no distinction with respect to voting rights between purchasers in the public offering and subsequent assignees.

The individual instruments of assignment provided for in the Partnership Agreement also support Raleigh's interpretation. Although there are necessarily some differences between the assignment of interests to purchasers in the public offering, who receive their assignments from the Initial Limited Partner, and subsequent assignees, who receive their assignments from Assignee Holders, the various provisions are the same in substance.

As to purchasers in the public offering, the Partnership Agreement provides that the Initial Limited Partner shall execute "an instrument of assignment, in form and substance satisfactory to the General Partner . . . ."[14] The Assignment Agreement provides that investors who subscribe and pay for interests in the public offering shall be, bound by the Partnership Agreement and the Assignment Agreement.[15]

As to subsequent assignees, the Partnership Agreement provides that the Partnership shall not recognize any assignment "unless there shall have been filed with the Partnership a duly executed and acknowledged counterpart of the instrument such assignment and such instrument evidences the written acceptance by the assignee of all of the terms and provisions of this Agreement . . . ."[16]

Since it was formed in 1987, Arvida has provided the instruments of assignment for subsequent assignments as well as for assignments to purchasers in the public offering. The instruments of assignment refer to all assignees as Assignee Holders pursuant to the Partnership Agreement and the Assignment Agreement. They authorize the assignment of all of the assignor's rights and interests to the assignee. Since the Assignee Holders who purchase interests in the public offering have the right to vote, the instruments of assignment seem to assign that right to subsequent assignees. Arvida originally sent a similar instrument of assignment to Raleigh for signature, but immediately revised the instrument to make it more consistent with Arvida's position on the issue before the court when Raleigh filed this action.

[9] The Supreme Court has recently discussed the interpretation of contracts governing publicly sold securities.[17] The court explained that it is not appropriate to use extrinsic evidence to construe such contracts and that the issuer must bear the burden of ambiguity. If JMB intended

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[14]Partnership Agreement SECTION 7.2B.

[15]Assignment Agreement ¶ 9.

[16]Partnership Agreement SECTION 7.2C.

[17]Kaiser Alum. Corp. v. Matheson, Del.Supr., 681 A.2d 392 (1996).

to limit voting rights to purchasers in the public offering, it knew how to do so. In other limited partnerships formed at about the same time as this one, JMB clearly provided that subsequent assignees do not have the right to vote.

Drafting changes caused ambiguity in this partnership agreement. In the paragraph of the Assignment Agreement on voting, the reference to "Assignee Holders pursuant to the Public Offering" was changed to "Assignee Holders pursuant to this Agreement." The clearest statement that subsequent assignees would not have voting rights was removed from the prospectus during the drafting process. The bracketed sentence was deleted from the following paragraph:

> The rights of any transferee of an Interest who does not become a Substituted Limited Partner will be limited to his share of Partnership Profits or Losses and cash distributions as described above. The voting rights of a transferor (other than the Initial Limited Partner) who transfers an Interest will terminate with respect to such Interest upon such transfer, whether or not the transferee thereof is admitted as a Substituted Limited Partner with respect thereto. [In addition, transferees of Interests who have not been admitted as Substituted Limited Partners with respect to such Interests will not be able to vote such Interests, by proxy or otherwise.]

Prospectus, *Description of Assignee Interests, Restrictions on Transfer*, p. 60. Since these changes were made when JMB was seeking the approval of state regulators, some of whom strongly believe that subsequent assignees should have voting rights, one suspects that JMB might have deliberately made the agreements more obscure.[18]

[10-11] JMB's subjective intent might have been to limit voting rights to those Assignee Holders who purchased interests in the public offering. But we must construe the agreements according to the reasonable expectations of the investors who purchased the Additional Limited Partnership Interests and thereby subjected themselves to the terms of the agreements.[19] Even if extrinsic evidence could be considered, the issuer's communication of intent in the prospectus could, at most, serve as an aid in interpreting the language of the controlling

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[18]See Restatement, Second, Contracts § 206, *Interpretation Against the Draftsman*, cmt. a.

[19]Kaiser Alum. Corp. v. Matheson, Del.Supr., 681 A.2d 392, 399 (1996).

agreements. The prospectus could not effect the reasonable expectations of subsequent assignees who do not necessarily receive the prospectus.

After carefully considering the Partnership Agreement, the Assignment Agreement, and the instrument of assignment provided by Arvida, I conclude that a reasonable investor could have read them as providing that subsequent assignees have voting rights. I have not relied on the extrinsic evidence presented by the parties, and will therefore not discuss that evidence, except to say that it confirms that the agreements are unclear. Certain extrinsic evidence submitted by Raleigh was received subject to Arvida's motion to strike. Since I have not relied on that evidence in interpreting the agreements, I need not decide those objections.

[12-14] Raleigh argues that Managers rejected Raleigh as a Substituted Limited Partner to entrench itself as general partner, and thus breached its contractual or fiduciary duty of good faith. The statute says that an assignee of a partnership interest may become a limited partner if and to the extent that the partnership agreement so provides.[20] The Partnership Agreement provides that "[t]he right of an assignee to become a Substituted Limited Partner shall be subject to the written Consent of the General Partner, which Consent may be granted or denied in the sole and absolute discretion of the General Partner . . . ."[21] It would be inconsistent with the statutory policy of enforcing partnership agreements to review Managers' exercise of its contractual right to deny consent in its sole and absolute discretion for abuse of discretion.[22] But a discretionary right must nonetheless be exercised in good faith.[23]

Although Managers was doubtless threatened by Raleigh's declared intention to replace Managers as general partner, it does not follow that Managers acted in bad faith. Managers could reasonably conclude that Raleigh would not be a suitable partner in such circumstances. Moreover, Managers had independent reasons to conclude that Raleigh would not be a suitable partner. Raleigh has not proven that its rejection as a Substituted Limited Partner was in bad faith.

Counsel should submit an agreed form of order or, if you cannot agree, your respective proposed orders.

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[20] 6 Del. C. § 17-704(a)(1).

[21] Partnership Agreement SECTION 7.2D.

[22] Cf. In re Marriott Hotel Properties II L.P. Unitholders Litigation, Del.Ch., Consol. C.A. No. 14961, Allen, C. (June 12, 1996), Mem. Op. at 14.

[23] Cf. Gilbert v. El Paso Co., Del.Supr., 575 A.2d 1131, 1143 (1990).

IN RE BALLY'S GRAND DERIVATIVE LITIGATION

No. 14,644 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

June 4, 1997

The plaintiffs filed this shareholder action challenging: (1) an acquisition by the defendant of the stock of a corporate subsidiary, (2) the payment of consulting fees, and (3) a management agreement between the corporation and a subsidiary. The defendants filed a motion to dismiss the latter two counts. For count II, defendants asserted that the derivative claims should be dismissed for failure to make a pre-litigation demand. Defendants further asserted that the improper delegation claim in count III should be dismissed for failure to state a claim pursuant to Court of Chancery Rule 12(b)(6), because the plaintiffs have failed to plead facts that, if true, would establish an improper delegation, and because the management agreement was adopted pursuant to a Bankruptcy Court order, thereby barring plaintiffs from challenging its validity. Count I was not at issue in this motion.

The court of chancery, per Vice-Chancellor Jacobs, denied the defendant's motion to dismiss counts II and III of the complaint, holding that the court could not decide either issue at that time. With regard to count II, the court directed the plaintiffs to plead, or the parties to otherwise stipulate to, the relevant facts concerning the identity and dates of service of the corporation's board at the time of the alleged improper transactions and the time this suit was filed. With regard to count III, the court held that it was unable to conclude that no reasonably inferable scenario existed under which plaintiffs might be entitled to relief. The court further held that because there were several unresolved questions regarding the bankruptcy issue, the parties were granted leave to submit further briefs consistent with this opinion.

1. Corporations ⚷ 206(4), 320(5)

The proper time to measure demand futility is as of the date the complaint is filed. DEL. CH. CT. R. 23.1.

2. Corporations ⟹ 206(4)

Demand will be excused if the derivative complaint pleads particularized facts creating a reasonable doubt that directors are disinterested and independent or the challenged transaction was otherwise the product of a valid business judgment.

3. Corporations ⟹ 206(4)

Where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced, where the subject of the derivative suit is not a business decision of the board, or where the decision being challenged was made by the board of a different corporation, demand is excused only where particularized factual allegations create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.

4. Corporations ⟹ 206(4)

A court cannot decide a demand futility issue at the motion to dismiss stage where it is unclear whether the directors who approved the challenged transactions were also board members at the time the suit was filed. DEL. CH. CT. R. 23.1.

5. Corporations ⟹ 206(2), 320(6)

Demand futility does not apply to direct or nonderivative claims.

6. Corporations ⟹ 305, 310(1)

The decision by directors to delegate responsibility to perform a particular task or function is not an abdication of directorial authority merely because it limits a board's freedom of future action; rather, these decisions are normally regarded as exercises of business judgment.

7. Corporations ⟹ 305, 310(1)

An agreement, wherein the directors delegate duties which lie at the heart of the management of the corporation or which have the effect

of removing from directors in a very substantial way their duty to use their own best judgment on management matters, will not be upheld.

8. Corporations ⟹ 310(1)

The board's duty to manage or supervise the management of the business and affairs of a corporation ordinarily entails the duty to establish or approve the long-term strategic, financial and organizational goals of the corporation; to approve formal or informal plans for the achievement of these goals; to monitor corporate performance; and to act, when in the good faith, informed judgment of the board it is appropriate to act.

9. Corporations ⟹ 305, 310

Whether or not a delegation of a particular responsibility constitutes an abdication of directorial duty is necessarily a fact specific question, especially where the directors do not delegate a formal duty, but instead cede to others control over a particular segment of the corporation's business operations.

10. Corporations ⟹ 305, 310(1)

Where the directors' ability to terminate a delegation arrangement is unfettered, and the delegation may be terminated at will, a broader delegation of duties will be upheld; however, the more restricted the directors' ability to terminate, the more narrow the delegation must be to sustain a finding that the board has not abdicated its directorial duties.

11. Pleading ⟹ 34(1)
Pretrial Procedure ⟹ 624

Where a court cannot conclude, based on what has been pleaded, that there is no state of facts under which a plaintiff would be entitled to relief, that court may not dismiss a claim for lack of legal sufficiency although a defendant's arguments may ultimately be found valid. DEL. CH. CT. R. 12(b)(6).

12. Corporations ⟹ 305, 310(1)

In determining whether a cognizable claim of improper delegation of directorial duty exists, where the supervision of a corporation's only

material business appears to be at the heart of the management of the corporation and is essential to the strategy and affairs of the corporation, and where the corporation's directors have abdicated their ability to supervise that business, that abdication cannot be trivialized by speculating that in the future the corporation may expand their business, thereby making their current business insignificant.

13. Corporations ⚷ 305, 310(1)
Pleading ⚷ 34(1)
Pretrial Procedure ⚷ 624

A complaint states a cognizable claim of an improper delegation of directorial duty where directors of a corporation, pursuant to a management agreement, have no power to initiate any action regarding daily operation of its subsidiary and were obligated to defend any exercise of its budgetary approval power as reasonable.

14. Corporations ⚷ 316(1)

A court will be unable to conclude as a matter of law that the board retained sufficient termination powers to validate a management agreement where the contractual provisions provide a vague standard under which the board would be lawfully entitled to exercise its termination powers.

15. Corporations ⚷ 305, 310(1)
Pleading ⚷ 34(1)
Pretrial Procedure ⚷ 624

An improper delegation claim will not be dismissed where a court cannot conclude that no reasonably inferable scenario exists under which plaintiffs might be entitled to relief. DEL. CH. CT. R. 12(b)(6).

16. Bankruptcy ⚷ 3568(2)
Judgment ⚷ 471, 650

A Bankruptcy Court's order of confirmation is treated as a final judgment; therefore, a party bound by that judgment cannot attack that judgment in a collateral proceeding where the validity of a corporate management agreement is at issue.

17. Judgment ⟹ 540, 634

Generally, claim preclusion, which is one of two concepts encompassed in the doctrine of *res judicata*, occurs when three conditions are satisfied: (1) the prior judgment was final and on the merits, and rendered by a court of competent jurisdiction in accordance with the requirements of due process; (2) the parties are identical, or in privity, in the two actions; and (3) the claims in the second matter are based upon the same cause of action involved in the earlier proceeding.

Robert D. Goldberg, Esquire, of Biggs and Battaglia, Wilmington, Delaware; and Sidney B. Silverman, Esquire, and John F. Harnes, Esquire, of Silverman, Harnes & Harnes, New York, New York, of counsel, for plaintiffs.

A. Gilchrist Sparks, III, Esquire, and Alan J. Stone, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants Jay Burnham, Jack L. MacDonald, and Nicholas H. Politan, Jr.

Brett D. Fallon, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware, for nominal defendants Bally's Grand, Inc.

Stephen E. Jenkins, Esquire, and Richard D. Heins, Esquire, of Ashby & Geddes, Wilmington, Delaware; and Dennis J. Block, Esquire, Stephen A. Radin, Esquire, and Jeffrey R. Stern, Esquire, of Weil, Gotshal & Manges, New York, New York, of counsel, for defendants Bally Entertainment Corporation, Arthur M. Goldberg, J. Kenneth Looloian, and Darrell A. Luery.

JACOBS, *Vice-Chancellor*

Pending decision is the defendants' motion to dismiss. The defendants are Bally Entertainment Corporation ("Entertainment"), Arthur M. Goldberg ("Goldberg"), Jay Burnham, J. Kenneth Looloian, Darrell A. Luery, Jack L. McDonald, Nicholas H. Politan, Jr., Bally's Grand, Inc. ("Grand"). Their motion seeks the dismissal of Counts II and III of the Second Amended and Supplemental Complaint (the "Complaint"), wherein the plaintiffs, who are Grand shareholders, challenge the validity of (i) certain transactions involving Grand, and (ii) a management agreement between Grand and an Entertainment subsidiary. This is the Opinion of the Court on the motion to dismiss.

I. FACTS[1]

The plaintiff, Alan Kahn, has been a shareholder of Grand since March 1995. Plaintiff David Shaev became a shareholder of Grand shortly after Mr. Kahn. (Pl. Ans. Br., at 3 n.4).

Grand is a Delaware corporation with its principal place of business in Las Vegas, Nevada. It owns and operates a casino hotel resort located in Las Vegas, Nevada, known as Bally's Las Vegas (the "casino"). Grand also owns other property in Las Vegas, but the casino is Grand's only material business.

Entertainment is a Delaware corporation with its principal place of business in Chicago, Illinois. Through certain subsidiaries, Entertainment operates casinos, casino hotels, and a national chain of health and fitness centers. As a holding company that conducts its business through operating subsidiaries, Entertainment meets its operating cash needs through cash distributions from its subsidiaries.

In 1991, Grand defaulted on its debt, and was placed into Chapter 11 reorganization in the United States Bankruptcy Court for the District of New Jersey. As part of that bankruptcy reorganization, Entertainment was divested of its stock ownership of Grand. Grand emerged from bankruptcy in August 1993. Thereafter, Entertainment began purchasing Grand stock. During 1994 and the first six months of 1995, Grand also made significant open market purchases of its own stock, acquiring over 2 million shares at a cost of over $20 million. As a result of those purchases, Entertainment ended up owning approximately 80% of the outstanding shares of Grand as of June 30, 1995.

On August 20, 1993, pursuant to an order of the Bankruptcy Court, Grand and Bally's Grand Management Co., Inc., a wholly-owned Entertainment subsidiary ("Bally Management"), entered into a management agreement (the "Management Agreement"). That Agreement requires Grand to pay Bally Management $3 million per year for providing casino management and other services. The Management Agreement gives Bally Management "uninterrupted control of and responsibility for the operation" of the casino, and directs that "Grand will not interfere or involve itself with [its] day-to-day operation."[2]

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[1]The facts are derived from the complaint, except where otherwise noted.

[2]Although integral to the complaint, the Management Agreement is not explicitly attached to that pleading or incorporated into it by reference. The defendants contend that this Court may take judicial notice of certain sections of the Management Agreement, because it is a publicly filed document. Because the plaintiffs have not contested the defendants' reliance upon the Management Agreement as filed with the Securities and Exchange Commission, the Court regards that Agreement as a "formal, uncontested matter" of which it may take judicial

(Jan. 24, 1994 Grand Form S-1 (hereinafter "Agmt.") at ¶ 2(b)). Bally Management is required to furnish Grand an annual budget detailing all expected costs and expenses. Grand's board of directors may disapprove that budget, but the board's approval may not be unreasonably withheld or delayed. Bally Management is also authorized to incur obligations on behalf of Grand, without the approval of Grand's board, up to $1 million above the approved budgeted expense level.

The Management Agreement is renewed automatically each year, and has a ten-year term. Bally Management's right to operate the casino free of interference is, however, subject "to exercise of the fiduciary duties under applicable law of Grand's Board of Directors." (Agmt. ¶ 2(b)). Grand may terminate the Management Agreement "[i]f [Grand's] Board of Directors . . . determines, based upon the written opinion of counsel, that in the exercise of the Board's fiduciary duties under applicable law it is necessary and in the best interests of Grand to terminate [the] Agreement." (Agmt. ¶ 8(b)(iv)(C)).

Finally, the Management Agreement authorizes Bally Management to determine who will receive stock option awards under a stock option plan covering Grand's directors and officers. All 600,000 shares authorized by the option plan were issued in 1993. 280,000 shares were issued to Goldberg, Grand's Chairman and Chief Executive Officer, and the remaining 320,000 shares were issued to other Grand officers. Most of the recipients of these options sold their Grand stock either to Entertainment or to Grand, shortly after their stock became transferable under the option plan.

On May 10, 1995, Grand made a $250,000 payment to Arveron Investments, L.P., a partnership whose managing partner is Goldberg, Grand's chief executive officer. That payment represented compensation for consulting work performed by Arveron in connection with Grand's purchase of securities, including, primarily, Grand's own stock.

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The Complaint contains three counts. Count I challenges an August 1996 acquisition by Entertainment of the stock of a Grand subsidiary and is not at issue in this motion. Count II alleges that the payment of a consulting fee to Arveron constituted waste and a gift of corporate assets, unfair dealing by Goldberg, and a breach of Goldberg's fiduciary duty to Grand. As to that Count, plaintiffs seek an accounting

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notice. In re Santa Fe Pac. Corp. Shareholder Lit., Del. Supr., 669 A.2d 59, 70 (1995); see also 7547 Partners v. Beck, Del. Supr., 682 A.2d 160, 163 (1996).

with respect to the consulting fee, and as to all stock purchases that occurred after March 1995.[3] Finally, in Count III, plaintiffs challenge the Management Agreement itself as an improper delegation by Grand's directors of their duty to manage the corporation. The plaintiffs seek a declaration that that Agreement is unlawful.

II. THE PARTIES' CONTENTIONS

The defendants argue that all of the derivative claims in Count II should be dismissed for failure to make a pre-litigation demand, because the plaintiffs have failed to allege particularized facts that raise a reasonable doubt as to the directors' disinterest or independence or as to whether the directors exercised proper business judgment in approving the challenged transaction.

The plaintiffs respond that they have alleged other earlier self-dealing transactions, which the board approved, that create reason to doubt the directors' independence. Plaintiffs also argue that the pleaded facts are sufficient to demonstrate that the challenged transactions were not the product of the directors' business judgment, because i) the board's decisions were made pursuant to the legally invalid Management Agreement; and ii) even if the Management Agreement were legally valid, the directors could not fulfill their fiduciary duties by delegating those duties to officers who were financially interested in the transactions.

The defendants next argue that the "improper delegation" claim in Count III should be dismissed for failure to state a claim pursuant to Court of Chancery Rule 12(b)(6). They contend that (i) plaintiffs have failed to plead facts that, if true, would establish an improper delegation, and (ii) because the Management Agreement was adopted pursuant to a Bankruptcy Court order, the plaintiffs are barred from challenging its validity. In response, the plaintiffs argue that they have sufficiently pleaded that the board improperly delegated its duties, and that this Court's power to invalidate the Management Agreement is neither limited nor abridged by the Bankruptcy Court order.

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[3]The plaintiffs concede that they have no standing to challenge any transactions that occurred before March, 1995, and that any alleged facts concerning transactions that occurred before that date have relevance only as background. (Pl. Ans. Br. at 3).

III. DEMAND EXCUSAL

[1-3] I first address the defendants' argument that Count II should be dismissed for failure to satisfy the demand requirement of Chancery Court Rule 23. 1. The proper time to measure demand futility is as of the date the complaint is filed.[4] Depending on the circumstances, demand futility must be determined under the standards articulated in Aronson v. Lewis[5] or Rales v. Blasband.[6] Under the two-pronged Aronson test, demand will be excused if the derivative complaint pleads particularized facts creating a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[7] As the Supreme Court stated in Rales v. Blasband, however, there are three circumstances in which the Aronson standard will not be applied: "(1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where . . . the decision being challenged was made by the board of a different corporation."[8] In those situations, demand is excused only where "particularized factual allegations . . . create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[9] That is, in those three circumstances described in Rales, the Court will apply only the first ("disinterest" and "independence") prong of Aronson.

[4] The difficulty with the present complaint is that it does not identify which persons constituted Grand's board of directors at the time this action was filed.[10] Accordingly, the Court cannot determine which

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[4]Harris v. Carter, Del. Ch. 582 A.2d 222, 228 (1990); see also Rales v. Blasband, 634 A.2d 927, 934 (1993); Pogostin v. Rice, Del. Supr., 480 A.2d 619, 624 (1984); Aronson v. Lewis, Del. Supr., 473 A.2d 805, 809-10 (1984); Seminaris v. Landa, Del. Ch., 662 A.2d 1350, 1354 (1995).

[5]Del. Supr., 473 A.2d 805 (1984).

[6]Del. Supr., 634 A.2d 927 (1993).

[7]Aronson, 473 A.2d at 814.

[8]Rales, 634 A.2d at 934.

[9]Id.

[10]The action was filed on October 27, 1995. Three of the named defendant directors, J. Kenneth Looloian, Darrell A. Luery and Nicholas H. Politan, Jr., are identified as having been Grand directors since October 30, 1995. A fourth director, Jack L. McDonald, is identified as having served as a director since 1993. No date is given from which defendant Goldberg began serving as a director. Defendant Jay Burnham is not explicitly identified as a director. No other facts concerning the pre-October, 1995 composition of Grand's board are

standard--Aronson or Rales--should apply, because it is unclear whether the directors who approved the challenged transactions were also board members at the time this suit was filed. Nor may the Court rely upon the plaintiffs' assertion that the board's acquiescence in earlier self-dealing transactions demonstrates a lack of board independence, because it is unclear whether the board that approved those transactions was the same board upon which a demand would have been made.

For these reasons the Court cannot decide the demand futility issue at this time. The Court directs the plaintiffs to plead, or the parties otherwise to stipulate to, the relevant facts concerning the identity and dates of service of Grand's board at the time of the alleged improper transactions and the time this suit was filed.[11]

IV. THE MANAGEMENT AGREEMENT CLAIM

[5] Unlike Count II, Count III (which challenges the Management Agreement) is a direct, not a derivative, claim. Therefore, as to this Count demand futility is not at issue. The defendants have moved to dismiss this Count under Chancery Court Rule 12(b)(6), on the ground that the allegations in the Complaint are insufficient to sustain a claim of improper delegation of board powers. In addition, the defendants argue that because the Management Agreement was adopted pursuant to an order of a Bankruptcy Court, this Court may not entertain a challenge to its validity. These claims are now addressed.

A. The Legal Sufficiency of the Claim

[6] The decision to delegate responsibility to perform a particular task or function is "not an abdication of directorial authority merely because [it] limit[s] a board's freedom of future action."[12] Rather, decisions by directors to delegate responsibilities to others are normally regarded as exercises of business judgment.[13]

[7] But, our courts will not uphold an agreement wherein the directors "delegate duties which lie 'at the heart of the management of the corporation'" or which "have the effect of removing from directors in a very substantial way their duty to use their own best judgment on

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alleged.

[11]Should the plaintiffs fail to respond to this direction in timely fashion, the Court will entertain a renewed motion to dismiss.

[12]Grimes v. Donald, 673 A.2d 1207, 1214 (1996).

[13]Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 943 (1985).

management matters."[14] The board must retain "the ultimate freedom to direct the strategy and affairs of the Company," for the delegation decision to be upheld.[15]

[8] The board's duty to manage or supervise the management of the business and affairs of a corporation ordinarily

> entails the duty to establish or approve the long-term strategic, financial and organizational goals of the corporation; to approve formal or informal plans for the achievement of these goals; to monitor corporate performance; and to act, when in the good faith, informed judgment of the board it is appropriate to act.[16]

[9] Whether or not a delegation of a particular responsibility constitutes an abdication of directorial duty is necessarily a fact specific question.[17] That is especially true where the directors do not delegate a formal duty, such as the duty to approve a sale of the assets of the corporation,[18] but instead cede to others control over a particular segment of the corporation's business operations.

[10] Critical to the analysis of the delegation issue is the directors' ability to terminate the delegation arrangement. Where that ability is unfettered and the delegation may be terminated at will, a broader delegation of duties will be upheld, because at any point in the relationship the directors may resume their predelegation managerial role.[19] On the other hand, the more restricted the directors' ability to

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[14]Grimes v. Donald, Del. Supr., 673 A.2d at 1214 (quoting Chapin v. Benwood, Del. Ch., 402 A.2d 1205, 1210 (1979) aff'd sub nom Harrison v. Chapin, Del. Supr., 415 A.2d 1068 (1980) and Abercrombie v. Davies, Del. Ch., 123 A.2d 893, 899 (1956), rev'd on other grounds, Del. Supr., 130 A.2d 338 (1957)); see also Canal Capital Corp v. French, Del Ch., C.A. No. 11,764. Mem. Op. at 4, Berger, V.C. (July 2, 1992) (Directors may not enter into arrangements that "substantially encroach on the duty of directors to exercise independent judgment" (quoting Abercrombie, 123 A.2d at 900)).

[15]Grimes v. Donald, 673 A.2d at 1215.

[16]Grimes v. Donald, Del. Ch., C.A. No. 13358, Allen C. (Jan. 11, 1995), Mem. Op. at 1, aff'd Del. Supr., 673 A.2d 1207 (1996); see also Cahall v. Lofland, Del. Ch., 114 A. 224, 229 (1921) ("the details of the business [may be] delegated to inferior officers, agents and employees").

[17]See Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 943 (1985) ("it is important to note why the delegation was made, and what task was actually delegated").

[18]See Clarke Memorial College v. Monaghan Land Co., Del. Ch., 257 A.2d 234 (1969).

[19]See Canal Capital Corporation v. French, Del. Ch., C.A. No. 11764, Berger, V.C. (July 2, 1992).

terminate, the more narrow the delegation must be to sustain a finding that the board has not abdicated its directorial duties.

The defendants argue that the Management Agreement did not constitute an abdication of directorial duties because the duties delegated to Bally Management were sufficiently narrow in scope. Specifically, the defendants argue that: 1) although the Management Agreement delegates the management of the casino, Grand's directors retain sufficient power to manage the other aspects of Grand's business; 2) Grand's directors retain sufficient powers to supervise Bally Management's management of the casino, because they are entitled to reject proposed budgets and a decision to incur debt exceeding $1 million above approved budget levels; and 3) the Grand directors retain sufficient power to cancel the contract when their fiduciary duties to Grand so require.

[11] Although these arguments may ultimately be found valid, the Court cannot conclude, based on what has been pleaded, that there is no state of facts under which the plaintiffs would be entitled to relief.[20] My reasons for that conclusion follow.

[12] The defendants first argue that the board has not delegated excessive powers, because it has ceded only control over the management of the casino but remains free to make unfettered decisions to purchase other casinos, enter new lines of business, or amend Grand's governing instruments. At present, however, the casino is Grand's only material business. Therefore, the supervision of that operation would appear to be "at the heart of the management of the corporation" and essential to "the strategy and affairs of the Company." If Grand's directors have abdicated their ability to supervise the casino, that abdication cannot be trivialized by speculating that at some future date the corporation might decide to expand the size and/or scope of its business such that the casino would become relatively insignificant.

The defendants next argue that the Management Agreement does not unduly constrict the powers of Grand's board of directors to supervise the management of the casino. But, the Management Agreement grants Bally Management "uninterrupted control of and responsibility for the operation" of the casino. Agmt. ¶ 2(b). Grand has delegated the responsibility for the day-to-day operation of the casino, including "room rates, food and beverage menu prices, charges to guests for other services performed by [Bally Management], the terms of admittance to the [casino] for rooms, gaming, commercial purposes and entertainment, entertainment policies and specific entertainment obligations, the labor

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[20] Delaware State Troopers Lodge No. 6 v. O'Rourke, Del. Ch., 403 A.2d 1109 (1979); Weinberger v. UOP, Inc., Del. Ch., 409 A.2d 1262 (1979).

policies of the [casino] and the type and character of publicity and promotion." (Agmt. ¶ 2(b)). Those delegated powers encompass the authority to hire all casino and hotel personnel (Agmt. ¶ 2(c)(ii)(A)), and to enter into any agreements deemed necessary to operate the casino. (Agmt. ¶ 2(c)(xii)).

Grand does retain certain powers. Its board must approve any budget that Bally Management proposes, but the board's approval may not be unreasonably withheld. Board approval is also required before the casino can incur additional debt exceeding $1 million above the current budgeted levels, but that approval may also not be unreasonably withheld. [13] The Court concludes that the Complaint states a cognizable claim that the Grand directors' acceptance of those restrictions constituted an improper delegation of directorial duty. Under the Management Agreement the directors have no power to initiate any action regarding the casino. Moreover, the board may be obligated to defend any given exercise of its approval power as reasonable. On this record, the Court is unable to conclude that no factual circumstances could exist where such limitations on the board's powers would amount to an improper delegation. Whether that has (or has not) occurred in this case must await a further development of the record.

Finally, the defendants argue that the Management Agreement is valid because (i) the Grand directors' agreement not to interfere in the operation of the casino is "subject . . . to exercise of the fiduciary duties under applicable law of Grand's Board of Directors" (Agmt. ¶ 2(b)), and (ii) the Agreement may be terminated "[i]f the Board of Directors of Grand determines, based upon the written opinion of counsel, that in the exercise of the Board's fiduciary duties under applicable law it is necessary and in the best interests of Grand to terminate this Agreement." (Agmt. ¶ 8(b)(iv)(C)).

Had Grand's board of directors retained the unfettered power to cancel the Management Agreement, the Court would agree with the argument that the contract is valid.[21] The issue is whether the contractual restrictions upon Grand's ability to cancel the Management Agreement preclude a finding that the Management Agreement is valid.

[14] In this Court's opinion, those contractual provisions are not so clear as to compel the conclusion that the Management Agreement is valid as a matter of law. The directors' power to terminate the Agreement is not unfettered. To exercise its power of termination, the board must first

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[21]See Canal Capital Corporation v. French, Del. Ch., C.A. No. 11764, Berger, V.C. (July 2, 1992) (upholding management contract because the corporation's board retained freedom to cancel the contract at any time).

obtain an opinion of counsel that a failure to terminate the contract would violate the board's fiduciary duties to Grand. Given the myriad factual circumstances that might arise, and the inherent uncertainty of what counsel might say the board's fiduciary obligations require, that standard is highly vague. Under that standard, it is impossible for one to predict ex ante, in what circumstances (if ever) the board would be lawfully entitled to exercise its termination power. Without further factual explication of how the parties intended for these provisions to operate, the Court is unable to conclude as a matter of law that the board retained sufficient termination powers to validate the Management Agreement.
[15] In short, because the Court cannot conclude that no reasonably inferable scenario exists under which plaintiffs might be entitled to relief, the improper delegation claim will not be dismissed.

B. The Bankruptcy Defense

Finally, the defendants argue that this Court may not invalidate the Management Agreement in all events, because that Agreement was adopted pursuant to a reorganization plan embodied in an order approved by the United States Bankruptcy Court.[22] The defendants argue that the plaintiffs may not now bring this state court action to invalidate the Management Agreement because 1) the action constitutes an improper collateral attack upon the Bankruptcy Court order; and 2) the doctrine of res judicata precludes a challenge to the Agreement. Without clear authority based upon fully developed arguments, this Court hesitates to conclude as a matter of law that the plaintiffs, who were not parties to or represented at the confirmation of the reorganization plan, are now barred from challenging in this Court an agreement that was approved as part of that plan. Because the parties have provided only skeletal arguments addressing these issues, the Court reserves decision on this question pending further (and adequate) supplemental briefing by the parties.[23]
[16] A Bankruptcy Court's order of confirmation is treated as a final judgment.[24] If the Bankruptcy Court had jurisdiction to render that

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[22]See Sept. 15, 1992 Order Confirming Fifth Amended Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code for Bally's Grand, Inc. at 18, ¶ 31; Plan, ¶¶ 7.12, 7.13 and Cl-C19. The defendants assert that this Court may take notice of that order as a formal, uncontested and objectively verifiable fact, under the principles outlined in Note 2, at 3. Because the Court defers decision on this issue, it need not presently decide whether it may take notice of the Bankruptcy Court Order.

[23]The defendants' argument consisted initially of one paragraph, to which the plaintiffs' responded with a footnote.

[24]In re Varat Enterprises, Inc., 81 F.3d 1310, 1315 (4th Cir. 1996).

judgment, a party bound by that judgment cannot attack that judgment in a collateral proceeding.[25] The defendants assert that this action amounts to a collateral attack upon the Bankruptcy Court's order, because it asks this Court to invalidate an agreement that the Bankruptcy Court has approved. To that contention, the plaintiffs offer no response.

The key question is whether this action constitutes an impermissible collateral attack upon the Bankruptcy Court's order. Does a Bankruptcy Court's order approving a reorganization plan that encompasses certain contracts implicitly determine that those contracts are valid in all respects under applicable state law? Does the invalidation of one contract in an extensive reorganization plan deny the force and effect of the Bankruptcy Court's order approving that plan? The briefs do not even raise, let alone adequately address, these questions.

The Court is also unable to decide the res judicata issue at this time. That doctrine encompasses two concepts: claim preclusion and issue preclusion. The defendants argue that both concepts are applicable in this case and bar the plaintiffs from asserting their claim.

[17] Generally, claim preclusion occurs when three conditions are satisfied:

> 1) the prior judgment was final and on the merits, and rendered by a court of competent jurisdiction in accordance with the requirements of due process; 2) the parties are identical, or in privity, in the two actions; and 3) the claims in the second matter are based upon the same cause of action involved in the earlier proceeding.[26]

The plaintiffs argue that claim preclusion does not bar their attack upon the Management Agreement, because they were not parties to the bankruptcy proceeding. The defendants respond that all creditors and shareholders of the debtor corporation are bound by the terms of a confirmed plan of corporate reorganization.[27] Because there are unanswered questions, the Court is unable to decide this issue. Does a Bankruptcy Court order approving a reorganization plan constitute a final judgment on the merits that all the contracts contained therein are valid

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[25] Thompson v. D'Angelo, Del. Supr., 320 A.2d 729, 734 (1974); see also Cavalier Oil Corp. v. Harnett, Del. Supr., 564 A.2d 1137, 1141 (1989).

[26] In re Varat Enterprises, Inc., 81 F.3d 1310, 1315 (4th Cir. 1996).

[27] 11 U.S.C. § 1141(a). Furthermore, the defendants point to a federal district court's conclusion in a non-bankruptcy case that for res judicata purposes, shareholders are in privity with the corporation. Garry v. Geils, 874 F.Supp. 195, 198 (N.D.Ill. 1995), aff'd on other grounds, 7th Cir., 82 F.3d 1362 (1996).

under applicable state law? Are subsequent purchasers of stock deemed to be in privity with the parties to the reorganization, even where those parties were creditors before the approval of the reorganization plan? Is this proceeding based upon the same cause of action as the bankruptcy proceeding? Those questions will also need to be addressed in supplemental briefing.

* * * * *

The summary arguments advanced by the parties have provided little guidance to the Court. Therefore, the Court denies the motion to dismiss, with leave to renew it after the parties have submitted further briefs consistent with this Opinion.

IT IS SO ORDERED.

BOYER v. WILMINGTON MATERIALS, INC.

No. 12,549

Court of Chancery of the State of Delaware, New Castle

June 27, 1997

Plaintiff, a director and shareholder, filed motions for summary judgment. Plaintiff's complaint arising from the sale of corporation's assets asserted claims of breach of fiduciary duties and violations of a shareholders' agreement against other directors (the individual defendants), breach of the shareholders' agreement against corporation, and a claim of tortious interference with contract against the corporation who acquired the assets. Defendants filed cross motions for summary judgment on all claims made by plaintiff, except the breach of fiduciary duty claims.

The court of chancery, per Chancellor Allen, denied summary judgment on the breach of fiduciary claims because the entire fairness of the transaction required additional evidence. The court granted summary judgment for the individual defendants on the violation of the

shareholders' agreement claim involving the directors' failure to purchase all of their hot mix requirements from the corporation because the shareholders' agreement was subject to the legitimate exercise of corporate power by the board. The court denied summary judgment on the other violation of the shareholders' agreement regarding the corporation's failure to pay plaintiff dividends and commissions to which he is entitled because there were issues of material fact in dispute regarding how much money the corporation owed plaintiff in the form of dividends and commissions, and upon what conditions that money must be repaid. Finally, the court granted defendant's motion for summary judgment on plaintiff's tortious interference with contract claim because there was no evidence presented to establish the elements of such a claim.

1. Corporations ⟹ 182.4

Where the sale of corporate assets to another corporation is an interested transaction, it is reviewed under the entire fairness standard.

2. Corporations ⟹ 310(2)

The entire fairness test requires the interested party to establish that the transaction was the product of fair dealing and fair price.

3. Corporations ⟹ 182.4(2)
Judgment ⟹ 181(2)

Where further testimony is required in determining what valuation formula should have been used to calculate the fair value of the assets, summary judgment is denied.

4. Corporations ⟹ 182.4(2)
Judgment ⟹ 181(2)

Summary judgment will be denied on plaintiff's claim that the corporation did not obtain a fair price in a transaction due to defendants' failure to disclose a holdback where there is a genuine issue of material fact in dispute concerning the effect of the failure to disclose the existence of the holdback.

5. Judgment ⚷ 181(2)

Summary judgment will only be granted where there exists no genuine issue of material fact in dispute and the moving party is entitled to judgment as a matter of law. DEL. CH. CT. R. 56(c).

6. Judgment ⚷ 185(2)

In a summary judgment proceeding, the burden of proof to establish the absence of any material factual dispute rests with the moving party and any doubt will be resolved against that party.

7. Judgment ⚷ 185(2)

In a summary judgment proceeding, the court will view the evidence in the light most favorable to the nonmoving party.

8. Corporations ⚷ 182.4
Judgment ⚷ 181(2)

Summary judgment will be denied where the entire fairness of the transaction requires additional evidence before a responsible judicial judgment can be reached.

9. Corporations ⚷ 310(1)

Directors do not breach their duty of attention where, through no fault of their own, relevant information is withheld from them by others.

10. Corporations ⚷ 182.4, 298

A board meeting is not required to last a minimum amount of time to be sufficient for the directors to fully consider a proposal such as a sale of assets.

11. Corporations ⚷ 182.4, 310(1)

Where the sale of assets was an interested director transaction, the individual defendants must establish that it was entirely fair to the disinterested parties and to the corporation.

12. Corporations ⟹ 310(1)

Entire fairness has two components: fair price and fair dealing.

13. Corporations ⟹ 310(1)

Fair dealing relates to when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.

14. Corporations ⟹ 182.4(2)

Fair price focuses on the financial conditions of the sale and seeks to determine whether the price paid for the assets reflected their true value.

15. Corporations ⟹ 182.4(1)

There is no requirement that even in an interested transaction an independent committee of directors must negotiate the price of a sale of assets nor is it required that the sale be approved by a majority of the minority shareholders.

16. Corporations ⟹ 182.4(1), 298(1)

Where interested directors excluded other directors from a meeting discussing a proposal for the sale of the assets, this fact may, upon further testimony concerning the interested directors' motives, provide some evidence of unfair dealing, but it does not, without more, constitute a breach of fair dealing.

17. Corporations ⟹ 182.4(1), 189(12)

Disinterested director's claim that the sale of the corporation's assets was deliberately timed to take advantage of market conditions which resulted in a low valuation of the corporation's assets, thereby resulting in unfair dealing, cannot be adjudicated at a summary judgment stage where disinterested director does not provide evidence to support this contention.

18. Corporations ⟹ 310(1)

In a self-dealing transaction, interested directors have a duty to disclose all material facts concerning the transaction to the other board members.

19. Corporations ⟹ 297

Where the legitimate exercise of corporate power by the board of directors makes it impossible for the shareholders to comply with provisions in the shareholders' agreement, the shareholders will not be held liable for noncompliance.

20. Corporations ⟹ 297

Absent an expressed limitation, the shareholders' agreement is to be subject to the power of the board of directors to exercise its authority to govern the corporation.

21. Corporations ⟹ 297

An implicit obligation in a shareholders' agreement, that the board is obligated to keep the corporation operating after the sale of its assets, cannot take precedence over legitimate exercises of corporate power by the board.

22. Torts ⟹ 12

The elements of tortious interference with contract claim are: (1) there must be a contract; (2) about which the defendant had knowledge; (3) defendant must commit an intentional act that is a significant factor in causing a breach of that contract; (4) defendant must act without justification; and (5) the breach must cause injury.

23. Torts ⟹ 12

A tortious interference claim will fail where the shareholders' agreement was not breached, so there is no breach of contract upon which to ground the tortious interference claim, and where there was no evidence presented that defendant committed an intentional act that caused the directors to breach the shareholders' agreement.

Wayne N. Elliott, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiff R. Arnold Boyer.

Joanne Shalk, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware, for defendant Wilmington Materials, Inc.

Daniel B. Rath, Esquire, of Duane, Morris & Heckscher, Wilmington, Delaware, for defendants Delaware Aggregate, Inc., Frank Corrado, and Joseph Corrado.

Jeffrey S. Goddess, Esquire, of Rosenthal, Monhait, Gross & Goddess, Wilmington, Delaware, for defendants Leonard Iacono and Verino Pettinaro.

ALLEN, *Chancellor*

Pending are cross-motions for summary judgment. This suit arises from the sale of substantially all of the assets of Wilmington Materials, Inc. ("WMI") to Delaware Aggregates, Inc. ("DAI"), a corporation in which several of the directors of WMI have an interest. The suit is brought individually and derivatively on behalf of WMI by Arnold Boyer ("Boyer" or "Plaintiff"), a director and shareholder of WMI, against other directors (the "Individual Defendants") of WMI and against the company itself, and DAI (collectively, "Defendants"). The complaint asserts claims of breach of fiduciary duties and violations of a shareholders' agreement against the individual defendants, breach of the shareholders' agreement against WMI, and a claim of tortious interference with contract against DAI, all of which relate to the sale of WMI's assets to DAI. Defendants have filed cross-motions for summary judgment on all claims made by plaintiff, except the breach of fiduciary duty claims. One of the individual defendants, Joseph Corrado ("Mr. J. Corrado"), asserts a counterclaim against plaintiff alleging that plaintiff owes him $30,250 arising out of an obligation of indemnification pursuant to the shareholders' agreement.

Argument on the cross-motions for summary judgment was held on March 12, 1997. In a ruling from the bench, certain aspects of plaintiff's motion were denied at that time. For the reasons that follow, I now deny plaintiff's motion for summary judgment and grant defendants' cross-motion for summary judgment in part. Further, I deny defendants' motion for summary judgment on his counterclaim.

A. Background

A brief summary of the relevant undisputed facts follows.

1. Capitalization and Structure of WMI.

WMI was incorporated in February 1987 for the purpose of owning and operating a hot mix asphalt plant. A May 1987 shareholders' agreement among all of the investors (the "Shareholders' Agreement") provided that 1,000 shares of WMI stock be issued to the shareholders as follows: plaintiff received 250 shares, and the remaining six shareholders each received 125 shares. In practice the six shareholders were aligned in three groups, each holding 250 shares. The three groups are: Frank and Joseph Corrado (The "Corrado Defendants"), Verino Pettinaro and Leonard Iacono, and Kenneth A. Kershaw and Stephen A. Cole. Shares of WMI common stock were issued to the shareholders for $200 per share.

The shareholders' agreement also contained provisions relating to the capitalization and governance of WMI. First, each shareholder group was obligated to lend WMI $25,000 interest free to serve as working capital for the corporation. The agreement also required shareholders to make additional, interest-bearing loans to WMI at the request of the board. Second, under conditions described in the agreement dividends and commissions (or rebates) on sales of hot mix products would be paid to the shareholder affiliates. Third, the agreement obligated each shareholder and the shareholders' affiliate companies to purchase all of their hot mix needs from WMI. Fourth, although not contained in the shareholders' agreement, the bylaws of WMI provided that each shareholder will serve as a board member so long as he held stock in the corporation.

2. "License" Agreement.

In order to begin operations, WMI needed to locate its hot mix plant and needed capital to acquire and operate it. Thus, on May 25, 1987, WMI entered into an agreement with Delaware Residual Products, Inc. ("Residual"), the owner of a suitable tract of land. Under that agreement WMI gained the right to use a portion of land owned by Residual in the Minquadale area of New Castle County, Delaware for a fifteen year term. This agreement was characterized by the parties as a license (the "License Agreement"). The license agreement obligated WMI to pay $36,000 per year with an increase to $48,000 in years six

through ten and to $55,000 in years eleven through fifteen. At the time the license agreement was signed, the Corrado defendants were the controlling stockholders of Residual and Mr. J. Corrado served as its president.

WMI obtained working capital loans from Mellon Bank ("Mellon") on the guarantee of defendants or their affiliates. The bank required that WMI assign its rights under the lease as security for the loans. Thus, WMI could not alter its residual rights in the lease without Mellon's prior consent.

3. Sanifill Deal and the Holdback Provision.

In June 1991, Residual merged with Sanifill of Delaware, Inc. ("Sanifill") to form a new entity, Delaware Recyclable Products, Inc. ("DRPI"). The Corrado defendants retained no equity interest in the resulting entity, DRPI. Sanifill preferred that DRPI use all of the Minquadale property for landfill operations and thus desired to terminate the license agreement. A provision in the merger agreement obligated Residual to use its best efforts to cause WMI to abandon its license agreement. Therefore, Sanifill withheld $1.5 million of the purchase price of the land (the "Holdback") until DRPI was able to secure an amendment to the license agreement with WMI. The amendment proposed that WMI would have to move the hot mix plant from its current location on DRPI's property within eighteen months of being given notice to do so by DRPI. Mellon Bank consented to this amendment prior to the closing of the merger between Sanifill and DRPI. WMI had no notice of the merger between Residual and Sanifill nor was it asked to agree to amend the license agreement prior to the merger.

In fact, the Corrado defendants did not disclose the merger to WMI until August 12, 1991. At that time, the Corrado defendants sent a letter to the WMI stockholders requesting that they agree to the amendment and announcing that they had identified a new location in Edgemoor to which the hot mix plant could be relocated.

Plaintiff did not favor moving the hot mix plant to Edgemoor and wrote a letter to WMI's president, Mr. Iacono, identifying the reasons why he objected to the move and suggesting that, if the move were to take place, each shareholder group should receive $200,000 as consideration for amending the license agreement. Opposition to the proposed move also came from another shareholder, Mr. Cole.

4. Sale of Assets to Delaware Aggregates, Inc.

Because the directors of WMI could not agree that the plant should be moved to Edgemoor, in the fall of 1991 management began to investigate the possibility of selling all of WMI's assets, including of course the lease on the DRPI property, to DAI. The Corrado defendants and Mr. Kershaw were officers and directors of DAI at this time.

In preparation for a possible sale of assets to DAI, the Corrado defendants obtained estimates of the value of WMI's two principle assets, the hot mix plant and a Caterpillar front loader from two companies which deal in used asphalt formulating equipment, CMI Corp. and GenTec Equipment Co. These estimates valued the hot mix plant at between $670,000 and $750,000, and the loader at $125,000 to $130,000. No estimate was obtained for the "recycled asphalt product" ("RAP") owned by WMI which allegedly also has some value, nor was the value of the license agreement determined. In addition to the estimates for the plant and the front loader, the Corrado defendants obtained an estimate of the value of WMI's assets from Duane, Morris & Heckscher ("DM&H"), a law firm which acted as WMI's counsel. DM&H utilized a capitalization of earnings formula to arrive at an estimate. The values arrived at by DM&H were similar to those given in the appraisals obtained by the Corrados.

DM&H, as counsel to WMI, advised WMI that any transaction between it and DAI, if challenged, would be evaluated under the entire fairness standard because the Corrados and Mr. Kershaw were directors of both corporations. Thus, DM&H prepared a plan of action which would allow WMI to complete the sale of assets to DAI in such a way that, in DM&H's opinion, the transaction would survive entire fairness review. On January 6, 1992 the directors of WMI, other than Mr. Boyer and Mr. Cole, met to discuss the plan for selling WMI's assets to DAI. DM&H attended that meeting. Mr. Boyer and Mr. Cole were not informed about nor invited to attend this meeting.

After the meeting, a special meeting of the WMI board of directors was called to take place on January 14, 1992. No announcement of the purpose of this meeting was made to Mr. Boyer or Mr. Cole. At the special meeting, Mr. Iacono delivered a letter to Mr. Boyer and Mr. Cole stating that DAI had offered to purchase substantially all of WMI's assets. Next, the individual defendants followed a planned procedural meeting agenda in which they outlined the terms of the DAI proposal and indicated their support for it. Ultimately, the board voted to approve the sale, with Mr. Boyer and Mr. Cole dissenting. According to the terms of the sale, the hot mix plant and the loader were sold to DAI for $825,000.

The RAP material was also acquired by DAI, in exchange for transporting it from the DRPI site.

At the January 14th meeting, after voting to approve the sale of assets, the WMI board passed a resolution purporting to affect the obligation on the loans made to WMI by the shareholders. The resolution provided that the loans would not be repaid in cash, but would be treated as if they were converted into an equivalent dollar amount of WMI common stock. These shares would not, however, have any voting rights.

B. Claims on Which the Court Has Denied Summary Judgment.

1. Fair Price.

[1-2] The parties have agreed that the sale of assets to DAI, because it was an interested transaction, is properly reviewed under the entire fairness standard. *See Weinberger v. U.O.P.*, Del. Supr., 457 A.2d 701 (1983). The entire fairness test requires the interested party to establish that "the transaction was the product of fair dealing and fair price." *Cede & Co. v. Technicolor, Inc.*, Del. Supr., 634 A.2d 345, 361 (1993). Plaintiff contended that, as a matter of law, defendants cannot establish that the price paid by DAI for WMI's assets was fair.

Plaintiff argued that the appraisals obtained by the Corrado defendants cannot be relied upon as accurate because the Corrados themselves selected the companies which provided the appraisals. Furthermore, argued plaintiff, it was DAI, not WMI, which suggested $825,000 as a fair price for the assets. WMI did not attempt to negotiate this price with DAI nor did it seek alternative offers. Plaintiff also attacked DM&H's calculation of the assets' value as being far too low. Specifically, plaintiff challenged the assumptions and the variables employed in DM&H's formula. To support his position, plaintiff submitted an alternative capitalization of earnings formula based on a model created by Horty and Horty, an accounting firm used by WMI in the past. Horty and Horty originally used this formula to calculate the value of WMI in 1988. Plaintiff asserted that the value of WMI is more fairly determined by using the Horty and Horty formula with the company's current numbers than by the capitalization formula employed by DM&H. The Horty and Horty formula, claimed plaintiff, has been used with the agreement of all WMI directors in the past to value its assets and, is, therefore, a more appropriate formula to use than one crafted by lawyers.

[3] I concluded at the end of the summary judgment argument that determining what valuation formula should be used to calculate the fair value of the assets sold to DAI cannot be done without further testimony. For instance, it is not clear what assumptions the Horty and Horty formula make about the stability of the environment in which the assets are evaluated. In other words, if the Horty and Horty model relies on the assumption that past earnings are an accurate predictor of future earnings, that assumption must be established, and its applicability to the environment present at the time of the deal attacked must be assessed. In a business such as WMI's, where the owners of the business are virtually its exclusive customers, and major changes in the location and composition of the company have taken place, it is not at all clear that prior year's earnings will provide a reasonable predictor of future earnings.

2. Disclosure of the Holdback.

Plaintiff claimed that the Corrado defendants did not disclose to the other shareholders and directors of WMI, before the vote on the asset sale, the existence of the $1.5 million holdback. As discussed previously, Sanifill "held back" $1.5 million from Residual when the two entities merged. The holdback was to be paid to Residual as soon as WMI agreed to either: (1) move its hot mix plant to a different location or (2) surrender its rights to license the land on Residual's property upon which the hot mix plant was located at the request of Sanifill. The sale of WMI's assets to DAI fulfilled the first alternative and the Corrados, as owners of Residual, received the $1.5 million holdback.

According to plaintiff, the Corrado defendants' failure to disclose the holdback raises three separate claims: (1) WMI did not obtain a fair price in the DAI transaction because it was unable to negotiate with either Corrado-controlled entities, Residual or DAI, to receive some compensation for agreeing to vacate the Minquadale site; (2) a breach of the duty of loyalty by the Corrado defendants; and (3) a breach of the duty of care by the WMI board which was uninformed of the holdback at the time it voted to approve the merger.

[4] At the conclusion of the hearing on the plaintiff's motion for summary judgment, I denied the motion with respect to the first claim. Although it is uncontested that the Corrado defendants kept secret the existence of the holdback until after the sale of assets to DAI, the effect of this failure to disclose on WMI's ability to extract additional consideration for giving up its rights in the license agreement is unclear. It is not inconsistent with the record that had the WMI board known that

the Corrado defendants stood to gain $1.5 million as a result of the sale, it could have used its rights in the lease as a lever to extract a better price from Corrado-controlled DAI for WMI's assets, or to force the Corrado defendants to share the value of the holdback with WMI. The WMI board was unable to negotiate in this manner with the Corrado defendants because it did not know that the holdback existed. I concluded, however, that at this stage, I am unable to hold that defendants could not establish that the terms of the transaction were, nevertheless, entirely fair.

I address the duty of care and duty of loyalty claims, on which I did not rule from the bench, in the following section.

C. Plaintiff's Remaining Claims.

1. Applicable Standard.

[5-7] Summary judgment will only be granted where there exists no genuine issue of material fact in dispute and the moving party is entitled to judgment as a matter of law. Ch. Ct. R. 56(c); *Burkhart v. Davies*, Del. Supr., 602 A.2d 56, 58-59 (1991), *cert. denied*, 112 S.Ct. 1946 (1992). The burden of proof to establish the absence of any material factual dispute rests with the moving party and any doubt will be resolved against that party. *Brown v. Ocean Drilling & Exploration Co.*, Del. Supr., 403 A.2d 1114, 1115 (1979). In addition, the Court will view the evidence in the light most favorable to the non-moving party. *Seagraves v. Urstadt Property, Co.*, Del. Ch., C.A. No. 10307, Jacobs, V.C., slip op. at 3 (April 1, 1996).

2. Breach of Fiduciary Duties.

[8] In my judgment the entire fairness of this transaction requires additional evidence before a responsible judicial judgment may be reached.

A. Duty of Care Theories.

Plaintiff asserts that the WMI directors breached their duty of care in several respects. First, he claims they were uninformed about the $1.5 million holdback which the Corrado defendants received as a result of the sale of assets to DAI, and that this condition rendered the directors liable for lack of care, and that reasonably active directors would have been informed. Second, and more generally, plaintiff asserts that defendants were not adequately informed about the merits of the proposed asset sale

to DAI and, therefore, breached their duty of care in approving the transaction. Plaintiff alleges that the fact that the January 14th meeting lasted only one hour provides circumstantial evidence relevant to a conclusion that the board was not adequately informed.

[9-10] With respect to the first assertion, although defendants do not contest plaintiff's claim that the Corrados failed to disclose the existence of the holdback to the other WMI directors before the DAI transaction was voted upon, this fact does not establish that the directors failed to fulfill their fiduciary obligation to take reasonable steps to be informed about the merits of the transaction. Directors do not breach their duty of attention where, through no fault of their own, relevant information is withheld from them by others. In this case, plaintiff does not allege that the directors should have known that the Corrado defendants would receive a $1.5 million payment upon completion of the sale to DAI. Therefore, summary judgment on a duty of care claim against the WMI directors who approved the sale cannot follow from their ignorance of the holdback. As to the second assertion, I am unable to grant plaintiff's motion for summary judgment on a breach of due care claim. There is no requirement under Delaware law that a board meeting last a minimum amount of time to be sufficient for the directors to fully consider a proposal such as a sale of assets. *See, e.g., Citron v. Steego Corp.*, Del. Ch., C.A. No. 10171, Allen, C. (Dec. 23, 1992). Here, five of the seven directors of the WMI board were familiar with the proposal before the January 14th meeting. I cannot conclude without further evidence that at the time the proposal was voted upon, the board as a whole was not appropriately informed of the material terms of the transaction or the circumstances or that it failed fully to consider the merits of the transaction before approving it.

B. Duty of Loyalty: Fair Dealing.

[11-14] Because the sale of WMI's assets was an interested director transaction, the individual defendants must establish that it was entirely fair to the disinterested parties and to the corporation. *Weinberger v. U.O.P., Inc.*, Del. Supr., 457 A.2d 701, 710 (1983). Entire fairness has two components: fair price and fair dealing. Fair dealing relates to "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." *Id.* at 711. Fair price, on the other hand, focuses on the financial conditions of the sale and seeks to determine whether the price paid for the assets reflected their true value. *Id.* I have concluded that whether the price paid for WMI's assets

constituted a "fair price" could not be determined without further testimony. Therefore, I now turn to the fair dealing claims.

Plaintiff cites the following aspects of the transaction and asserts that they establish a breach of the individual defendants' duty to deal fairly as a matter of law. First, the price of the assets to be sold to DAI was never negotiated by an independent committee of directors. Instead the price was determined by appraisals of the equipment's value obtained by the Corrado defendants, who were also the buyers, and corroborated by a capitalization of earnings valuation performed by DM&H, a law firm not ordinarily in the business of providing valuations.

Second, the transaction was approved by a straight majority vote of the board, not a majority of the minority shareholders. Plaintiff contends that since all the board members who approved the transaction were directors or shareholders of DAI at the time the transaction was approved, or shortly thereafter, the asset sale was inherently unfair.

Third, plaintiff and Mr. Cole, the two directors who expressed interest in keeping WMI at the Minquadale site, were not told about the sale of assets proposal until the January 14, 1992 meeting at which it was voted upon. The other directors had met with DM&H to discuss the proposal on January 6th.

Fourth, plaintiff asserts that the individual defendants purposefully timed the proposal to purchase WMI's assets in order to take advantage of certain existing conditions which operated to DAI's benefit at the expense of WMI. For instance, according to plaintiff, the appraisals and the capitalization of earnings valuation both rendered artificially low values for WMI's assets because (1) the equipment market was flooded at the time the appraisals were done and (2) WMI's earnings were particularly low that year. In addition, plaintiff claims that at the time the valuations were calculated the Corrado defendants had reason to suspect that they would be awarded a lucrative contract to participate in a highway reconstruction project in Cherry Hill, N.J. According to plaintiff, the value that this project ultimately brought to DAI through sales of hot mix should have been included in the valuation of WMI's assets.

Fifth, the acknowledged failure of the Corrado defendants to disclose the existence of the holdback is said to constitute a breach of candor and a manipulation of corporate process.

[15] For the following reasons I conclude that plaintiff has not alleged facts which permit the Court to conclude on a motion for summary judgment that defendants failed to meet their fiduciary obligation of fair dealing. First, addressing plaintiff's two initial claims, there is no requirement under Delaware law that even in an interested transaction an

independent committee of directors must negotiate the price of a sale of assets nor is it required that the sale be approved by a majority of the minority shareholders. *Jedwab v. MGM Grand Hotels, Inc.*, Del. Ch., 509 A.2d 584, 599 (1986); *Bershad v. Curtiss-Wright Corp.*, Del. Supr., 535 A.2d 840, 846 (1987). That is not to say that the lack of these procedural safeguards are without significance. To the contrary, they are important factors for the Court to consider in its overall assessment of whether the transaction was fair. *See Sealy Mattress Co. v. Sealy, Inc.*, Del. Ch., 532 A.2d 1324 (1987). But, this assessment can only be made after additional evidence is presented, not at the summary judgment stage.

[16] Second, plaintiff's complaint that he was not invited to participate in the January 6th meeting to discuss DAI's proposal cannot be the basis for relief on a motion for summary judgment. The president of the company, Mr. Iacono, is certainly entitled to meet with company counsel without giving notice and an opportunity to participate to all the other directors. That the individual defendants excluded Mr. Boyer and Mr. Cole from the meeting may, upon further testimony concerning individual defendants' motives, provide some evidence of unfair dealing, but it does not, without more, constitute a breach of fair dealing.

[17] Third, plaintiff's final claim that the transaction was deliberately timed to take advantage of market conditions which resulted in a low valuation of WMI's assets, cannot be adjudicated at this stage. Plaintiff has provided no evidence to support his contention that the defendants timed the transaction with these market conditions in mind. Furthermore, plaintiff has not established that the equipment market was in fact flooded at the time the equipment appraisals were sought. Regarding DM&H's valuation formula, as discussed previously, I cannot determine without further testimony whether it was a reasonable manner in which to calculate the value of WMI's assets. The claim that the value of the Cherry Hill paving contract should have been included in the valuation of WMI's assets is also not capable of being decided at the summary judgment stage. Plaintiff has provided no evidence that the individual defendants, or the Corrado defendants for that matter, knew that the paving contract would be awarded to the Corrados before the sale to DAI. The contract was in fact awarded *after* the sale was completed and, therefore, plaintiff has not provided the Court with any justification for including the value of the contract to DAI in the determination of a fair price of WMI's assets.

[18] The failure to disclose the holdback may raise a viable *duty of loyalty* claim against the Corrado defendants. In a self-dealing transaction, interested directors have a duty to disclose all material facts concerning the transaction to the other board members. The standard of

materiality is set forth in many cases including *Zirn v. VLI, Inc.*, Del. Supr., 681 A.2d 1050 (1996). If this information was material, by withholding it, the Corrado defendants breached their duty of loyalty to WMI. Materiality, however, cannot be determined as a matter of law in this instance. It is a determination which can only be made following a trial on the merits.

3. Breach of the Shareholders' Agreement.

Plaintiff alleges that the individual defendants have breached several provisions of the WMI shareholders' agreement to which they are a party by (1) failing to purchase all of their hot mix requirements from WMI and (2) failing to pay plaintiff dividends and commissions to which he is entitled on hot mix sold by WMI.

In response to plaintiff's motion for summary judgment on this claim, defendants have also moved for summary judgment.

A. Requirements Provision.

Paragraph 7(a) of the shareholders' agreement states in relevant part:

> Except where emergency conditions or distance between job site and plant shall make such purchases impractical, the Stockholders shall purchase all paving materials needed by them . . . from [WMI]. . . . In the event of a default from the obligation to purchase materials from [WMI], [WMI] may make a claim to the defaulting Stockholder for lost profits . . . .

Plaintiff alleges that the individual defendants have violated this provision of the shareholders' agreement at all times after WMI's assets were sold to DAI because the individual defendants now buy all their paving materials from DAI. The fact that the assets were sold to DAI, says plaintiff, does not relieve the individual defendants' of their obligation to WMI under the shareholders' agreement. Paragraph 11 of the shareholders' agreement states that it cannot be altered without the written consent of all the shareholders. Plaintiff has not signed an amendment permitting the individual defendants to buy their hot mix elsewhere. In addition, plaintiff alleges that simply by approving the sale to DAI, the individual defendants have violated paragraph 11 of the shareholders' agreement which obligates them to vote "in a manner

consistent with the Agreement", because the sale forces them to violate the requirements provision of paragraph 7.

[19-20] Plaintiff's arguments are unpersuasive. The agreement among the shareholders to purchase their paving material needs from WMI and to vote consistently with the shareholders' agreement (i.e., vote not to sell WMI's assets so that the shareholders can comply with the requirements provision) is subject to the legitimate exercise of corporate power by the WMI board. In other words, where, as here, the legitimate exercise of corporate power by the board (selling WMI's assets to DAI) made it impossible for the shareholders to comply with the requirements provision, the shareholders will not be held liable for buying paving materials elsewhere. If the shareholders wanted to bind themselves to the explicit terms of the shareholders' agreement in all events, they had to express that intention in the agreement. For instance, here they could have stated specifically in the agreement that the company would not be liquidated. Absent such an expressed limitation, the shareholders' agreement is to be subject to the power of the board to exercise its authority to govern the corporation.

[21] Plaintiff's position, it seems, is that the WMI board had an obligation to keep the corporation operating. Nowhere is such an obligation stated. An implicit obligation such as this, if it exists at all, cannot take precedence over legitimate exercises of corporate power by the board. Once the board approved the asset sale, the shareholders were no longer obligated to comply with those provisions of the shareholders' agreement obviated by the sale. Here, the sale of assets to DAI made it impossible for shareholders to comply with the requirements provision in paragraph 7 because WMI did not have any paving materials to sell. Therefore, it is not a violation of paragraph 7 of the shareholders' agreement for the defendants to purchase paving materials from DAI. Furthermore, by voting as shareholders to approve the asset sale, the individual defendants did not violate paragraph 11 of the shareholders' agreement because this action was not inconsistent with the other provisions of the agreement.

Summary judgment is, therefore, awarded to the defendants on this claim.

B. Commissions and Dividends.

Plaintiff alleges that WMI has failed to pay dividends and commissions on the sale of paving materials owed to him under paragraphs 5 and 6 of the shareholders' agreement. According to WMI's 1991 financial statements, WMI did pay $159,977 in dividends and

$36,628 in sales commissions to the shareholders. Paragraphs 5(b) and 6(b) of the shareholders' agreement entitle each shareholder to dividends when they are declared by the board and to a portion of the commissions as calculated by a formula contained in the agreement.

Plaintiff asserts that he is entitled to 25% of the total amount of dividends and commissions paid in 1991. Based on his 25% ownership of WMI stock during that year, plaintiff does appear to be entitled to one-fourth of the dividends paid in 1991. Plaintiff's share of the commissions, however, is determined by a formula in paragraph 5(b) which takes into account the amount of paving materials purchased by the shareholder and his affiliates. Plaintiff has not established that based on this formula he has earned one-fourth of the total commissions paid in 1991.

Defendants contest plaintiff's eligibility to receive *any* dividend or commission payments at this time. Defendants allege that plaintiff owes WMI at least $57,000. According to a written consent signed by all of the WMI directors, including plaintiff, "[a]ny Stockholder of the Corporation whose accounts exceeds 90 days past due . . . *shall have his . . . commissions [and] dividends . . . frozen until normal payment terms are met.*" (emphasis added). Plaintiff does not deny that he owes WMI money, instead arguing that at most, the money he owes to WMI should be counted as a set-off against what WMI owes him. Nothing in the shareholders' agreement or the board consent permits such a set-off. Therefore, plaintiff must make payment arrangements with WMI before he can collect any dividends or commissions.

Plaintiff's motion for summary judgment on this claim is, therefore, denied. In addition, since I have concluded that defendants did not breach the shareholders' agreement by not paying dividends and commissions to plaintiff, defendants' motion for summary judgment on the breach of contract claim is granted.

There are, however, clearly issues of material fact in dispute regarding how much money WMI owes to plaintiff in the form of dividends and commissions, and upon what conditions that money must be repaid. These issues can only be resolved after evidence is presented to the Court at trial.

4. Tortious Interference with Contract.

[22] Plaintiff alleges that defendant DAI tortiously interfered with a contract between plaintiff, the individual defendants and WMI, by inducing the individual defendants to breach the shareholders' agreement. The elements of a tortious interference with contract claim are: (1) there

must be a contract; (2) about which the defendant had knowledge; (3) defendant must commit an intentional act that is a significant factor in causing a breach of that contract; (4) defendant must act without justification; and (5) the breach must cause injury.

[23] Plaintiff's tortious interference claim fails for two reasons. First, the Court has not found that the shareholders' agreement was breached, so there is no breach of contract upon which to ground the tortious interference claim. Second, no evidence has been presented establishing that DAI committed an intentional act that caused the defendants to breach the shareholders' agreement. Offering to purchase WMI's hot mix equipment and front loader is not such an act. Therefore, defendants' motion for summary judgment on this claim is granted.

5. Conversion of Plaintiff's Loans.

Plaintiff asserts that he has loaned WMI $133,669, none of which has been repaid. The defendants, on the other hand, maintain that WMI satisfied its obligations regarding the loans.

Paragraph 4(c) of the shareholders' agreement required each shareholder group to loan WMI $25,000 interest free as working capital. Paragraph 4(c) further obligated shareholders to loan the corporation money at the call of the board of directors. In fact, the board never did call loans pursuant to paragraph 4(c). Instead it arranged for WMI's shareholders to loan the corporation a portion of the dividends and commissions they were to receive. According to plaintiff, these loans were to be repaid with interest of 8.1% or 8.2% per annum. Plaintiff alleges that he loaned WMI $108,669 in the form of commissions and dividends.

On the same date as the sale of assets to DAI, January 14, 1992, the WMI board adopted a resolution which purported to treat "all loans from the stockholders or directors of the Company to the Company . . . as if they constituted an equivalent dollar amount of the common stock of the Company, provided that such loans shall not be deemed to have any of the voting or other rights associated with shares of the capital stock of the Company . . . ." By "converting" the shareholder loans to common stock of WMI, a company with no assets and no on-going operations, WMI, for all practical purposes, gave the shareholders nothing of value as repayment for their loans.

Defendants contend that this method of repayment is acceptable under the shareholders' agreement. Paragraph 4(b) states that the $25,000 working capital loan "shall be repaid as revenues become available and *under terms to be determined by the Board of Directors.*" (emphasis

added). Defendants cite this clause as support for their position that the board, at its discretion, could decide what type of consideration would suffice to repay the shareholders. Thus, they conclude, the board resolution providing that the loans will be repaid by treating them like common stock of WMI is a legitimate method to discharge WMI's obligations under the loans.

For the following reasons, I deny both plaintiff's and defendant's motions for summary judgment on this claim. First, regarding repayment of the $25,000 capital loan, paragraph 4(b) of the shareholders' agreement, the relevant part of which is quoted in the preceding paragraph, does not clearly articulate the terms under which the loan must be repaid. In particular, the phrase stating the loan shall be repaid "under terms to be determined by the board" is ambiguous. Without further evidence regarding the meaning of this phrase, I cannot conclude whether this phrase operates to allow the board to repay the loans with something other than cash.

Second, as to the additional loans made by plaintiff, both parties rely on the wording of paragraph 4(b) to govern the terms of repayment of those loans. That paragraph, however, applies only to the repayment of the $25,000 working capital loan. It states that "[s]aid loan" (referring to the working capital loan), not all loans, will be repaid according to terms designated by the board. Therefore, this clause does not provide the terms under which the additional loans are to be repaid. In order to determine the manner in which these loans were to be repaid, I must first consider the terms of the loans as originally agreed to by the parties. Because the original terms of the loans have not been presented to the Court, I cannot make a ruling on this claim at this time.

D. Mr. J. Corrado's Counterclaim.

Defendant Mr. J. Corrado has filed a counterclaim against plaintiff seeking indemnification under the shareholders' agreement of funds paid to Mellon. As discussed earlier, Mellon loaned WMI money in 1988. As required by paragraph 10(a) of the shareholders' agreement, the loans were personally guaranteed by the shareholders through their affiliate companies. Prior to the asset sale, Mellon apparently made an oral demand for repayment of the loans. The proceeds from the asset sale did not suffice to cover the extent of WMI's obligations to Mellon. According to Mr. J. Corrado, Mellon made demand upon Corrado-American, his corporate affiliate which originally guaranteed the loan, to pay a portion of the outstanding balance. Mr. J. Corrado alleges that to satisfy Mellon's demand, Corrado-American paid $121,000 to Mellon.

The shareholders' agreement, paragraph 10(b), requires the other shareholders to indemnify any shareholder who is called upon by a creditor of WMI to repay a loan made to WMI. Therefore, contends Mr. J. Corrado, plaintiff must pay him $30,250 which is 25% (plaintiff's proportionate share of ownership of WMI common stock) of the amount allegedly paid by Corrado-American to Mellon.

In order to grant Mr. J. Corrado's motion for summary judgment on his counterclaim, there must be undisputed evidence in the record establishing that Mellon made demand upon Corrado-American and that Corrado-American in fact paid Mellon $121,000. Defendant has provided no evidence which establishes that either of these events occurred. Therefore, summary judgment on the counterclaim is denied.

CARLTON INVESTMENTS v. TLC BEATRICE INTERNATIONAL HOLDINGS, INC.

No. 13,950

Court of Chancery of the State of Delaware, New Castle

May 30, 1997

Special litigation committee (SLC), appointed by defendant corporation's board of directors to investigate allegations that certain past and present directors and officers engaged in conduct constituting breach of fiduciary duty, corporate waste, fraud, and conspiracy, negotiated settlement with former CEO's estate, whereby, the estate would return a portion of paid compensation. Plaintiff, Carlton Investments, resisted approval of the settlement alleging that the SLC appointed by the board of directors and its counsel were not independent, did not attempt to maximize the settlement value, and did not conduct a reasonable investigation. Plaintiff also contended that the proposed settlement was grossly inadequate compared to what it believed it could have recovered in litigation.

The court of chancery, per Chancellor Allen, approved the proposed settlement. The court concluded that the SLC and its counsel

were independent, that the settlement was fair, reasonable, and within the best long-run interest of the corporation and that the SLC acted in good faith in its investigation and evaluation of ambiguous and conflicting testimony.

1. Compromise and Settlement ⚷ 57
Corporations ⚷ 212, 213

In evaluating a proposed settlement, the court does not attempt to make substantive determinations concerning disputed facts or the merits of the claims alleged.

2. Corporations ⚷ 213

In evaluating a proposed settlement, the court considers whether the proposed settlement is fair and reasonable in light of the factual support for the alleged claims and defenses in the discovery record before it.

3. Compromise and Settlement ⚷ 57
Corporations ⚷ 213

In ruling on motion to approve proposed shareholder derivative suit settlement negotiated by board of directors appointed investigating committee, the court of chancery must analyze the independence and good faith of the committee, and the bases supporting its conclusions, and, if independence and good faith are found, exercise its own business judgment, considering both the corporation's best interest and matters of law and policy.

4. Compromise and Settlement ⚷ 57
Corporations ⚷ 213

The court of chancery may deny motion to approve proposed settlement of shareholder derivative suit negotiated by board appointed independent investigating committee, if it finds that, while the committee acted independently and with good faith, the result reached was, nevertheless, irrational or egregious; however, the court should not make such judgments but for reasons of legitimacy and shareholder welfare.

5. Compromise and Settlement ⟹ 57
Corporations ⟹ 212, 213

In ruling on motion to approve proposed settlement of shareholder derivative suit negotiated by board appointed independent investigating committee, the court of chancery must evaluate whether the committee acted in good faith to reach a fair and reasonable settlement, and whether the settlement is in the best interest of the company.

6. Compromise and Settlement ⟹ 57
Corporations ⟹ 213

In ruling on motion to approve proposed settlement of shareholder derivative suit negotiated by board appointed independent investigating committee, the court of chancery must determine whether the committee acted independently, basing its conclusions upon the merits of the issues rather than being governed by extraneous considerations or influences.

7. Corporations ⟹ 213

The independence of a board of directors appointed committee investigating allegations of breach of fiduciary duty, corporate waste, fraud and conspiracy may be compromised if an inappropriate relationship exists between the committee and its counsel and interested directors of the company.

8. Corporations ⟹ 212

Absent indications that members of committee investigating corporate abuses accepted their appointments in bad faith or behaved in an improper manner during the investigation, the fact that committee members or their counsel had prior connection with firm representing wife of defendant CEO does not support challenge to independence of the committee.

9. Corporations ⟹ 212, 213

Board appointed committee, investigating allegations of breach of fiduciary duty, corporate waste, fraud and conspiracy and proposing a settlement amount, must consider what is in the long-run best interest of the corporation and is not required to maximize returns from the lawsuit.

10. Compromise and Settlement ⟹ 57
Corporations ⟹ 212, 213

In ruling on motion to approve proposed settlement of shareholder derivative suit negotiated by board appointed independent investigating committee, the court of chancery must evaluate the deal itself for fairness and reasonableness and not each part of it.

11. Corporations ⟹ 212, 213

Board appointed committee investigating allegations of breach of fiduciary duty, corporate waste, fraud and conspiracy may exercise good faith reliance on independent, competent counsel to assist the committee in investigating claims.

12. Corporations ⟹ 213

Where there is no evidence of overreaching by counsel or neglect by board appointed committee investigating allegations of corporate abuse, the court ought not second guess the committee's decisions regarding the role which counsel played in assisting the committee in their task.

13. Compromise and Settlement ⟹ 57
Corporations ⟹ 213

While merits of claims of the party opposing the proposed settlement are not to be adjudicated on a motion to approve the proposed settlement, the court of chancery must exercise its own business judgment with respect to the reasonableness of the settlement.

14. Corporations ⟹ 212, 213

Minutes of board of directors' meeting need not record a legal opinion if the board does not pass a resolution based upon that opinion; however, where the board does pass a resolution based upon a legal opinion, a clear record of the opinion is necessary.

15. Corporations ⟹ 212, 310(1)

In making decisions on complex legal issues, a board of directors is not limited to only unqualified legal opinions.

16. Corporations ⚷ 212

Although a written legal opinion is preferable from the standpoint of a court engaged in a post facto review of a board's decision, an oral opinion is not inherently flawed, because whether a legal opinion is oral or in writing is of no consequence to a board of directors at the time of its decision.

17. Compromise and Settlement ⚷ 57
Corporations ⚷ 212, 213

The court of chancery is not required to adjudicate the correctness of a reasonable interpretation of the record by a board appointed committee proposing a settlement.

18. Compromise and Settlement ⚷ 57
Corporations ⚷ 212, 213

In ruling on a motion to approve a proposed settlement of a shareholders' derivative suit, where a board appointed investigating committee has reasonably relied upon legal opinion, has acted in good faith, and reached a reasonable conclusion, the correctness of the committee's conclusions is not in issue.

19. Corporations ⚷ 212, 213

A board appointed investigating committee may justifiably rely on an expert's report in making a determination concerning their proposed settlement where their determination was reached in good faith after reviewing an ambiguous record with advice from experienced counsel.

20. Compromise and Settlement ⚷ 72
Corporations ⚷ 213

A settlement is not the procedure to determine contested facts.

21. Corporations ⚷ 212, 213

In a proposed settlement context, the fact that a document of potential relevance could have been overlooked or misplaced in an investigation involving a magnitude of documents does not suggest that

an investigating committee failed to perform an adequate investigation or acted in bad faith.

22. Compromise and Settlement ⟹ 23(1)
Corporations ⟹ 212, 213

A challenger to a proposed shareholders' derivative suit settlement carries the burden of proving the significance and weight of documentary evidence which it argues goes against the proposed settlement.

23. Corporations ⟹ 212, 213

Board appointed committee investigating allegations of breach of fiduciary duty, corporate waste, fraud and conspiracy has discretion to weigh conflicting testimony regarding alleged improprieties and make a determination regarding the appropriate settlement amount.

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Kenneth J. Nachbar, Esquire, Alan J. Stone, Esquire, and David J. Teklits, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Richard C. Tufaro, Esquire, Fred W. Reinke, Esquire, Edmund D. Daniels, Esquire, and Melissa R. Hodgman, Esquire, of Milbank, Tweed, Hadley & McCloy, Washington, D.C., of counsel, for special litigation committee.

Gregory V. Varallo, Esquire, C. Malcolm Cochran, IV, Esquire, and Russell C. Silberglied, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendants Loida N. Lewis and Leslie N. Lewis, as co-executrixes of the estate of Reginald F. Lewis, TLC Group, L.P., TLC General Corporation, TLC Holdings Corporation, and McCall Patterns Holding, Inc.

Michael D. Goldman, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendants Lee A. Archer, Jr., Robert C. DeJongh, James E. Obi, Ricardo J. Olivarez, Samuel P. Peabody, William S. Mowry, Jr., Leslie N. Lewis, Marilda G. Alfonso, Sanford Cloud, Jr., and Anthony S. Fugett.

Henry E. Gallagher, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware; and William M. McErlean, Esquire, John F. Verhey, Esquire, and Julie A. Garvey, Esquire, of Seidler & McErlean, Chicago, Illinois, of counsel, for defendants TLC Beatrice International Holdings, Inc. and TLC Transport, Inc.

William D. Johnston, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware, for defendant Jean S. Fugett, Jr.

David J. Margules, Esquire, of Wolf, Block, Schorr & Solis-Cohen, Wilmington, Delaware, for defendant Dumas Simeus.

Steven J. Balick, Esquire, of Ashby & Geddes, Wilmington, Delaware, for defendant W. Kevin Wright.

ALLEN, *Chancellor*

Pending is a motion pursuant to Chancery Court Rule 23.1 for approval of a Special Litigation Committee ("SLC") proposed settlement of a derivative action on behalf of TLC Beatrice International Holdings, Inc., ("TLC Beatrice"). The action was brought on January 4, 1995, by Carlton Investments ("Carlton"), a very substantial stockholder of TLC Beatrice. The complaint alleged that certain past and present directors and officers of TLC Beatrice had engaged in conduct constituting breach of fiduciary duty, corporate waste, fraud, and conspiracy. At the core of this action is the claim that individual defendants breached their fiduciary duties in connection with the board's approval of an approximately $19.5 million[1] compensation package awarded to the company's former CEO, Reginald F. Lewis, on December 24, 1992. The case has been strongly contested on both sides.

On May 24, 1996, after more than a year of extensive discovery and several contested motions, the board of directors of TLC Beatrice unanimously voted to add two new directors and to constitute them as the SLC, empowering it to investigate the allegations of misconduct and determine the best course of action for the company with regard to this litigation. After a five month investigation of eleven principal claims

[1]The amount of the challenged compensation package is often referred to in the pleadings as $22.1 million because in addition to $19.5 million paid in compensation for services, Mr. Lewis received more than $2.5 million in reimbursement for unrelated litigation expenses incurred by Mr. Lewis while CEO of TLC Beatrice.

alleged by Carlton in its Second Amended Complaint[2], the SLC entered into a proposed settlement with the Estate of Reginald Lewis ("Estate"), the principal defendant in this action. Pursuant to a stipulation of settlement, submitted to this Court on November 12, 1996, the Estate has agreed, subject to court approval, to pay TLC Beatrice a total of $14,932,000 plus interest, in installment payments over the next seven years. While the parties differ somewhat on the present value of this obligation, Carlton, for example, claims that in no event could it be worth more than $13,032,926 presently. In all events, Carlton, as the plaintiff, warmly resists this proposed settlement. It has filed a brief in opposition to the proposed settlement and presented its objections at a settlement approval hearing held before this court on April 16, 1997.

I.

[1-2] Before discussing the proposed settlement itself, it is appropriate to note the role of the court under Delaware law in reviewing proposed settlements generally, and to note several unique issues presented in this particular case. As a general rule, in evaluating a proposed settlement, this court does not attempt to make substantive determinations concerning disputed facts or the merits of the claims alleged. *See Polk v. Good*, Del. Supr., 507 A.2d 531, 536 (1986). Instead, the court considers whether the proposed settlement is fair and reasonable in light of the factual support for the alleged claims and defenses in the discovery record before it. *Id.; see also In re Caremark Derivative Litigation*, Del. Ch., C.A. No. 13670, Allen, C. (Sept. 25, 1996), Mem. Op. at 2. Thus, with respect to factual matters, what follows does not represent an adjudication worthy of collateral estoppel effect.

[3] Since this proposed settlement was negotiated by an SLC, the parties have agreed that under Delaware law, it is to be reviewed under the two step approach set forth in *Zapata Corp. v. Maldonado*, Del. Supr., 430 A.2d 779 (1981).[3] First, the court must analyze the "independence and good faith of the committee and the bases supporting

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[2]*See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Del. Ch., C.A. No. 13950, Allen, C. (April 16, 1996)(granting leave to file second amended complaint adding claims of usurpation of corporate opportunity, fraud, and conspiracy in connection with TLC Beatrice's french subsidiaries and certain voting rights assigned to Mr. Lewis, and adding additional defendants).

[3]*Compare Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979); *Houle v. Lowe*, 556 N.E.2d 51 (Mass. 1990) (discussing *Auerbach* and *Zapata* approaches); *Cuker v. Peco Energy Co.*, 1997 Pa. LEXIS 789 (Pa. 1997) (settlement of suit treated as any other business decision if made by disinterested informed board).

its conclusions." *Zapata*, 430 A.2d at 788. Second, the court is directed to exercise its own business judgment to determine whether the settlement should be approved, considering both the corporation's best interests and matters of law and policy. *Id.* at 789.

[4] After carefully reviewing the investigation and negotiation process of the SLC, the evidentiary basis for the conclusions reached by the SLC, and the terms of the proposed settlement, I have reached the following conclusions. First, the SLC and its counsel proceeded in good faith throughout the investigation and negotiation of the proposed settlement. Second, the conclusions reached by the SLC, which formed the basis for the amount of the proposed settlement, were well informed by the existing record. Third, the proposed settlement falls within a range of reasonable solutions to the problem presented. Finally, to the extent I am required by the second step of *Zapata*, uncomfortably, to exercise some form of independent judgment concerning the merits of the settlement, I cannot conclude that it is badly off the mark. It is true that in some respects the claims that Carlton asserts on behalf of TLC Beatrice appear strong. But the settlement proposed offers substantial consideration for then release. As to the conceptually difficult second step of the *Zapata* technique, it is difficult to rationalize in principle; but it must have been designed to offer protection for cases in which, while the court could not consciously determine on the first leg of the analysis that there was no want of independence or good faith, it nevertheless "felt" that the result reached was "irrational" or "egregious" or some other such extreme word.[4] My opinion is that courts should not make such judgments but for reasons of legitimacy and for reasons of shareholder welfare. *See, e.g., In re Caremark*, Del. Ch., __A.2d__ (1996); *Gagliardi v. TriFoods Intern., Inc.*, Del. Ch., 683 A.2d 1049 (1996). But if I am directed to exercise my own "business judgment" by the second step of *Zapata*, I must conclude that this settlement represents one reasonable comprise of the claims asserted.

* * *

[4]The idea suggested in *Zapata* that the court may - for reasons of public policy - require the board to continue a litigation even though an independent committee determines in good faith and on appropriate information that a proposed settlement is advantageous to the corporation, is difficult to understand. It is fair to ask, on what basis may a court legitimately impose the cost and risk of litigation on a party in order to achieve *only a perceived public benefit*? In other contexts the constitution explicitly protects against such exactions (*i.e.*, takings clause of U.S. constitution).

It is appropriate, too, to note certain substantive limitations that the nature of the parties' litigations impose. A significant background feature of this case is provided by the fact that this action is unique because Carlton filed an *individual breach of contract claim* against TLC Beatrice in New York six months prior to initiating this derivative suit in Delaware. *See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Index No. 114798/94 (N.Y. Supr. May 20, 1994). Substantially all of the facts, documents, and parties overlap in these two pending suits. At the heart of the Delaware breach of fiduciary duty claim challenging the approval of the $19.5 million compensation package, is a dispute regarding legal advice received by the board concerning whether the payment of Mr. Lewis' compensation package was contractually barred by a pre-existing stockholders' agreement. In New York, Carlton has filed a complaint alleging that the stockholders' agreement was breached by that payment.

The Delaware suit did not assert any personal right of Carlton nor did it claim any right to relief for TLC Beatrice arising out of the contract. Thus the SLC does not purport to have reached any conclusion concerning any such claim and that claim is not a part of the proposed settlement. Accordingly, this court did not consider the strength or weaknesses of any breach of contract claim in determining whether the SLC, in good faith, negotiated a fair and reasonable settlement of the claims alleged by Carlton in the Delaware action.[5]

The following facts were among those reviewed in reaching the decision that the settlement is a fair and reasonable resolution of the claims presented in the Delaware action.

II. FACTUAL BACKGROUND

A. 1987 Acquisition of TLC Beatrice

In 1987, Reginald Lewis[6], through a newly created investment vehicle, TLC Group, L.P., ("Group"), made a leveraged $950 million bid

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[5]In an opinion issued after the hearing on the proposed settlement, this court ruled that the parties to the settlement of the Delaware action could not purport to release the New York breach of contract claim brought by Carlton individually against TLC Beatrice. *See Carlton Investments v. TLC Beatrice Int'l Holdings, Inc.*, Del. Ch., C.A. No. 13950, Allen, C. (April 21, 1997). More on this at p. 51 *infra*.

[6]Mr. Lewis, who had acquired McCall Pattern Holdings, Inc. in a $23 million leveraged buyout in 1984, successfully sold the company in 1987 for $63 million in cash, creating a reputation for himself as a dealmaker.

to acquire TLC Beatrice[7], with the financing assistance of the junk bond group at Drexel, Burnham, Lambert, Inc. ("Drexel"). After the bid was accepted, Drexel arranged for $300 million of high-yield bond financing. The substantial remainder of the capital was raised by Mr. Lewis from banks (over $400 million) and from sales of three TLC Beatrice subsidiaries ($426 million in aggregate proceeds some of which paid down bank debt). Mr. Lewis himself invested only approximately 1% of the total acquisition price.

As of December 1, 1987, the effective date of the acquisition, the capital structure of TLC Beatrice was as follows. Mr. Lewis controlled approximately 45% of the company's outstanding common stock and held Series B and C preferred stock through entities he controlled. The remainder of the common stock was held by Carlton, Drexel, and various institutional investors that had bought the junk bonds.[8] Series A preferred stock was held by Drexel for both itself and various institutional investors.

Two significant events occurred prior to the closing of the acquisition. First, a dispute arose between Mr. Lewis and Drexel personnel or Affiliates ("Drexel") concerning Mr. Lewis' demand for a $15 million cash fee to compensate him for his role as dealmaker. It appears that Drexel resisted giving Mr. Lewis an upfront cash payment for his involvement in the deal because as a result of the acquisition Mr. Lewis was going to become the controlling shareholder of TLC Beatrice, owning just under 50% of the company's equity. Although Drexel objected to Mr. Lewis receiving any fee whatsoever initially, an agreement was reached. Drexel agreed that Lewis be paid at closing an "acquisition fee" of approximately $7.6 million in Series C preferred stock. In addition, Drexel agreed that Mr. Lewis would receive indirectly through Group a "monitoring fee": a $1 million management fee to be paid annually for seven years.

Second, on November 30, 1987, TLC Beatrice, TLC Holdings Corp.[9], Carlton[10], and certain other post-acquisition shareholders, entered into a stockholders' agreement. The agreement was intended to set out

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[7]TLC Beatrice was the international division of the Beatrice Company which had been acquired by Kohlberg Kravis & Roberts in the preceding year.

[8]In order to induce certain members of Beatrice International's management to continue working for the company after the acquisition, they were promised an aggregate of 10% of the outstanding shares. Such shares were issued one year after the acquisition.

[9]Holdings, wholly owned by Mr. Lewis, was the general partner in TLC Beatrice International Partnership, L.P., the vehicle through which Mr. Lewis maintained majority control of TLC Beatrice.

[10]Carlton was formed as an investment vehicle for senior Drexel executives in 1987.

certain rights and obligations of the shareholders of TLC Beatrice. Significantly for the dispute that evolved later concerning Mr. Lewis' compensation, Section 3(a) provides for the payment of the $1 million annual "monitoring fee," and Section 2(c) governs the company's ability to enter into transactions with affiliates, such as Group and Mr. Lewis.[11] The interpretation of those two provisions provides essential background to the claim here (as well as the N.Y. claim) because Carlton contends that the stockholders' agreement was intended to set a $1 million cap on future payments of any kind to Mr. Lewis.

B. Mr. Lewis' Management Role

Mr. Lewis was involved in the daily management of TLC Beatrice from its inception. By the end of 1989, Mr. Lewis had implemented several key changes in the company. First, he relocated himself to Paris, to spend approximately half his time in Europe overseeing the company's extensive european operations. Second, Mr. Lewis cut $3 million in annual costs by reducing the former thirty member management staff to himself and nine employees. Third, Lewis divested several subsidiaries of the company, resulting in aggregate proceeds of $871 million, approximately half of which was used to eliminate debt, while maintaining a steady level of net sales.

Throughout this period, it appears that Mr. Lewis was performing the ordinary functions of a CEO.[12] Mr. Lewis received the $1 million "monitoring fee" in addition to reimbursement for his expenses (which are attacked here as excessive), but did not receive any direct compensation as CEO. While the value of his stock presumably increased as a result, Mr. Lewis nevertheless appears to have quickly grown dissatisfied with this compensation arrangement.[13]

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[11]Section 2(c) regarding transactions with affiliates provides that:

> The Company will not, and will not permit its Subsidiaries to, directly or indirectly enter into or permit to exist any transaction . . . with any person or group holding five percent or more of any class of equity securities . . . [provided that] the foregoing restriction shall not apply to . . . (vii) the payment of fees set forth in Section 3 hereof . . . .

Section 3 provides for a "monitoring fee" "not to exceed $1,000,000 per year" which "shall be exclusive of any other amounts payable to TLC or its Affiliates (except as otherwise set forth in this Section 3 and except in respect of ownership by TLC and its Affiliates of Company securities)."

[12]Bill Mowry, the Chief Operating Officer of the company as of the acquisition, refused to accept the CEO position in 1989 and left the company shortly thereafter.

[13]In October 1988, Thomas Lamia, an attorney representing TLC Beatrice sent a letter to a Drexel representative proposing amendments to the stockholders' agreement which would,

C. Mr. Lewis' Compensation

In late 1989, the company initiated steps to address the compensation issue. In conjunction with a proposed IPO in 1989, Mr. Lewis would have received a $16 million bonus and a long-term employment contract, guaranteeing him future compensation for his services as CEO.[14] However, the IPO was not effectuated, leaving the issue of Mr. Lewis' compensation unresolved.

In 1990, on Mr. Lewis' request, the board established a compensation committee to address the issue of his compensation. After reviewing information concerning CEO salaries in other companies compiled by Bear, Stearns & Co, and suggested term sheets provided by Everett Grant, a TLC Beatrice Senior Vice President, the compensation committee proposed a compensation package to the board.[15]

The proposed compensation package had many of he myriad benefits consultants have dreamed up. It was comprised of: $9 million in retroactive payment for three years of services performed from December 31, 1987 through November 30, 1990; a prospective $1.5 million annual base salary; 750,000 stock options exercisable at $1 per share of common stock; incentive based stock appreciation rights bonuses; a consulting agreement for services after leaving the company; continued reimbursement for living expenses[16]; and other benefits.

The recommended package was contingently approved by the board at a meeting on December 19, 1990.[17] It is undisputed that TLC Beatrice

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in effect, have expressly permitted Mr. Lewis to receive any compensation package approved by the board in addition to the $1 million award fee. The amendments were not adopted.

[14]As part of the IPO, the company planned to request that stockholders waive their rights under the stockholders' agreement in order to avoid any potential conflicts between the agreement and terms of the proposed offering. Although unwilling to amend the stockholders' agreement in the past, it appears that Carlton agreed not to object to the compensation and bonus terms of the IPO because Carlton would have liquidated its investment in TLC Beatrice as part of the IPO. The IPO, however, did not occur.

[15]Mr. Grant provided both the compensation committee and Bear Stearns a copy of a preliminary compensation package term sheet, based in part upon terms discussed in connection with the 1989 IPO and terms suggested by Mr. Lewis. The compensation committee discussed the final compensation package with Mr. Grant and a Lewis & Clarkson attorney before recommending it to the board. It should be noted that Bear Stearns was not asked by Mr. Grant or the compensation committee to analyze the reasonableness of the compensation package.

[16]In addition to reimbursements for his Paris living expenses, Mr. Lewis was receiving security services to protect him against threats to his life and access to a corporate jet, which he used for both business and personal purposes. Throughout Mr. Lewis' tenure as CEO, Group received reimbursement for its expenses as well, for its substantial work on TLC Beatrice matters.

[17]It does not appear that the net aggregate value of the compensation package was

was experiencing significant financial growth under Mr. Lewis' management and the board expressed a desire to resolve the compensation issue in order to retain Lewis as the company's CEO. Payment was not authorized at that time, however, because the approval was made contingent "upon attainment of all necessary consents, approvals and amendments." Whether or not legally required under the stockholders' agreement, the company decided to seek Carlton's approval for the compensation package, realizing that such approval would, at least, mitigate against a perceived litigation threat posed by Carlton. The company's 1990 Form 10-K disclosed that the board had "approved, subject to the approval of stockholders, a compensation package for [Mr. Lewis] . . ." and that a "liability [would] not be recorded until the required stockholder approval has been obtained."[18]

D. Stockholders' Agreement Evasion Strategies

Carlton's approval was sought to be achieved or made unnecessary through various unsuccessful strategies, including an amendment to the stockholders' agreement by proxy, the formulation of a legal argument entitling the company to rescind the stockholders' agreement, and a second failed IPO which would have expressly approved the payment of the compensation package.[19] Several law firms were consulted by Kevin Wright, TLC Beatrice's general counsel, in conjunction with each of these strategies. Although the stockholders' agreement was reviewed by outside lawyers, none were asked to give a formal legal opinion concerning whether payment of the compensation package would violate the stockholders' agreement.

Carlton's approval had neither been obtained nor made unnecessary by December 31, 1991, but the board decided to pass a resolution mandating the payment of the cash component of the compensation package by March 15, 1992.[20] Although the company still did not accrue

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calculated or considered by the board at that time.

[18]TLC Beatrice's independent auditors, Deloitte & Touche, informed the company that they needed an unqualified opinion from outside counsel that the stockholders' agreement did not preclude payment of the compensation package before the package could be accrued as a liability. No such opinion was provided by the company. Thus, the liability was not accrued in 1990. Nor was the liability accrued in 1991, because again the company did not provided the auditors with a "clean" opinion regarding this issue.

[19]Carlton would not endorse the inclusion of the compensation package in the 1991 IPO. Recognizing this dispute, the underwriter, Morgan Stanley requested a legal opinion concluding that the terms of the IPO would not violate the stockholders' agreement. No such opinion was provided by the company.

[20]The company's 1991 annual report stated that the aggregate value of the