well together for a few years. They rescued MT & T from the brink of bankruptcy, then developed the company into a worldwide organization with wide ranging operations. MT & T, through its subsidiaries, conducts tugboat operations in the major ports of the eastern United States and Puerto Rico, provides ferry service from Long Island to Connecticut, provides vessels for offshore oil drilling worldwide, and has its own oil facilities in South America. MT & T generates $250 million in revenues and employs over 2,500 people. The traditional core of the business is its tugboat operation, but the tugboats no longer generate the majority of MT & T's revenues.

The declining importance of the tugboat business may be the reason for the break up of the good working relationship between Brian and Kallop. Kallop wants MT & T to reduce its involvement in the tugboat industry and concentrate on its other ventures. Kallop believes the other ventures are more profitable. Brian will not agree to discontinue the tugboat operations. He still considers MT & T to be his family tugboat business and will not agree to dismantling it.

MT & T was formed to acquire McAllister Brothers, Inc. ("McAllister Brothers"), the McAllister family's tugboat company. In the 1960s, Brian, Anthony, James and Neill worked for McAllister Brothers. The prior generation of McAllisters, which includes Anthony McAllister, Sr. ("Anthony Sr."), the father of Brian and Tony, and James P. McAllister, Sr. ("J.P."), the father of Neill and James, owned and operated the company. By the late 1960s, the senior McAllisters wanted to retire and needed to liquidate their equity interests in McAllister Brothers. The junior McAllisters wanted to carry on the family business, but the senior McAllisters needed to sell the company. Several interested buyers began negotiating to purchase McAllister Brothers. The junior McAllisters, especially Brian, did not want to work for a "Wall Street outfit." They decided to try to purchase McAllister Brothers from their fathers.

The senior McAllisters had kept McAllister Brothers debt free, so the junior McAllisters could feasibly finance their purchase of the company entirely with debt. They formed MT & T in 1969 and sought financing for the deal. Brian urged his father to consider selling the business to the sons, but Anthony Sr. doubted the sons could put an attractive offer together.

In the early 1970s, Brian recognized that the junior McAllisters were losing their bid to purchase the company. Another group, led by Donaldson, Lufkin and Jenrette, was very close to closing a deal. To strengthen MT & T's chances, Brian invited Kallop to join MT & T. At the time, Kallop was working with another group that was also trying to acquire McAllister Brothers. Anthony Sr. had told Brian that Kallop's presentation for the other group was very impressive, so Brian thought Kallop could help convince the senior McAllisters to sell to MT & T. Brian informed Kallop that neither Kallop's group nor MT & T were likely to win, but if Kallop joined MT & T, then it might have a chance. Kallop agreed to join MT & T as an equal stockholder.

The imminent deal with Donaldson, Lufkin and Jenrette fell through, but MT & T was still unable to purchase McAllister Brothers. A long simmering feud between Anthony Sr. and J.P. complicated the negotiations between MT & T and McAllister Brothers. MT & T brought Bruce McAllister, the brother of Brian and Tony and the son of Anthony Sr., into the negotiations because Bruce had a good relationship with all of the senior McAllisters. Bruce was somewhat of an outsider because he didn't work for McAllister Brothers. He was a lawyer who practiced maritime law just blocks away from McAllister Brothers' offices in lower Manhattan. As Bruce became more involved in the negotiations, he demanded a stake in MT & T. The stockholders of MT & T eventually agreed that all six of them (including Bruce) should have an equal stake in the company.

With Bruce leading the negotiations, MT & T was able to purchase McAllister Brothers. MT & T found financing that placed its bid in range with competing bids, but it also offered the senior McAllisters important non-monetary consideration: J.P. and Anthony Sr. could continue their involvement with the company. The family connection helped to close the deal, but it also created problems that forced a restructuring of the stockholders' relative interests in MT & T.

The rivalry between J.P. and Anthony Sr. complicated the deal. If all the stockholders of MT & T had equal interests, the sons of Anthony Sr. would own more stock than the sons of J.P. because Anthony Sr. had three sons in MT & T. J.P. rejected any proposal that gave his sons less stock than the sons of Anthony Sr. J.P. was the largest stockholder in McAllister Brothers and he wanted that status to continue into the next generation. To accommodate the wishes of J.P., James and Neill each received an extra 49 shares, which made their combined stockholdings roughly equal to that of the sons of Anthony Sr. MT & T had an option to repurchase those extra shares without the consent of Neill and James.

The tax aspects of the buyout further prevented the stockholders from holding equal interests in MT & T. Under Section 302(b) of the Internal Revenue Code, the money Anthony Sr. received for the sale of his stock would have been considered ordinary income, which was taxed at a top marginal rate of 70% in 1974, if his sons owned 50% or more of MT & T. Anthony Sr. could not accept the deal unless his proceeds from the sale of McAllister Brothers were treated as capital gains, which was taxed at a rate of 30% in 1974. For the purposes of Section 302(b) of the Internal Revenue Code, the redeemable shares issued to Neill and James were irrelevant. MT & T had to issue an extra share to Kallop, Neill or James so that the sons of Anthony held less than 50% of MT & T. Because of the feud between J.P. and Anthony Sr., issuing an extra share to Neill or James was out of the question. Kallop, the only non-family member, was issued an extra share. Therefore, at the time MT & T acquired McAllister Brothers, the stock ownership of MT & T was:

William Kallop	100	
Bruce McAllister	99	
Tony McAllister	99	Sons of Anthony Sr.
Brian McAllister	99	
James McAllister	148 (49 shares subject to redemption)	Sons
Neill McAllister	148 (49 shares subject to redemption)	of J.P.

MT & T sought a revenue ruling from the IRS approving Anthony Sr.'s proceeds as capital gains under this arrangement. The IRS issued a letter opinion approving capital gains treatment of Anthony Sr.'s proceeds from the sale of his stock. The IRS premised its ruling on the fact that Kallop owned his extra share outright, with no obligation to redeem it at any time in the future. As of 1974, Kallop had no obligation to return his extra share.

The stockholders of MT & T altered their ownership interests in the company to accommodate the desires of J.P. and Anthony Sr., but they still intended to act like equal stockholders. At or around the time of the closing, they entered into a stockholders agreement (the "1974 Stockholders Agreement"). The 1974 Stockholders Agreement provided each stockholder with identical management rights and compensation. By its terms, the 1974 Stockholders Agreement would expire if the number of stockholders fell below three. As a result of the 1974 Stockholder

Agreement, each stockholder had an equal say in the management of MT & T. Kallop's extra share thus had no practical significance in 1974.

The stockholders made nominally different capital contributions to MT & T, but they undertook equal obligations to repay the debts of the company. The stockholders contributed only $30 per share to the capital of MT & T. Thus, Kallop and Brian contributed $3000 and $2970 respectively. With only a few thousand dollars in capital, MT & T had to borrow virtually all the money needed to acquire McAllister Brothers. The two banks that financed the acquisition held all of the stockholder certificates of MT & T as collateral. They also requested that each stockholder jointly and severally obligate himself to repay the loan obligations of the corporation. MT & T had borrowed so much money to finance the acquisition of McAllister Brothers that it had to be very well managed to survive.

MT & T struggled to meet that challenge. The company was originally run by a ten member board of directors, which included the six stockholders, plus J.P., Anthony Sr., and two others. The six stockholders soon realized the unwieldly nature of the board and transferred power to themselves. Even the six of them had problems working together. Petty fighting over relatively unimportant issues, such as the naming of ships, inhibited their ability to run the company effectively. In 1977, the two banks that had financed the acquisition called in their loans.

Due to the efforts of Bruce, MT & T kept afloat by refinancing the loans with Citibank. The arrangement with Citibank resembled MT & T's original financing. Citibank took the stock certificates of MT & T as collateral and required each stockholder to jointly and severally guarantee the loan. Because Citibank trusted Bruce, it demanded that he become CEO of the company. Bruce headed the company for a couple of years, but he disliked the constant struggle to satisfy MT & T's creditors. By 1979, Bruce had had enough. He decided to leave MT & T.

The Departure of Bruce

Bruce announced his intention to depart early in 1979, but his departure was not completed until November. MT & T repurchased his shares for 1.5 million dollars. The struggling company did not have the cash available to buy back Bruce's shares, so he remained a creditor of MT & T for many years.

Brian seized on Bruce's departure as an opportunity to equalize the shares of all the stockholders. The uneven share ownership irked Brian.

He remembered the problems his father had because his father owned less stock in McAllister Brothers than J.P. Brian did not want to end up in a similar predicament. In the words of Kallop, Brian "went on a crusade" to equalize the shares in 1979. He contacted Roger Mulvihill, an attorney from Olwine, Connelly, Chase, O'Donnell & Weyher, the law firm which represented MT & T at the time. At Brian's request, Mulvihill drafted an agreement through which Kallop would turn in one share and Neill and James would turn in their extra 49 shares. Brian circulated the draft agreement in May of 1979.

Neill and James rejected the agreement. MT & T had an option to redeem their extra 49 shares, but it would have cost the financially strapped company over $100,000. Kallop testified that MT & T could not afford to redeem Neill and James in 1979. Brian became frustrated because he could not equalize the shareholdings without the consent of Neill and James.

On May 10, 1979, Brian circulated a memo to the other stockholders regarding the stockholders' equalization agreement that Mulvihill had drafted. Brian bluntly wrote that "it seems foolish that I should portray myself as an equal owner in this corporation when in fact I am not . . . ." The memo states that the proposed stockholders' equalization agreement puts into effect the understanding that the stockholders had at the time of the acquisition--eventual equalization of shareholdings. Brian was clearly upset about James and Neill's rejection of the agreement. The memo describes their attitudes toward equalization as deplorable.

Brian had more success convincing Kallop to turn in his extra share. The May 10 memo states:

> I had reviewed the situation with William Kallop, and he is ready to execute these documents as presented. Bill's attitude is although he has no legal requirement to do so he understands that it was the basis of our agreement when we entered into the purchase of McAllister; and he is ready now or any time to put his signature behind his commitment.

Because he could not convince Neill and James to turn in their extra shares, Brian gave up on the draft stockholders' equalization agreement. He focused his equalization crusade on Kallop's 100th share. Mulvihill counseled Brian that Kallop's share was more important than the shares held by Neill and James because MT & T had an option to repurchase Neill's and James' shares. Mulvihill reminded Brian that nobody could force Kallop to redeem his 100th share.

During the summer of 1979, Mulvihill drafted a Letter Agreement for transferring a single share of Kallop's stock back to MT & T. On August 15, 1979, Kallop signed this Letter Agreement, with Brian signing it on behalf of MT & T. The Letter Agreement states:

> I believe it is in the best interest of McAllister Towing and Transportation Company, Inc. (the "Company") and will contribute to its success and future growth if I contribute one share of Common Stock of the Company owned by me to its capital. Accordingly, I hereby give, transfer and deliver to the Company one share of Common Stock as a contribution to capital. At the request of the Company, I shall execute such further documentation, if any, as may be necessary or desirable to fully effectuate such transfer.

Kallop admits that at the time he signed the Letter Agreement, he fully intended to transfer his share back to MT & T.

In the months following the execution of the Letter Agreement, nobody sought to cancel Kallop's certificate and issue him a 99 share certificate. Kallop testified that he did not believe that the Letter Agreement actually transferred the share because "further documentation" was necessary. He expected Mulvihill to take those additional steps. Mulvihill always dealt with Brian, so Kallop never attempted to follow up on completing the transfer. Brian believed that the Letter Agreement completed the transfer. He didn't follow up on the Letter Agreement with Mulvihill because he didn't think it was necessary. At trial, Brian stated that he expected Kallop, who was the corporate secretary, or Beverly Reilly, who was Bruce's assistant until his departure and then became Kallop's assistant, would have taken any further steps if they were necessary.

The parties are also unsure about what happened to the Letter Agreement after Kallop and Brian signed it. Brian believes that Kallop kept the document. Kallop testified that he did not keep the document. He believes that Brian kept the document, or that Brian sent the document to Olwine, Connelly. Mulvihill testified that Brian never sent him the document or a signed copy. No copy was found in Olwine, Connelly's files, but the completeness of those files is disputed. Brian contends that the original Letter Agreement was found in the company safe during discovery in this lawsuit. Kallop believes that Brian retained the Letter Agreement in his possession since 1979.

The history of the stock certificates is much clearer. At the time the Letter Agreement was executed, Citibank held all the stock

certificates of MT & T. If someone had sought to cancel Kallop's certificate, they would have had to retrieve it from Citibank.

Kallop testified that he had a change of heart about turning in his extra share approximately one month after signing the Letter Agreement. He said he was concerned about a possible investigation by the IRS into a tax fraud conspiracy. Kallop stated that no conspiracy existed, but he was afraid that the circumstantial evidence, especially Brian's May 10, 1979 memorandum, might cause the IRS to believe there was one. The May 10 memorandum states that the stockholders had a "secret understanding" in 1974 that they would eventually equalize the shares. Kallop said he feared that the IRS would uncover that memo in an investigation and possibly bring criminal charges against all the stockholders. Although Kallop testified that he decided not to turn back his share in late 1979, he never told anyone else of his concerns until after this lawsuit began. He never approached Brian and told him that he decided that redeeming his share might cause an IRS investigation.

In November 1979, Bruce redeemed his shares. With attorneys from Olwine, Connelly directing him, Bruce executed a stock power to effect the transfer of his certificate. Brian and Kallop were present at the closing. Kallop testified that he expected the Olwine, Connelly attorneys conducting the closing to have prepared a stock power for him. Because they had not, he believed that MT & T no longer intended to complete the Letter Agreement. After the closing, Kallop concluded that the Letter Agreement was no longer of any importance.

Six days after the closing, December 3, 1979, Citibank sent the share certificates to Olwine, Connelly. Olwine returned the certificates, including Kallop's 100 share certificate, to MT & T. Reilly, Kallop's secretary, received the certificates and placed them in the company safe at MT & T's headquarters. Reilly is the only person with a key to the safe, but she would open it at the request of any stockholder. Kallop's certificate had not been canceled.

The Departure of Neill and James

In 1980, the stock register of MT & T listed the share ownership as Kallop, 100 shares, Brian and Tony, 99 shares each, and James and Neill, 148 shares each.[1] Although James and Neill were MT & T's

[1]As a corporation conducting shipping operations in the territorial waters of the United States, MT & T had to submit MARAD affidavits attesting to the citizenship of the stockholders of the corporation. In 1980, Brian signed a MARAD affidavit that listed Kallop's ownership of 100 shares of MT & T stock. Kallop emphasized this fact at trial, but it does not

largest shareholders, they had the smallest role in the operation of the company. The 1974 Stockholders Agreement ensured that each stockholder had equal voting powers and equal compensation, but in reality James and Neill did not have equal power in 1980. In the late 1970s, Bruce demanded that James and Neill take a leave from the company to straighten out some personal problems. They returned to their positions a short time later, but they had constant disagreements with the other stockholders.

Around the same time as Bruce's departure, J.P., the father of James and Neill, sought to buy Kallop's interest in the company. This would have given Neill and James control of the company. In response, Kallop, Brian and Tony entered into an independent stockholders agreement. This new stockholders agreement prevented Kallop, Brian and Anthony from transferring their shares to James, Neill or J.P. With Kallop, Brian and Tony pitted against them and capable of outvoting them, James and Neill sought to sell their shares to an outsider. To prevent this, Reilly sent the shares to Olwine, Connelly to be legended to prevent transfers in violation of the 1974 Stockholders Agreement.

Neill and James grew more disgruntled. They filed suit against MT & T in 1982. To settle the lawsuit, MT & T bought back all of Neill and James' shares. All of the stockholders, including Brian, signed a general waiver of all claims then existing against the company or any other stockholder as part of the settlement.

Departure of Tony

After Neill and James left, Tony, Kallop and Brian were in control of the company. Tony was the President, as he had been since Bruce's departure, but his power was dissipated by the three member board of directors. Tony, Kallop and Brian were allied against Neill and James, but they came apart on their own. Kallop and Brian usually sided against Tony. Because they constituted two thirds of the board of directors and worked well together, they tried to manage the company through the board.

Tony distrusted Kallop. He was very concerned about Kallop's extra share. Jean Brown, Tony's secretary at the time, remembers that Tony frequently complained to Brian that Kallop had an extra share. Brian says that he tried to tell Tony that he took care of Kallop's extra

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strike me as very significant. Brian says he just signed a standard form that the company had to send to the government to conduct its operations. He testified that someone else prepared it and doubts he even read it. I find Brian's testimony on this point credible and persuasive.

share a few years before, but Tony did not believe him. In March of 1983, Tony sent a memo to Reilly about Kallop's extra share. Tony wrote that Kallop was supposed to turn in his share when Neill and James left. He asked Reilly to check to see if this was ever done. Reilly doesn't specifically remember responding to this memo. However, she does recall that in 1983 she was unaware of the August 1979 Letter Agreement. She told Tony that Kallop still owned 100 shares.

A few months later, Tony sought to increase his power in the company. MT & T planned to purchase a large vessel for its ferry service. In order to secure financing for the purchase, each of the stockholders had to sign another personal loan guaranty. Tony went along with the plan to purchase the new ship until just before the closing. At the closing, Tony refused to sign the loan guarantee unless Kallop and Brian accepted an amendment to the stockholders agreement. The proposed amendment to the stockholders agreement would give Tony the power to appoint one extra director and Kallop and Brian, together, to appoint one extra director. Kallop considered the proposal a stick up, but he accepted it to prevent derailing the financing of the new boat. Pursuant to the amendment (the "June 1983 Amendment"), Kallop and Brian appointed Larry Chan as their extra director. Tony appointed Bruce.

Even after he increased his power on the board, Tony was concerned about Kallop's extra share. As a precaution, Kallop took his stock certificate from the safe and brought it home. Kallop responded to Tony's efforts to even the shares in a memo to Brian. The memo, dated January 5, 1983, but actually sent on January 5, 1984, provides:

> First Beverly [Reilly] and now you have apparently been designated to serve as intermediaries regarding the issue set forth in the attached memorandum. While, in my opinion, this matter pales in comparison with our overall operating problems and difficulties, the indisputable equity of this situation is that we are supposed to be equal business partners. Accordingly, I will be glad to turn in the extra share of stock precisely and exactly equalizing our 1/3 shareholdings when, again in the interest of equity based upon equal representation for equal shares, each of the three of us once again has equal rights regarding the Board of Directors.

Brian's response to this memo is not recorded. Brian testified that he did not consider this memo a repudiation of the 1979 Letter