termination of the Strategic Alliance. In any case, defendants argue, Rogers left the board meeting voluntarily, and intentionally relinquished whatever right he had to learn of, and participate in, board actions taken in his absence.

Second, the defendants specifically deny that Kusek told Moore that he wanted to work to improve the Strategic Alliance. All that Kusek told Braun (defendants argue) is that he (Kusek) wanted to improve the business relationship[19] -- as distinguished from the Strategic Alliance -- with Moore. The defendants also urge that because Moore never cashed the $4.48 million check tendered to it, they did not violate the contractual covenant that prohibited Holdings from incurring any new debt.

Third, the defendants contend that the Court has previously dismissed Moore's third (fiduciary duty) claim and Moore's fifth (equitable estoppel) claim, and that that prior adjudication is the law of the case.[20] Fourth, the defendants claim that KPMG was properly selected to appraise Moore's Preferred Stock, and that there was no contractual requirement that KPMG be told that its valuation was for purposes of Section VII.F of the Purchase Agreement. Defendants also contend that they did not give KPMG any incorrect information. In response to Moore's sixth claim, the defendants argue that because the Strategic Alliance had been validly terminated, they were no longer required to elect Moore's designee to the Holdings board.

Finally, the defendants argue, by way of affirmative defense, that (i) the board's September 23, 1994 ratification of its previous actions cured any arguable deficiencies in the termination process, and (ii) under Section VIII.E of the Purchase Agreement the exclusive remedy for a breach of any duty is specific performance; therefore, Moore's exclusive remedy is for Rogers to receive now the information that was concealed from him in 1994.

III. ANALYSIS

Moore's claims and the defendants' responses to them frame the issues that the Court must resolve. Three of those issues may be disposed of summarily. In its earlier Opinion, the Court held that Moore's claim that the defendants breached fiduciary duties owed to Moore was not a cognizable claim upon which relief could be granted. The Court also

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[19]See n. 12, supra.

[20]Moore Business Forms, Inc. v. Cordant Holdings Corp., Del. Ch., C.A. No. 13911, Jacobs, V.C., Mem. Op. at 13-14 (Nov. 2, 1995).

dismissed Moore's claim based on a theory of equitable estoppel.[21] Thus, Moore's third and fifth claims are barred by reason of this Court's prior adjudication.

As for Moore's sixth claim, the parties agree that if the defendants' termination of the Strategic Alliance was legally valid, then the defendants were entitled to elect Ms. Wood (or whomever else they wished) to the Holdings board, but if the termination was not effective, than the defendants remained contractually obligated to elect Moore's representative (Mr. Duane). Thus, Moore's sixth claim depends on whether or not the defendants validly terminated the Strategic Alliance, which is the critical dispute in this case.

Thus, six issues presently remain: (1) Did the defendants violate Delaware corporate law precepts by concealing from Rogers the information given to the other Holdings board members and by preventing Rogers from fully participating, as a board member, in the decision to terminate the Strategic Alliance? (2) Did the defendants breach their implied obligation to perform the contract in good faith by failing to treat Moore fairly and equally and by (mis)representing to Moore that they wanted to improve the Strategic Alliance? (3) Did the defendants breach their contract obligation not to incur new debt without Moore's knowledge or consent? (4) Did the defendants breach Section VII.F of the Purchase Agreement by selecting KPMG improperly, by failing to inform KPMG of the purpose of its valuation, by allowing KPMG to perform an (allegedly) incompetent valuation, and/or by giving KPMG false information? (5) Was the defendants' September 27 ratification vote legally effective? (6) Are the plaintiffs limited to specific performance as their exclusive remedy?

For the reasons next discussed, the Court finds that the defendants' conduct violated Delaware corporate law precepts, as well as the Purchase Agreement and the Shareholders Agreement. As a consequence, the defendants' termination of the Strategic Alliance was void ab initio,[22] and could not later be ratified by the Holdings' board. The board's attempted ratification of its August 23 action to terminate the Strategic Alliance was,

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[21]Moore Business Forms, Inc. v. Cordant Holdings Corp., Del. Ch., C.A. No. 13911, Jacobs, V. C., Mem. Op. at 21 (Nov. 2, 1995) (Moore's allegation of an affirmative misrepresentation is not well pleaded. I therefore need not consider whether Moore has successfully pleaded the other elements essential to a claim of equitable estoppel. Because Count III fails to allege an actionable omission or affirmative misrepresentation by the defendants, it does not state a valid claim for equitable estoppel.")

[22]For this reason, the Court does not reach Moore's claim that the defendants breached Section VII.F of the Purchase Agreement.

therefore, ineffective. Lastly, the Court determines that the plaintiffs are not limited to the remedy of specific performance.

A. The Directors' Rights of Access to Board Information, and to Receive Notice of and Participate in Board Action

[1-3] The principle that all directors have equal rights of access to board information and to participate fully in board proceedings is well established. That right is not absolute, however: it may be limited by agreement of the shareholders, expressed either as an amendment to the certificate of incorporation or as a private contract among the shareholders.[23] But, absent such a contractual limitation, each director has the same right of access to information as any other director.[24] In this case, Holdings and Cordant possessed no right conferred by charter, bylaws, or other contract to limit any individual director's entitlement to information or to participate in board deliberations and decisions. Therefore, the defendants had no legal power to withhold information from Rogers or prevent Rogers' participation in board action relating to terminating the Strategic Alliance, without his consent.[25]

The defendants claim that they did not procure Rogers' absence, because Rogers knowingly and voluntarily excused himself from the board meetings. The defendants also argue that the August 23 meeting was not a board meeting. Both contentions are without merit. The defendants admit that at the August 23 meeting they formally resolved to terminate the Strategic Alliance.[26] Because the Strategic Alliance could only be

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[23]Lehrman v. Cohen, Del. Supr., 222 A.2d 800, 808 (1966) (certificate of incorporation); 1 David A. Drexler, et al., Delaware Corporation Law and Practice § 13.01[l] (1997).

[24]See Moore Business Forms, Inc. v. Cordant Holdings Corp., Del. Ch., C.A. Nos. 13911 & 14595, Jacobs, V.C., Mem. Op. at 10 (June 4, 1996) ("In this case, the only way that Mr. Rogers' legal right of equal access to 'board information' could be diminished would have been by an ex ante agreement among the contracting parties."); Kumar v. Racing Corp. of America, Del. Ch., C.A. No. 12039, Berger, V.C. (April 26, 1991) (the board of directors, as a whole, must be informed).

[25]It is undisputed that the defendants withheld material information from Rogers, including the selection and engagement by Jeffers and Decker of KPMG, the plan for terminating the Strategic Alliance, the Deloitte & Touche opinion concerning the effect of termination upon Holdings' capital, the negotiations and agreement with Chase Bank to amend the credit facility to repurchase Moore's shares, the intention to deliberate and vote on terminating the Strategic Alliance at the May 17 board meeting, and the special board meeting of August 23, at which the decision to terminate was actually made.

[26]Michlovitz Dep. at 189:10-190:18; Casazza Dep. at 115:2-5, 133:17-21; Jeffers Dep. at 257:18-258:10.

terminated by formal board action, it follows that the August 23 meeting was a board meeting.[27]

[4-5] Nor have the defendants satisfied the Court that Rogers voluntarily and knowingly relinquished his right to participate in all board discussion and actions pertaining to the Strategic Alliance. Rogers' practice was to excuse himself from board meetings when the Strategic Alliance issue came up for discussion. The evidence of record shows that Rogers did that as a courtesy to enable the other board members to discuss the Strategic Alliance openly and frankly. At no point did Rogers consent to the board taking action outside his presence. To permit the defendants to contort Rogers' courtesy into a waiver of his information and participation rights would be inequitable and contrary to fact. In these circumstances, the board had an affirmative duty to inform Rogers of any actions that it was proposing to take, so that he could intelligently decide whether to recuse himself from the meeting, abstain from voting, or take some different course of action by reason of a conflict of interest.[28] The board was also obligated to provide Rogers accurate minutes of the meetings reflecting any deliberations and action taken in his absence.

[6-8] A most significant error on defendants' part was their decision not to give Rogers notice of the August 23, 1994 special board meeting. Delaware law is well settled that board action taken in the absence of a director, where the absence is obtained by trickery or deceit or where notice of a special meeting was not given to a director, is void.[29] In *Schroder v. Scotten, Dillon Co.*,[30] the board convened a special meeting in which it purported to remove the chairman of the board and to make other changes in the board membership. One director was deliberately not given notice of the meeting.[31] Invalidating the board action taken at that meeting, then-Chancellor Duffy held: "A special meeting held without due notice to all

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[27]If it was not, then that alone would defeat the defendants' overall position, because any action taken at the August 23 meeting would, by defendants' own admission, be a nullity.

[28]See 1 R. Franklin Balotti and Jesse A. Finkelstein, The Delaware Law of Corporations and Business Organizations § 4.1E (2d ed. 1997) ("After Smith v. Van Gorkom, one would expect that all directors . . . must have access to all of the information and material upon which [a] decision is based in order to discharge properly their duty of due care"); Mem. Op., June 4, 1996 at 10-11; Lehrman, 222 A.2d at 808.

[29]Bruch v. National Guarantee Credit Corp., 116 A. 738, 740 (Del. Ch. 1922) ("Unless notice be given to each director of a special meeting of the board of directors as required by the by-laws, the meeting is illegal and action taken thereat is not binding."); see also Liberis v. Europa Cruises Corp., Del. Ch., C.A. No. 13103, Balick, V.C., (February 8, 1996); Pepsi-Cola Bottling Company of Cincinnati v. Woodlawn Canners, Inc., Del. Ch., C.A. No. 6161, Brown, C. (March 14, 1983).

[30]Del. Ch., 299 A.2d 431, 435 (1972).

[31]*Id.*

directors as required by the by-laws is not lawful and all acts done at such meeting are void"[32] That principle is equally applicable here. It is undisputed that Rogers was intentionally not given notice of the August 23 special meeting at which the defendant board voted to terminate the Strategic Alliance. That vote occurred in a context where Moore and Rogers had earlier been led to believe that the Strategic Alliance was not in jeopardy. Because the decision to terminate the Strategic Alliance occurred at a board meeting of which Rogers was deliberately not given notice, the actions taken by the Holdings board to terminate the Strategic Alliance were void ab initio.

B. The Breach of Contract Claim

[9-10] Moore also claims that the defendants' termination of the Strategic Alliance was legally invalid (and that as a consequence Moore was excused from tendering its Preferred Stock to Holdings) because the defendants breached material terms of the Purchase Agreement and the Shareholders Agreement. I conclude that the defendants did breach their contract(s) with Moore in two respects. First, they violated their implied obligation to perform the Purchase Agreement and the Stockholders Agreement in good faith. As previously noted, to protect its $11 million dollar investment, Moore bargained for the right to appoint a director to the Holdings board. Implicit in that arrangement was that Moore's designee would have the same information and participation rights as the other directors.[33]

[11] Second, defendants breached Section VIII.A of the Purchase Agreement by incurring new debt without Moore's consent or approval. That provision required the defendants to obtain Moore's consent before the corporation(s) could incur any new debt.[34] Without obtaining Moore's consent, the defendants negotiated a new financing agreement with Chase Bank, amended Holdings' credit facility and pledged $3 million of accounts receivable as collateral. Those actions constituted a material breach of the parties' contract and excused Moore from tendering its Preferred Stock to Holdings.[35]

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[32] *Id.*

[33] In its previous Opinion in this case, Mem. Op., June 4, 1996, at 10, the Court ruled that "all directors are entitled to equal access to corporate information furnished to the Board, . . . the only way that Mr. Rogers' legal right of equal access to 'board information' could be diminished would have been by an ex ante agreement among the contracting parties. No such agreement was made here."

[34] See n. 6, supra.

[35] Hudson v. D&V Mason Contractors, Inc., Del. Super., 252 A.2d 166, 169-70;

The defendants argue that no breach occurred "because the ($4.48 million) check [tendered as the payment for the repurchase of Moore's Preferred Stock] was never presented against the line of credit, [and] the debt contemplated by the September 8, 1994 option with Chase was never 'incurred' within the meaning of Section VIII.A."[36] To say it differently, defendants argue that although "Holdings 'obtained' the form of a modification to an existing credit facility . . . which it had an option to execute, it did not execute that option, and therefore did not agree to the Modification.[37]

[12] This argument ignores the indisputable fact that the defendants committed the

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company to incur new indebtedness, by pledging $3 million of the corporation's assets and then drawing down the $4.48 million repurchase price from the modified credit facility with Chase Bank. That Moore refused to accept the money does not change this fact. Accordingly, the Court concludes that defendants breached their obligation to obtain Moore's consent before incurring or assuming any indebtedness.

C. Ratification

At a special meeting held on September 27, 1994, the Holdings board adopted a resolution ratifying the actions they had taken on and before August 23 to terminate the Strategic Alliance. The defendants contend that that ratifying vote cured any arguable deficiencies in the board's decision-making process. The plaintiffs reply that any procedurally flawed actions by the defendants were void, not voidable, and that because void actions cannot be ratified, the September 27 ratifying vote was a legal nullity.

[13-14] To determine if the board's ratification vote was effective, the Court must decide two questions: (1) were the defendants' actions void or only voidable; and (2) what was the legal consequence of the board's ratification of those actions if they were (a) void or (b) voidable? Delaware law recognizes that a board may

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RESTATEMENT (SECOND) OF CONTRACTS §§ 229, 237, 241 (1979) (failure of performance excuses non-breaching party's performance).

[36]Def. Br. at 27.

[37]*Id.* at 48.

[end - revised page - March 5, 1998]

ratify its prior acts,[38] but in this case the defendants' acts were void and therefore not curable by ratification.

[15-16] In *Michelson v. Duncan*,[39] the Delaware Supreme Court distinguished between void and voidable acts as follows:

> The essential distinction between voidable and void acts is that the former are those which may be found to have been performed in the interest of the corporation but beyond the authority of management, as distinguished from acts which are *ultra vires*, fraudulent or gifts or waste of corporate assets.

Although Holdings' purported termination of the Strategic Alliance was not *ultra vires*, a gift, or waste, for the reasons previously discussed[40] Holdings' intentional failure to give Rogers notice of the August 23 special board meeting rendered void the board actions taken at that meeting. Consequently, the termination vote at the August 23 meeting was not ratifiable.

D. Remedy

The final issue concerns the remedy. Section XIII.E of the Purchase Agreement provides that the sole remedy for breach of the Agreement is specific performance. The defendants argue that that provision means that even if Rogers was illegally deprived of access to information to which he was legally entitled, Moore's sole remedy is an order directing the defendants to provide that information to Rogers now.

[17] That argument lacks merit. Such a result would be inequitable and would amount to no remedy at all. Moore had already received the information. The problem is that Moore did not receive the information until after its motion to compel discovery was granted -- long after the Holdings board had voted to terminate the Strategic Alliance and far too late to enable Moore to preempt the defendants' termination. The purpose

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[38]See Essential Enterprises Corp. v. Automatic Steel Products, Inc., 164 A.2d 437, 438 (Del. Ch. 1960) ("There can be no question but that in certain situations a [board's] ratification may relate back so as to bestow legality on an earlier invalid act.").

[39]407 A.2d 211, 218-19 (Del. 1979).

[40]See pp. 19-20, supra, of this Opinion; Schroder v. Scotten, Dillon Co., Del. Ch., 299 A.2d 431, 435 (1972).

of the specific performance remedy is to place the aggrieved party in the position that it would have been in but for the breach. Had Rogers been told that the board was intending to terminate the Strategic Alliance, he would have informed Moore, and Moore would have had the opportunity to invoke its termination right preemptively. Moreover, to the extent the defendants' conduct violated Delaware corporate law precepts, Section XIII.E of the Purchase Agreement has no relevance, because it applies only to "the covenants set forth in this Agreement." Because Rogers' rights to access board information and participate in board action also flow from a legal source independent of the covenants of the Purchase Agreement (i.e., corporate law precepts), Section XIII.E cannot operate to limit Moore's remedy.

* * *

Counsel shall confer and submit a form of order implementing the rulings in this Opinion.

OHRSTROM v. HARRIS TRUST CO. OF NEW YORK

No. 15,709

Court of Chancery of the State of Delaware, New Castle

January 7, 1998

Defendant, a New York corporation that served as a transfer agent for two Delaware corporations that were also defendants in this action, filed a motion to dismiss for lack of personal jurisdiction. The transfer agent asserted that Delaware's long-arm statute did not reach the activities that it performed for the Delaware corporations in its capacity as a transfer agent, and furthermore, that the exercise of personal jurisdiction over it offended traditional notions of due process of law under the Fourteenth Amendment to the United States Constitution. The defendant maintains no physical presence in Delaware and conducts all of its business for its two Delaware client corporations from New York.

The court of chancery, per Chancellor Chandler, granted defendant's motion to dismiss for lack of personal jurisdiction. Noting that defendant did not conduct any business in Delaware and did not have minimum contacts with Delaware, Chancellor Chandler concluded that plaintiffs had not demonstrated: (1) a basis for exercising personal jurisdiction over defendant Harris Trust under Delaware's long-arm statute, or (2) a basis for concluding that the exercise of such jurisdiction over Harris Trust comported with traditional notions of fair play and substantial justice under the Fourteenth Amendment.

1. Courts ⚷ 12(2), 12(2.5), 12(2.10), 12(2.15), 39
   Federal Courts ⚷ 76, 76.5, 76.10, 76.15
   Pretrial Procedure ⚷ 684

The Delaware Court of Chancery is without personal jurisdiction over a nonresident transfer agent when the transfer agent does not conduct any business in Delaware and does not have minimum contacts with Delaware.

2. Courts ⚷ 12(2)
   Federal Courts ⚷ 76
   Pretrial Procedure ⚷ 683

On a motion to dismiss, once the defendant has challenged personal jurisdiction, the plaintiff bears the burden of demonstrating a factual basis for asserting jurisdiction over the defendant.

3. Constitutional Law ⚷ 305(4), 305(5)
   Courts ⚷ 12(1)
   Federal Courts ⚷ 76
   Pretrial Procedure ⚷ 683

On a motion to dismiss, once the defendant has challenged personal jurisdiction, the plaintiff must satisfy its burden of demonstrating a factual basis for asserting jurisdiction over the defendant by alleging facts sufficient to satisfy not only Delaware's long-arm statute, but also the due process clause of the United States Constitution. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996); U.S. CONST. amend. XIV.

4. Constitutional Law ⟹ 305(4), 305(5)
Courts ⟹ 12(1), 39
Federal Courts ⟹ 76
Pretrial Procedure ⟹ 683, 684

On a motion to dismiss, once the defendant has challenged personal jurisdiction, if the plaintiff is unable to allege facts sufficient to satisfy Delaware's long-arm statute and the Due Process Clause of the United States Constitution, the defendant's motion to dismiss will be granted. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996); U.S. CONST. amend. XIV.

5. Constitutional Law ⟹ 305(4), 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76
Pretrial Procedure ⟹ 683, 684

Plaintiffs fail to demonstrate that the Delaware Court of Chancery may assert personal jurisdiction over a nonresident transfer agent when plaintiffs (1) fail to allege facts that satisfy Delaware's long-arm statute, and (2) fail to allege jurisdictional facts that comport with traditional notions of fair play and substantial justice as required by the Fourteenth Amendment. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996); U.S. CONST. amend. XIV.

6. Courts ⟹ 12(2), 12(2.5), 12(2.10), 12(2.15), 12(2.25), 12(2.30), 39
Federal Courts ⟹ 76, 76.5, 76.10, 76.15, 76.25, 76.30

The Delaware long-arm statute provides that a court may exercise personal jurisdiction over any nonresident, or a personal representative, who in person or through an agent: (1) transacts any business or performs any character of work or service in the state; (2) contracts to supply services or things in this state; (3) causes tortious injury in the state by an act or omission in this state; (4) causes tortious injury in the state or outside the state if the person regularly does or solicits business, engages in any other persistent course of conduct in the state or derives substantial revenue from services, or things used or consumed in the state. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996).

7. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76

Delaware's long-arm statute is broadly construed to assert jurisdiction to the maximum parameters of the Due Process Clause. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996).

8. Courts ⟹ 12(2), 12(2.15), 39
Federal Courts ⟹ 76, 76.15

Under the Delaware long-arm statute, a Delaware court may exercise personal jurisdiction over a nonresident defendant that transacts business in Delaware. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996).

9. Courts ⟹ 12(2), 12(2.15), 39
Federal Courts ⟹ 76, 76.15

Where a nonresident transfer agent transfers and registers shares of stock from its offices in New York, and provides stock-related services for a corporation organized under Delaware law, the transfer agent has not transacted business in Delaware sufficient to satisfy the Delaware long-arm statute. DEL. CODE ANN. tit. 10, § 3104(c)(1) (Supp. 1996).

10. Courts ⟹ 12(2), 12(2.15), 39
Federal Courts ⟹ 76, 76.15

A nonresident transfer agent does not conduct business in Delaware, when it has no place of business in Delaware, no telephone number in Delaware, no post office box or mailing address in Delaware, and no agent for service of process in Delaware.

11. Courts ⟹ 12(2), 12(2.30), 39
Federal Courts ⟹ 76, 76.30

Under the Delaware long-arm statute, a Delaware court may exercise personal jurisdiction over a nonresident defendant when the defendant contracts to supply services in Delaware. DEL. CODE ANN. tit. 10, § 3104(c)(1) (Supp. 1996).

12. Courts ⟹ 12(2), 12(2.30), 39
Federal Courts ⟹ 76, 76.30

Merely contracting with an entity that is incorporated within a forum state does not provide necessary connections between the contract and the forum to support a finding of jurisdiction.

13. Courts ⟹ 12(2), 12(2.30), 39
Federal Courts ⟹ 76, 76.30

A nonresident transfer agent has not contracted to supply services in Delaware, sufficient to satisfy the second prong of Delaware's long-arm statute, where the negotiations leading to the contract between the New York transfer agent and the Delaware corporation took place in New York, and all services were provided to the Delaware corporation from the transfer agent's New York office. DEL. CODE ANN. tit. 10, § 3104(c)(1) (Supp. 1996).

14. Courts ⟹ 12(2), 12(2.10), 12(2.25), 39
Federal Courts ⟹ 76, 76.10, 76.25

Under the Delaware long-arm statute, a Delaware court may exercise personal jurisdiction if the plaintiff demonstrates that the nonresident defendant has caused a tortious injury in Delaware and that this injury was due to the defendant's act or omission in Delaware. DEL. CODE ANN. tit. 10, § 3104(c)(3) (Supp. 1996).

15. Courts ⟹ 12(2), 12(2.10), 12(2.25), 39
Federal Courts ⟹ 76, 76.10, 76.25

Plaintiffs cannot rely on the third prong of Delaware's long-arm statute to secure personal jurisdiction over a nonresident transfer agent when, assuming that plaintiffs were injured in Delaware as a result of the transfer agent's conduct, none of the acts alleged to have caused plaintiff's injury took place in Delaware. DEL. CODE ANN. tit. 10, § 3104(c)(3) (Supp. 1996).

16. Courts ⟹ 12(2), 12(2.5), 12(2.10), 12(2.15), 12(2.25), 39
Federal Courts ⟹ 76, 76.5, 76.10, 76.15, 76.25

Under Delaware's long-arm statute, a Delaware court may assert jurisdiction over a nonresident where the plaintiff demonstrates that: (1) the

defendant has injured the plaintiff; (2) this injury occurred as a result of an act or omission outside of the state; (3) the defendant regularly does or solicits business, engages in any other persistent course of conduct in the state or derives substantial revenue from services, or things used or consumed in the state. DEL. CODE ANN. tit. 10, § 3104(c)(4) (Supp. 1996).

17. Courts ⟹ 12(2), 12(2.5), 12(2.10), 12(2.15), 39
Federal Courts ⟹ 76, 76.5, 76.10, 76.15

The fact that a transfer agent registers and transfers stock from its New York office for 360 Delaware corporations does not satisfy the requirement, under the fourth prong of Delaware's long-arm statute, that the nonresident transfer agent regularly transacts business in Delaware, engages in a persistent course of conduct in Delaware, or derives substantial revenues from services performed in Delaware. DEL. CODE ANN. tit. 10, § 3104(c)(4) (Supp. 1996).

18. Courts ⟹ 12(2), 12(2.5), 12(2.10), 39
Federal Courts ⟹ 76, 76.5, 76.10

Under Delaware law, in order to be found to engage in a persistent course of conduct, sufficient to satisfy the fourth prong of Delaware's long-arm statute, the nonresident must have a "presence" in Delaware. DEL. CODE ANN. tit. 10, § 3104(c)(4) (Supp. 1996).

19. Courts ⟹ 12(2), 12(2.5), 12(2.10), 39
Federal Courts ⟹ 76, 76.5, 76.10

Where a nonresident transfer agent performs its entire role as transfer agent and registrar for a Delaware corporation in New York, a Delaware court is unable to find that the transfer agent has engaged in any course of conduct in Delaware, let alone a course of conduct sufficient to establish a jurisdiction-conferring presence in Delaware under the fourth prong of Delaware's long-arm statute. DEL. CODE ANN. tit. 10, § 3104(c)(4) (Supp. 1996).

20. Constitutional Law ⟹ 305(4), 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76

Even if plaintiffs are able to demonstrate that a nonresident transfer agent's activities fall within the ambit of Delaware's long-arm statute, the

court is compelled to grant the transfer agent's motion to dismiss when plaintiffs fail to demonstrate that the court's exercise of jurisdiction over the transfer agent would not offend traditional notions of fair play and substantial justice as required by the Fourteenth Amendment. DEL. CODE ANN. tit. 10, § 3104 (Supp. 1996); U.S. CONST. amend. XIV.

21. Constitutional Law ⟹ 305(4), 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76
Pretrial Procedure ⟹ 683

Under the Due Process Clause of the Fourteenth Amendment, plaintiffs must establish that a nonresident transfer agent has had minimum contacts with Delaware of such a nature and quality to indicate that: (1) the agent purposefully availed itself of the privilege of conducting activities within Delaware, and (2) the agent should reasonably have anticipated being haled into court in Delaware. U.S. CONST. amend. XIV

22. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 12(2.5), 12(2.30), 39
Federal Courts ⟹ 76, 76.5, 76.30

A nonresident transfer agent's contract with a Delaware corporation alone, without more, cannot automatically establish sufficient minimum contacts such that the transfer agent would expect to defend an action in Delaware.

23. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 12(2.5), 12(2.15), 39
Federal Courts ⟹ 76, 76.5, 76.15

A nonresident transfer agent must have continuous and systematic general business contacts with Delaware for a Delaware court to exercise personal jurisdiction over it in accordance with due process.

24. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 12(2.5), 39
Federal Courts ⟹ 76, 76.5

The fact that Delaware law governs and protects a Delaware corporation, for which a nonresident transfer agent provides services, does

not establish minimum contacts with the state of Delaware sufficient to confer personal jurisdiction over the nonresident transfer agent.

25. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 12(2.5), 39
Federal Courts ⟹ 76, 76.5

When a nonresident transfer agent provides services for a Delaware corporation, the fact that the situs of the corporation's stock is Delaware does not satisfy the Fourteenth Amendment's minimum contacts standard. U.S. CONST. amend. XIV

26. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 12(2.5), 39
Federal Courts ⟹ 76, 76.5

When the only connection between a nonresident transfer agent and the state of Delaware is that a corporation for which the transfer agent provides services is incorporated in Delaware, the nexus is insufficient to pass constitutional muster under the minimum contacts requirement of the Fourteenth Amendment. U.S. CONST. amend. XIV

27. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76

Plaintiffs fail to show that the assertion of personal jurisdiction over a nonresident transfer company comports with traditional notions of fair play and substantial justice where (1) the burden on the nonresident transfer agent to defend the action in Delaware is formidable, given that the agent has absolutely no contacts with Delaware; and (2) Delaware has little, if any, interest in adjudicating the dispute between plaintiffs and the nonresident transfer agent where the action does not involve a unique issue of Delaware law.

28. Constitutional Law ⟹ 305(5)
Courts ⟹ 12(2), 39
Federal Courts ⟹ 76
Pretrial Procedure ⟹ 683, 684

The Delaware Court of Chancery will grant a nonresident transfer agent's motion to dismiss the complaint against it for lack of personal

jurisdiction when plaintiffs have not demonstrated a basis for exercising personal jurisdiction over the transfer agent under Delaware's long-arm statute or a basis for concluding that the exercise of such jurisdiction over the transfer agent would comport with traditional notions of fair play and substantial justice under the Fourteenth Amendment. U.S. CONST. amend. XIV

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CHANDLER, *Chancellor*

[1] Before the Court is a motion to dismiss for lack of personal jurisdiction brought by a New York corporation that has served as transfer agent for the two Delaware corporations that also are defendants in this action. Because the transfer agent does not conduct any business in Delaware and does not have minimum contacts with Delaware, I conclude that this Court is without personal jurisdiction over the transfer agent. Therefore, I grant its motion to dismiss.

I. BACKGROUND

This action is brought by shareholders, George Ohrstrom and G.L. Ohrstrom and Co. (collectively, "Plaintiffs"), against defendants, Dover Corporation ("Dover"), DII Group ("DII") and Harris Trust Company of New York ("Harris Trust"). Dover is a publicly-traded Delaware corporation. Since 1955 Dover's stock has split eleven times. DII, a publicly-traded Delaware corporation, was spun off from Dover in March 1993. In the spin-off, Dover shareholders received one share of DII for every ten registered shares of Dover.

Harris Trust, a New York corporation, has been Dover's transfer agent and stock registrar since 1984. In this capacity, Harris Trust serves as Dover's agent with respect to stock transfers and specific shareholder activities.[1] Harris Trust also served as the exchange agent for the spin-off of DII. It is alleged that Harris Trust currently serves as DII's transfer agent and registrar.[2]

Plaintiffs allegedly held unregistered certificates for 11,154 shares of Dover stock (the "Unregistered Shares"). These certificates bore various dates ranging between 1956 and 1969. In May 1993, Harris Trust registered the shares at Plaintiff's request.

Thereafter, Plaintiffs requested stock certificates and consequent cash dividends stemming from the stock dividends, stock splits, and DII spin-off shares that Plaintiffs would have earned on the Unregistered Shares had they been registered at the time of these events. Plaintiffs assert that this amounts to approximately 950,000 Dover shares, 95,000 DII shares (collectively referred to as the "Dividend Shares") and cash dividends of about $6 million plus interest.[3] Defendants refused to give Plaintiffs the Dividend Shares and cash dividends that they requested because, among other things, the underlying shares were not registered to Plaintiffs at the time the dividends were declared. Finally, Plaintiffs assert that Harris Trust's transfer records reflected that Plaintiffs owned approximately 11,000 Dover shares for which they did not possess stock certificates (the "No-certificate Shares").

Harris Trust's 1993 registration of the Unregistered Shares resulted in a 10,954 share over-issue of the total number of Dover shares outstanding. To remedy this over-issue problem, Harris Trust cancelled approximately 4,600 of Plaintiffs' No-certificate Shares. Plaintiffs insist that Defendants are obligated to provide stock certificates for the cancelled

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[1]The following is a list of duties Harris Trust assumed by contract when Harris Trust became the transfer agent for Dover:

> Provide[] certain shareholder services to customers, including acting as a transfer agent, cotransfer agent, registrar, drop agent or dividend disbursing agent in respect [to] equity securities issued by such customers, providing proxy processing services, including acting as inspector of elections at shareholder meetings, providing services in connection with dividend reinvestment plans of such customers and providing tender offer agency, exchange agency and similar agency services to customers on a nonrecurring, transactional basis with respect to mergers, tender offers, exchange offers, subscription offerings and conversions.

[2]Harris Trust denies that it is currently the transfer agent for DII, but this dispute is not material to this decision.

[3]The parties have estimated that the Dividend Shares are worth about $70 million, based on publicly-traded market values.

shares, as well as for all other shares registered with Harris Trust for which they do not possess stock certificates.[4]

Harris Trust contends that it should be dismissed from this suit because this Court lacks personal jurisdiction over it. Specifically, Harris Trust asserts that Delaware's long-arm statute, 10 *Del. C.* § 3104, does not reach the activities that Harris Trust performs for Dover in its capacity as transfer agent and, furthermore, that to exercise personal jurisdiction over Harris Trust would offend traditional notions of due process of law under the Fourteenth Amendment to the United States Constitution.

Harris Trust notes that the negotiations leading to Harris Trust's engagement as transfer agent and stock registrar for Dover took place in New York. Except for certain data processing functions (which are performed in Chicago), Harris Trust performs all of its duties as transfer agent and stock registrar for Dover in its New York office. Further, Harris Trust has no office, address, post office box, telephone number or telephone listing in Delaware. Harris Trust is not registered to do business in Delaware; nor does it have an agent for service of process in Delaware. In short, Harris Trust neither solicits nor conducts any business in Delaware.

Plaintiffs contend that Harris Trust is the "alter ego" of Dover, acting on behalf of the Delaware corporation. According to this argument, Harris Trust does everything that Dover would normally do with respect to issuing and transferring shares and interacting with shareholders of the corporation (even though Harris Trust performs these essential functions in New York). As such, Plaintiffs argue that Delaware's long-arm statute reaches Harris Trust, and also that it is within the parameters of the Fourteenth Amendment to subject Harris Trust to personal jurisdiction in Delaware.

II. MOTION TO DISMISS

[2-4] On a motion to dismiss, once the defendant has challenged personal jurisdiction, the plaintiff bears the burden of demonstrating a factual basis for asserting jurisdiction over the defendant.[5] The plaintiff must allege facts sufficient to satisfy not only Delaware's long-arm statute, but also the

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[4]The record is unclear as to whether Plaintiffs also seek an additional 2,000 shares stemming from stock splits and cash dividends subsequent to 1993 on 2,000 of the shares which were cancelled. It is equally unclear why Plaintiffs apparently seek Dividend Shares and cash dividends for only 2,000 of the cancelled shares and not all of the cancelled shares.

[5]*Newspan, Inc. v. Hearthstone Funding Corp.*, Del. Ch., C.A. No. 13304, Allen, C. (May 10, 1994), slip op. at 7-8.

Due Process Clause of the United States Constitution.[6] If the plaintiff is unable to allege facts sufficient to satisfy either of these two requirements, the defendant's motion to dismiss will be granted.

[5] In this case, Plaintiffs not only have failed to allege facts that satisfy Delaware's long-arm statute, but they also have failed to allege jurisdictional facts that comport with traditional notions of fair play and substantial justice as required by the Fourteenth Amendment. Accordingly, Plaintiffs have failed to demonstrate that this Court may assert personal jurisdiction over Harris Trust.

III. ANALYSIS

A. *Delaware's Long-Arm Statute*

[6-8] The Delaware long-arm statute[7] provides four separate grounds upon which a Delaware court may exercise jurisdiction over a nonresident defendant.[8] First, a Delaware court may exercise personal jurisdiction over a nonresident defendant that transacts business in Delaware. Plaintiffs argue that because Harris Trust is the "alter ego" of Dover, Harris Trust transacts business in Delaware. Plaintiffs cite the following facts to support this contention:

- Dover is a Delaware corporation.

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[6] *Hercules, Inc. v. Leu Trust and Banking*, Del. Supr., 611 A.2d 476, 483 (1992); *LaNuova D & B, S.p.A v. Bowe Co.*, Del. Supr., 513 A.2d 764, 768 (1986).

[7] 10 *Del.C.* § 3104 provides in pertinent part that:

> (c) As to a cause of action brought by any person arising from any of the acts enumerated in this section, a court may exercise personal jurisdiction over any nonresident, or a personal representative, who in person or through an agent:
>
> (1) Transacts any business or performs any character of work or service in the State;
>
> (2) Contracts to supply services or things in this State;
>
> (3) Causes tortious injury in the State by an act or omission in this State;
>
> (4) Causes tortious injury in the State or outside of the State by an act or omission outside the State if the person regularly does or solicits business, engages in any other persistent course of conduct in the State or derives substantial revenue from services, or things used or consumed in the State.

[8] *See Transportes Aereos de Angola v. Ronair, Inc.*, 544 F. Supp. 858, 964 (D. Del. 1982) (noting the broad construction of Delaware's long-arm statute to assert jurisdiction "to the maximum perimeters of the due process clause").

- Harris Trust entered into a contract to act as an agent for Dover in connection with Dover stock transfers and shareholder relationships.
- The situs of Dover's stock is Delaware, and Delaware law protects Dover and Dover's shareholders.
- A Delaware corporation owns Harris Trust.
- The activities of Harris Trust are directly attributable to Dover because Dover, as Harris Trust's principal, directs Harris Trust's activities.

[9] This argument, however, does not have merit. The unalterable fact is that Harris Trust transfers and registers shares of Dover stock from its offices in New York. That Harris Trust provides stock-related services for a corporation organized under Delaware law cannot change this fact.[9]

[10] The record clearly supports a finding that Harris Trust does not conduct business in Delaware. It has no place of business in Delaware, no telephone number in Delaware, no post office box or mailing address in Delaware, and no agent for the service of process in Delaware.

[11-13] Under the long-arm statute, the Court may also exercise personal jurisdiction over a nonresident defendant when the defendant contracts to supply services in Delaware.[10] As discussed earlier, however, Harris Trust services Dover from its New York office.[11] Moreover, "merely contracting with an entity that is incorporated within a forum state does not provide necessary connections between the contract and the forum to support a finding of jurisdiction."[12] In this case, even the negotiations leading up to the contract between Harris Trust and Dover took place in New York.[13] Accordingly, this Court cannot find that Harris Trust has contracted to supply services in Delaware. Therefore, the second prong of Delaware's long-arm statute does not confer personal jurisdiction over Harris Trust.

[14] Plaintiffs further contend that this Court may assert jurisdiction over Harris Trust pursuant to the third prong of Delaware's long-arm statute.[14] Under subsection (c)(3), the Court may exercise personal jurisdiction if the

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[9]*See In re Chambers Dev. Co., Inc. Shareholders Litig.*, Del. Ch., C.A. No. 12508, Chandler, V.C. (May 20, 1993), slip op. at 9-11 (accounting firm's audit of Delaware corporation performed outside of Delaware not sufficient contact to confer personal jurisdiction).

[10]10 *Del. C.* § 3104(c)(2).

[11]Dover's office is also located in New York.

[12]*Abajian v. Kennedy*, Del. Ch., C.A. No. 11425, Allen, C. (Jan. 17, 1992), slip op. at 24 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 479 (1985)).

[13]*See Abajian*, slip op. at 24.

[14]10 *Del. C.* § 3104(c)(3).

plaintiff demonstrates that the nonresident defendant has caused a tortious injury in Delaware and that this injury was due to defendant's act or omission in Delaware.

[15] Assuming for the sake of argument that Plaintiffs were injured in Delaware as a result of Harris Trust's conduct,[15] Plaintiffs still have failed to demonstrate that their injury occurred as a result of an act or omission that took place in Delaware. As previously statute, Harris Trust's office is in New York. All of the acts Harris Trust undertook that Plaintiffs allege caused their injury took place in New York, including the over-issuance of the Dover shares, the cancellation of the No-certificate Shares, and the failure to furnish Plaintiffs the requested stock certificates. In short, none of the acts that are alleged to have caused Plaintiffs' injury, with respect to Harris Trust, took place in Delaware. Therefore, Plaintiffs cannot rely on the third prong of Delaware's long-arm statute to secure personal jurisdiction over Harris Trust.

[16] Finally, under § 3104(c)(4) of Delaware's long-arm statute, the Court may assert jurisdiction over a nonresident where the plaintiff demonstrates that: (1) the defendant has injured the plaintiff; (2) this injury occurred as a result of an act or omission outside of the state; and (3) the defendant "regularly does or solicits business, engages in any other persistent course of conduct in the State or derives substantial revenue from services, or things used or consumed in the State."[16]

Assuming that the first two elements of subsection (c)(4) are satisfied, Plaintiffs still have failed to establish that Harris Trust regularly does business in Delaware, engages in a persistent course of conduct in Delaware or derives substantial revenues from services performed in Delaware.[17] Plaintiffs argue that Harris Trust regularly does business in Delaware, engages in a persistent course of conduct in Delaware and derives substantial revenues from services performed in Delaware by virtue of the fact that apparently 360 of Harris Trust's 544 clients are incorporated in Delaware.

[17] That Harris Trust regularly registers and transfers stock from its New York office for 360 Delaware corporations, however, does not establish that Harris Trust regularly transacts business in Delaware, engages in a persistent course of conduct in Delaware or derives substantial revenues from services performed in Delaware. All that it establishes is that Harris

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[15]Injury occurred in Delaware, according to Plaintiffs, because of their status as stockholders in a Delaware corporation.

[16]10 *Del. C.* § 3104(c)(4).

[17]*See In re Chambers*, slip op. at 10; *Finkbiner v. Mullins*, Del. Super., 532 A.2d 609, 620 (1987).

Trust performs services for a number of companies whose state of incorporation is Delaware.

[18] Under Delaware law, in order to be found to engage in a persistent course of conduct, the nonresident must have a "presence" in Delaware.[18] In *Finkbiner*, the Court found that a nonresident car dealer who sold hundreds of cars to Delaware dealers did not have a presence in Delaware sufficient to establish a persistent course of conduct in Delaware.[19] The Court based its decision on the fact that all of the elements of sale took place in Maryland, including transfer of possession and control of the cars, transfer of title, and receipt of payment.[20]

[19] This case is no different from *Finkbiner*. Just as the nonresident car dealer in *Finkbiner* performed all of the elements of sale in Maryland, Harris Trust performs its entire role as transfer agent and registrar for Dover in New York. Moreover, this Court is unable to find that, as Dover's transfer agent, Harris Trust has engaged in <u>any</u> course of conduct in Delaware, let alone a course of conduct sufficient to establish a jurisdiction-conferring presence in Delaware.[21] Accordingly, this Court holds that Harris Trust's activities do not satisfy the requirements of the fourth prong of Delaware's long-arm statute.

Just as in *Finkbiner*, where the Court found that the plaintiff did not carry his burden of establishing a basis for personal jurisdiction over the nonresident car dealer pursuant to subsection (c)(4) of Delaware's long-arm statute, this Court similarly finds that Plaintiffs have not carried their burden of demonstrating a basis for personal jurisdiction over Harris Trust pursuant to subsection (c)(4) of Delaware's long-arm statute. In sum, Plaintiffs have not persuaded the Court that they have satisfied any of the four grounds upon which personal jurisdiction may be predicated under 10 *Del. C.* § 3104.

B. *Minimum Contacts*

[20] Even if Plaintiffs were able to demonstrate that Harris Trust's activities fell within the ambit of Delaware's long-arm statute, this Court would still be compelled to grant Harris Trust's motion to dismiss, based on Plaintiffs' failure to demonstrate that this Court's exercise of jurisdiction

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[18]*Finkbiner*, 532 A.2d at 619.

[19]*Id.*

[20]*Id.*

[21]Because Harris Trust provides no services in Delaware, it cannot "derive[] substantial revenues from services performed in Delaware."

over Harris Trust would not offend "traditional notions of fair play and substantial justice" as required by the Fourteenth Amendment.[22]

[21] Under the Due Process Clause of the Fourteenth Amendment, Plaintiffs must establish that Harris Trust has had minimum contacts with Delaware of such a nature and quality to indicate that: (1) Harris Trust purposely availed itself of the privilege of conducting activities within Delaware, and (2) Harris Trust should reasonably have anticipated being haled into court in Delaware.[23]

[22-23] Plaintiffs argue that by entering into a contract to become the transfer agent for Dover, a Delaware corporation, and undertaking the concomitant duties of transferring shares of a Delaware corporation, Harris Trust has availed itself of the privilege of conducting activities in Delaware and invoking the protection and benefits of Delaware's laws. I disagree. Harris Trust's contract with Dover "alone, without more, cannot automatically establish sufficient minimum contacts such that [Harris Trust] would expect to defend an action in [Delaware]."[24] Harris Trust "must have 'continuous and systematic' general business contacts with Delaware for a court to exercise personal jurisdiction over it in accordance with Due Process."[25]

[24-26] In this case, the record clearly shows that Harris Trust has never had continuous and systematic general business contacts with Delaware. In fact, it appears from the record that, as transfer agent for Dover, Harris Trust has had no business contacts whatsoever with Delaware. That Delaware law governs Dover and protects Dover's stockholders does not establish minimum contacts sufficient to confer personal jurisdiction over Harris Trust.[26] Similarly, the fact that the situs of Dover stock is Delaware does not satisfy the Constitution's minimum contacts standard.[27] The only connection between Harris Trust and Delaware is that Dover is incorporated in Delaware. This nexus is insufficient, in my opinion, to pass constitutional muster.

[27] Additionally, Plaintiffs have failed to show that the assertion of personal jurisdiction over Harris Trust would comport with "traditional

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[22]*See Newspan*, slip op. at 12 (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)).

[23]*Id.* at 13-14.

[24]*Id.* at 14 (citing *Burger King Corp. v. Rudzewicz*, 85 L. Ed. 2d 528, 545 (1985)).

[25]*In re Chambers*, slip op. at 11 (citing *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 415-16 (1984)).

[26]*See Shaffer v. Heitner*, 433 U.S. 186 (1977).

[27]*Meeker v. Bryant*, Del. Ch., C.A. No. 6245, Hartnett, V.C. (May 12, 1981), slip op. at 8.

notions of fair play and substantial justice."[28] The burden on Harris Trust to defend this action in Delaware would be formidable, given that Harris Trust has absolutely no contacts with Delaware. Furthermore, Delaware has little, if any, interest in adjudicating a dispute between Plaintiffs and Harris Trust. This action does not involve a unique issue of Delaware law. It is merely a commercial dispute among individuals and entities based in New York. Accordingly, I find that it would be unreasonable for Harris Trust to be required to defend against this action in Delaware.

[28] Finding that Plaintiffs have not demonstrated a basis for exercising personal jurisdiction over defendant Harris Trust under Delaware's long-arm statute or a basis for concluding that the exercise of such jurisdiction over Harris Trust would comport with traditional notions of fair play and substantial justice under the Fourteenth Amendment, I grant Harris Trust's motion to dismiss the complaint against it for lack of personal jurisdiction.

IT IS SO ORDERED.

SANDERS v. DEVINE

No. 14,679

Court of Chancery of the State of Delaware, New Castle

September 24, 1997

Plaintiff, a holder of preferred stock in a merged corporation, claimed the defendants induced him to purchase preferred stock in the defendant's company by fraud and misrepresentation. The plaintiff's amended complaint alleged that: (1) defendants breached the implied covenant of good faith and fair dealing in setting the terms of the merger, and (2) the defendants breached their fiduciary duties of good faith, fair dealing and loyalty by issuing a misleading prospectus. The defendant filed a motion to dismiss for failure to state a claim upon which relief may be granted.

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[28] *LaNuova*, 513 A.2d at 769 (citing *International Shoe*, 326 U.S. at 316).

The court of chancery, per Vice-Chancellor Lamb, granted the defendants' motion to dismiss because: (1) the terms of the certificate of designations are clear and unambiguous concerning the rights of the stockholder in the event of a cash-out merger; (2) the relevant contract between the parties was the certificate of designations, and the terms of that contract govern, not an implied covenant of good faith and fair dealing; and (3) the repeated disclosure about a possible cash-out merger demonstrates that there was no misrepresentation on the part of the defendant.

1. Pleading ⟹ 193(5)

In deciding a motion to dismiss for failure to state a claim upon which relief can be granted, the court is obliged to accept all well-pleaded allegations as true and draw all reasonable inferences in favor of the nonmoving party.

2. Fraud ⟹ 18
   Pleading ⟹ 61

It is inherent in a complaint alleging disclosure violations that the misstated or omitted facts be identified; therefore, the pleadings may not be conclusory and plaintiff must provide some basis for the court to infer that the alleged misstatements or omissions were material.

3. Fraud ⟹ 18
   Pleading ⟹ 8(3), 61

In complaints alleging disclosure violations by a corporation, pleader must allege facts missing from proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury to the plaintiff.

4. Fraud ⟹ 18
   Pleading ⟹ 193(5)

Under Chancery Court Rule 12(b)(6), in disclosure cases, documents outside the pleadings may be examined to establish materiality, and examination of prospectuses and proxy statements is permitted as long as the documents are integral to the plaintiff's claim. DEL. CH. CT. R. 12(b)(6).

5. Pleading ⟹ 11

In disclosure cases, documents such as prospectuses and proxy statements are not relied upon to establish the truth of the matters asserted therein, but rather only to determine what was actually disclosed.

6. Corporations ⟹ 307, 314(1)

In order to prevail on a breach of fiduciary duty claim, the plaintiff must first establish that he was a person to whom a fiduciary duty was owed.

7. Corporations ⟹ 317(4)

Where plaintiff was not a stockholder at the time a prospectus he relied on was issued, as a matter of law, there can be no liability under any fiduciary duty theories for disclosures made in connection with a stock offering.

8. Corporations ⟹ 307

The rights of preferred stockholders, to the extent they are provided in a certificate of designations, are primarily contractual in nature; thus, the scope of duties owed are measured by reference to the specific provisions of the certificates of designations, rather than any general fiduciary standard.

9. Contracts ⟹ 143
Corporations ⟹ 62

The court's function in the context of shareholder contracts is merely to construe the contract by employing the well established methods of contract interpretation.

10. Corporations ⟹ 310(1)

Where the terms of the certificate of designations expressly address the terms of a dispute, those express contractual terms, not an implied covenant of good faith and fair dealing, govern the parties' relations.

11. Corporations ⟹ 307

Where express contractual terms define under what conditions and at what price shares could be cashed-out, such terms preclude the implication of a more generalized duty of good faith and fair dealing.

12. Fraud ⟹ 13(3)
Corporations ⟹ 317(4)

In order to prevail on a claim for negligent misrepresentation, the following elements must be satisfactorily pled: (1) a pecuniary duty to provide accurate information, (2) the defendant supplied false information, (3) failure to exercise reasonable care in obtaining or communicating the information, and (4) a pecuniary loss caused by justifiable reliance upon the false information.

13. Fraud ⟹ 18
Corporations ⟹ 317(4)

A complaint must contain specific allegations that defendant company acted with scienter when making a material misrepresentation in order to recover under a fraudulent inducement theory.

14. Pleading ⟹ 11, 193(5)

In a motion to dismiss, a court cannot give credence to facts alleged for the first time in briefs where the complaint is devoid of any such allegations.

15. Pleading ⟹ 193(5)

Amended complaint alleging company had a secret plan to cash out shares when first issued fell under the rubric of fraud by hindsight and was insufficient to defeat a motion to dismiss under Chancery Court Rule 9(b). DEL. CH. CT. R. 9(b).

Joseph A. Rosenthal, Esquire, of Rosenthal, Monhait, Gross & Goddess, P.A., Wilmington, Delaware; and Stanley M. Grossman, Esquire, and Paul O. Paradis, Esquire, of Pomerantz Haudek Block & Grossman, New York, New York, of counsel, for plaintiff.

R. Franklin Balotti, Esquire, and Anne C. Foster, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and George M. Newcombe, Esquire, of Simpson Thacher & Bartlett, New York, New York, of counsel, for defendants.

LAMB, *Vice-Chancellor*

Pending before the Court is defendants' motion to dismiss for failure to state a claim upon which relief may be granted and to strike the class action allegations found in the first two counts of the Amended Complaint ("AC"). For the reasons set forth *infra* the motion to dismiss shall be granted. I do not reach the motion to strike.

I. Background

The Merger

This action arises out of a merger (the "Merger"), announced October 13, 1995, of Ford Holdings Capital Corporation with and into Ford Holdings, Inc. ("Ford Holdings" or the "Company"), with the Company as the surviving entity. The Merger became effective on December 31, 1995. Before the Merger, the Company's capital structure consisted of outstanding shares of common stock, all owned, directly or indirectly by Ford Motor Company ("Ford"), and approximately twenty series of preferred stock, held entirely by persons not affiliated with Ford. Following the Merger, the outstanding common shares of the Company remained outstanding and unchanged, but all of the preferred shares were converted into the right to receive a fixed amount of cash. Thus, as a result of the Merger, Ford acquired 100% ownership interest in the equity of the Company.

Plaintiff was the holder of 1,200 Depositary Shares, each share representing 1/4,000 of a Share of Ford Holdings Series A Cumulative Preferred Stock. Plaintiff evidently acquired those securities at their offering price of $25 per share in the initial public distribution in May of 1992. In this action, he also purports to act on behalf of all persons who purchased Depositary Shares (the "Shares") representing interests in any of Ford Holdings Series A, B or D Cumulative Preferred Stock, all of which Shares were converted in the Merger into the right to receive $25 in cash

plus accrued but unpaid dividends. The holders of Shares were entitled to seek appraisal for their shares in the Merger and some did.[1]

Central to the Chancellor's decision in the appraisal case is the fact, not contested in this action, that the certificate of designations relative to the Ford Holding Series A Cumulative Preferred (and the Series B and C as well) clearly and unambiguously provide that, in the case of a cash-out merger, holders are entitled to be paid the liquidation preference ($25 per Share) plus accrued and unpaid dividends, no more and no less.

The Complaint

Rather than pursue his appraisal remedy, plaintiff Sanders filed this action on November 3, 1995, alleging that he was induced to purchase the Shares by fraud and misrepresentation concerning the period of time the Shares were likely to remain outstanding. In particular, he claims that he was misled into believing that the Shares were "non-redeemable" and "perpetual" in duration. According to plaintiff, at the time Ford issued the Shares its undisclosed corporate tax strategy created a risk to investors that Ford would eliminate the Shares by means of a cash-out merger in 1994 or shortly thereafter.[2] He further alleges that, if he had known this fact, he either would not have purchased the Shares or would have demanded a lower price or a higher yield. Plaintiff's complaint also contains claims that defendants (i) breached the implied covenant of good faith and fair dealing in setting the terms of the Merger and (ii) breached their fiduciary duties of "good faith, fair dealing and loyalty" by issuing a false and misleading prospectus and by causing the Shares to be cashed-out at $25 per Share.

Plaintiff alleges damages to be the difference between the trading price of the Shares (approximately $27 per Share) immediately before a

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[1]On March 20, 1997 Chancellor Allen determined that the holders of Ford Series A, B and C Cumulative Preferred Stock were not entitled to appraisal rights, while Series D Preferred Stock was entitled to appraisal rights. *See In the Matter of The Appraisal of Ford Holdings, Inc. Preferred Stock*, Del. Ch., C.A. No. 14852, Allen, C. (March 20, 1997). Chancellor Allen reached this conclusion by determining that the instruments establishing the rights and preferences of the series A, B and C preferred stock could contractually limit the right of holders to seek judicial appraisal, under § 262 of the Delaware General Corporation law, in the event of a cash-out merger. *See id.* As the Chancellor stated:

> [t]here is no ambiguity in [the Certificate of Designations] regarding the value to be paid to shareholders if they are forced to give up their shares in a cash-out merger. The shareholder can not now come to this court seeking additional consideration in the merger through the appraisal process.

Id. at 11.

[2]In his brief, but not his complaint, plaintiff makes the more serious charge that, at the time it issued the Shares, Ford already had a secret plan or fixed intention to effect such a transaction. *See* discussion *infra* pages 21-23.

September 15, 1995 news report that Ford was considering a "reorganization of its financial services operations" and the trading price ($25.38) on the day Ford announced its intent to reacquire the Shares at the Merger price.

Shortly after filing his complaint, plaintiff made an application for expedited proceedings and a preliminary injunction. When defendants objected, plaintiff withdrew his requests, stating that he and his counsel had "concluded that adequate relief can be afforded to class members after the merger . . . is consummated.' DKT. 10.

Ford Holdings

Ford created the Company in 1989 as its "deconsolidated" subsidiary to permit Ford to achieve greater utilization of its foreign tax credits.[3] Ford then contributed to the Company the assets of certain of its U.S. subsidiaries (in particular those associated with Ford's financial services operations) which generated significant interest expense. By "deconsolidating" these domestic operations, Ford was able, it is alleged, to avoid having to allocate interest expenses associated with those operations in a way which would have interfered with Ford's ability to utilize a significant amount of foreign tax credits.

To satisfy the requirements of the Internal Revenue Code relating to the "deconsolidation" of subsidiaries from a consolidated filing group, it was necessary that Ford Holdings be at least 20% owned by persons not affiliated with Ford.[4] To satisfy this requirement, in 1989 Ford Holdings publicly issued $800 million of preferred stock that represented more than 20% of the "vote or value" of Ford Holdings. Over time, increases in the equity value of Ford Holdings led to further offerings of preferred stock by Ford Holdings in order to maintain the 20% minimum equity ownership by non-affiliates. One such offering was the May 1992 offering in which plaintiff acquired his Shares.

The Shares

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[3]In the context of this motion to dismiss, I accept the well pleaded allegations of fact in the Amended Complaint as true. *Solomon v. Paths Communications Corp.*, Del. Ch., C.A. No. 12563, Allen, C. (April 21, 1995) Mem. Op. at 10. See *infra* pages 10-12 and accompanying notes.

[4]Plaintiff also alleges that the tax laws required that Ford Holdings remain "deconsolidated" a minimum of five years. Defendants contest this latter point, which I find unnecessary to resolve.

The Shares were issued and sold pursuant to a public prospectus dated May 28, 1992 (the "Prospectus"). On the cover page of the Prospectus, the following disclosure appears:

> The Series A Preferred Stock and the Depositary Shares representing such stock are not redeemable. However, in any merger or consolidation of the Company with or into any other corporation (including any affiliated corporation) which by its terms provides for the payment of only cash to holders of Series A Preferred Stock, the holders of Series A Preferred Stock will be entitled to receive an amount equal to the liquidation preference of the Series A Preferred Stock, plus an amount equal to accumulated and unpaid dividends thereon, and no more.

Substantially the same disclosure is found at page 4 of the Prospectus. The Liquidation Preference of the Shares was $25 per share, a fact readily ascertained from the certificate of designations governing the Shares (Exhibit C to Affidavit of Raymond J. DiCamillo dated December 17, 1997)[5] and prominently disclosed in the Prospectus. At page 13, there appears a fuller description of "Rights on Liquidation or Cash Merger" which clearly spell out that, in the case of a cash-out merger, the holders of Shares would be entitled to receive per Share only $25 plus accumulated and unpaid dividends.

The Prospectus, on the cover page also disclosed the following:

> A merger or consolidation in which the holders of Series A Preferred Stock, Voting Preferred and Parity Preferred receive an amount equal to the liquidation preference, premium, if any, and accumulated and unpaid dividends on their shares <u>may be approved at any time</u> without a class vote of holders of such shares. (emphasis added)

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[5]For purposes of deciding this motion to dismiss, the certificate of designations may be relied on for ascertaining the contractual terms of the Shares. *See In re Santa Fe Pac. Corp. Shareholder Litig.*, Del. Supr., 669 A.2d 59, 70 (1995) (noting courts have considered the contract in breach of contract cases) (citing *Fayetteville Investors v. Commercial Builders, Inc.*, 936 F.2d 1462 (4th Cir. 1991) (contract and performance bond); *Quiller v. Barclays Am./Credit, Inc.*, 727 F.2d 1067 (11th Cir. 1984) (loan agreement); *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429 (7th Cir. 1993) (letter of intent)). Here, the certificate of designations is essentially a contract, therefore, it is appropriate to rely on it for determining its content. See *infra* pages 10-12 and accompanying notes.

At page 14, under the heading "Voting Rights" the Prospectus restates this information advising prospective purchasers that "The shares of Series A Preferred Stock will vote together as a single class with all shares of Common Stock [and other voting preferred shares]."

The Amended Complaint correctly notes that the Prospectus describes the Shares as non-redeemable. AC §32. It also alleges that a wire service known as "Dalnet Wires" carried information describing the Shares as "Perpetual" and having a "Non-Call[able] Life." From this it is alleged that Class Members reasonably believed that they were purchasing Shares which "had been issued in perpetuity" and which were "not redeemable." AC §34. The Amended Complaint does not allege that plaintiff saw, read or relied upon the "Dalnet Wires" service report, nor is a copy of that report made a part of the record.

The critical allegations in the Amended Complaint are found at paragraph 35. Plaintiff there alleges that the Prospectus disclosure that the Shares were non-redeemable and the Dalnet Wires report to the effect that the Shares were being issued in "perpetuity" were materially misleading because the defendants omitted to state "information regarding the circumstances and reasons why Ford Holdings had offered the Depositary Shares and prior similar securities in the first place, and the risk of effective redemption associated therewith." AC ¶35. In particular, plaintiff alleges that the Prospectus should have disclosed.

> a. defendants had caused Ford Holdings to issue the Depositary Shares as part of Ford's sophisticated tax strategy . . . to enable Ford to preserve millions of dollars worth of foreign tax credits that could be "carried forward" for a maximum period of five years from the year in which the foreign tax was incurred, thereby reducing Ford's overall tax liability;
>
> b. had Ford Holdings not been "deconsolidated" from Ford, Ford would have lost the ability to fully utilize these millions of dollars of foreign tax credits and would have realized a greatly increased United States income tax liability;
>
> c. to insure its success, this tax strategy necessitated that more than 20% of Ford Holdings "vote or value" securities be held by non-affiliated (e.g., public shareholders) for at least five years (i.e., 2-3 years after issuance of the Depository Shares), but that this structure need not be maintained thereafter; and

d. there was a risk to investors that after expiration of the five year period, Ford would reconsolidate Ford Holdings and thereby effectively redeem the Depositary Shares.

AC ¶35.

While making reference to the Prospectus disclosure that the Shares were non-redeemable, the Amended Complaint omits any reference to the disclosure, found in the same paragraph of the Prospectus, and quoted *supra* at pages 6 and 7, of the possibility of a cash-out merger at $25 per Share or to the disclosure that such a merger "may be approved at any time" without a class vote of the holders of Shares.

II. Discussion

Standard

[1-5] Before the Court is defendants' motion to dismiss for failure to state a claim upon which relief can be granted pursuant to Chancery Court Rule 12(b)(6). I must determine whether "it appears with a reasonable certainty that, under any set of facts which could be proven to support the claim, plaintiff would not be entitled to relief." *In re Santa Fe Pac. Corp. Shareholder Litig.*, Del. Supr., 669 A.2d 59, 65 (1995). In deciding this motion I am obliged to accept all well-pleaded allegations as true and draw all reasonable inferences in favor of the plaintiff. *See Loudon v. Archer-Daniels-Midland Company*, Del. Supr., C.A. No. 14638, slip op., Veasey, C.J. (Sept. 17, 1997) (stating Court must assume truthfulness of all well-pleaded allegations for purposes of motion); *Cincinnati SMSA Limited Partnership v. Cincinnati Bell Cellular Systems Co.*, Del. Ch., C.A. No. 15388, Chandler, V.C. (Aug. 13, 1997) Mem. Op. at 2. It is inherent in a complaint alleging disclosure violations that the misstated or omitted facts be identified, therefore, the pleadings may not be conclusory. *Loudon* at 11. *See also Cincinnati* at 2 (stating conclusory allegations which are unsupported by specific factual references will not be accepted as true). Plaintiff must provide some basis for the Court to infer that the alleged misstatements or omissions were material. *See Loudon* at 13 (stating pleader must "allege facts missing from proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury"). This often requires an examination of documents outside the pleadings, a practice which has been held not to conflict with the general rule limiting review of a motion to dismiss to the well-pleaded facts

contained in the complaint.[6] *In re Santa Fe*, 669 A.2d at 65. In disclosure cases, documents such as prospectuses and proxy statements are not relied upon to establish the truth of the matters asserted therein, but rather only to determine what was actually disclosed. *See id.* at 68-69.[7] Therefore, an examination of documents outside the pleadings is permitted as long as the documents are integral to the plaintiff's claim. *See Noerr v. Greenwood*, Del. Ch., C.A. no. 14320, Jacobs, V.C. (July 16, 1997) Mem. Op. at 6 (stating Court will not consider facts and documents extrinsic to complaint except those "integral to the claim and incorporated by reference into the complaint") (citing *Sapala v. Forest Health Service Corp.*, Del. Ch., C.A. No. 14260, Jacobs, V.C. (May 3, 1997) Ltr. Op. at 3; *James River-Pennington, Inc. v. CRSS Capital Inc.*, Del. Ch., C.A. No. 13870, Steele, V.C. (March 6, 1995) Mem. Op. at 9. In the present case, I shall consider the Prospectus for the matters disclosed therein and the certificate of designations governing the Shares for the contractual terms thereof as the contents of these documents are integrally related to the claims alleged.

Alleged Breach of Fiduciary Duties

I begin the analysis by addressing the fiduciary duty claims raised by plaintiff in Count IV of his complaint. Paragraph 55 of the Amended Complaint alleges that, by virtue of their control of Ford Holdings, defendants owed fiduciary duties of "good faith, fair dealing and loyalty" to the holders of the Shares. Paragraph 56 claims that defendants breached these duties by (I) making the allegedly misleading disclosures in connection with the Prospectus and the offering of the Shares, and (ii)

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[6]The relevant portion of Chancery Court Rule 12(b) states as follows:

> [i]f on a motion asserting the defense numbered (6) to dismiss for failure of the pleadings to state a claim upon which relief can be granted, matters outside the pleadings are presented to and not excluded by the Court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Ct. Ch. R. 12(b)(6).

[7]In commenting on the use of proxy statements in a motion to dismiss, the Supreme Court noted that "[w]ithout the ability to consider the document at issue, 'complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure.'" *In re Santa Fe*, 669 A.2d at 70 (quoting *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 774 (2d Cir. 1991). In the present case, because the certificate of designations sets forth the relevant contractual terms of the Shares needed to decide this motion, it is integral to the complaint; therefore, it is also appropriate for me to rely on the certificate in deciding this motion to dismiss without converting it to a summary judgment motion. *See, e.g., Winston v. Mandor*, Del. Ch., C.A. Nos. 14807 & 15416, Steele, V.C. (May 12, 1997) Mem. Op. at 10-11 & n.6.

causing the cash-out of the Shares at $25 per Share. Neither of these claims can withstand scrutiny.

[6-7] In order to prevail on a breach of fiduciary duty claim, plaintiff Sanders must first establish that at the time the Prospectus was issued he was a person to whom a fiduciary duty was owed. In the present case, plaintiff was not a stockholder at the time the prospectus was issued, therefore, as a matter of law, there an be no liability under any fiduciary duty theories for the disclosures made in connection with the offering. *See Glaser v. Norris*, Del. Ch., C.A. No. 9538, at 19-20, Chandler, V.C. (July 13, 1989) (finding no fiduciary duty owed plaintiff for alleged misrepresentation in prospectus because class had not yet become shareholders); *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, Del. Supr., 545 A.2d 1171, 1177 (1988) (finding no fiduciary duties imposed on corporation or its directors because prior to distribution date of interest plaintiff not considered a legal or beneficial stockholder).

[8-9] Moreover, neither the director defendants, the Company nor Ford can be thought to have breached a fiduciary duty by cashing out the Shares strictly in accordance with the cash-out merger terms specified in the certificate of designations. The rights of preferred stockholders, to the extent they are provided in that certificate, are primarily contractual in nature, thus, the scope of the duties owed are measured by reference to the specific provisions of the certificate of designations, rather than any general fiduciary standard. *See Jedwab v. MGM Grand Hotels, Inc.*, Del. Ch., 509 A.2d 584, 594 (1986) (stating claim that merger constitutes wrongful attempt to circumvent redemption provision of preferred stock relates to negotiated preference and must be evaluated strictly as contract action); *H.B. Korenvaes Invs., L.P. v. Marriott Corp.*, Del. Ch., C.A. No. 12922, slip op., Allen, C. (June 9, 1993) (stating rights of preferred stock created by corporate charter or certificate of designations and are primarily contractual in nature). The Court's function in this context is merely to construe the contract by employing the well established methods of contract interpretation. *See Wood v. Coastal States Gas Corp.*, Del. Supr., 401 A.2d 932, 937 (1979) (stating rights of preferred shareholder dependent on the share contract and not rules of law). Here, the terms of the certificate of designations are clear and unambiguous as to the rights of the stockholders in the event of a cash-out merger. Plaintiff, therefore, is precluded from suing the defendants for acting in conformity with the terms of an agreement which he freely entered into, and which concededly, governs his rights.

Alleged Breach of Implied Covenant of Good Faith and Fair Dealing[8]

Count III of the Amended Complaint alleges (¶51) that when plaintiff purchased Shares, he entered into a contract with Ford Holdings which included an implied covenant of good faith and fair dealing. Plaintiff then alleges (¶52) that defendants violated this covenant both by making misrepresentations and material omissions in connection with the offering of the Shares and by causing the Shares to be cashed-out at the $25 cash-out price.

[10-11] Neither of these claims is legally sufficient. At the time the Shares were marketed and the prospectus disclosures made, there was no contractual relationship between the plaintiff and any of the defendants. Thus, plaintiff's claim that the alleged misrepresentations or omissions made in connection with the offering of the Shares violated a contractually based "implied covenant" does not bear analysis. Further, the law is settled that where the terms of a contract expressly address the terms of a dispute, those express contractual terms — not an implied covenant of good faith and fair dealing — govern the parties' relations. *See Abex, Inc. v. Koll Real Estate Group, Inc.*, Del. Ch., C.A. No. 13462, Mem. Op. at 22-24, Jacobs, V.C. (Dec. 22, 1994) (stating Court will not rewrite parties' agreement by implying a duty that the parties expressly contracted not to create); *Gilbert v. El Paso Co.*, Del. Supr., 575 A.2d 1131, 1143 (1990) (finding that mere exercise of company's contractual right to terminate tender offer without more did not constitute breach of its implied covenant of good faith and fair dealing). The only relevant contract at issue here is the certificate of designations governing the Shares. There is no dispute in this case that the certificate of designations expressly governed the terms, including the price terms, on which the Shares could be cashed-out and that, in the merger which gave rise to this action, the Shares were cashed-out on the terms

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[8]In passing, after determining that the Amended Complaint does not implicate well pleaded claims for breach of fiduciary duty and does not otherwise seek equitable relief, I feel obligated to comment on the Court's jurisdiction to decide plaintiff's remaining claims. This is especially true in light of the fact that plaintiff, while initially filing a motion for expedited injunctive proceedings, withdrew his request stating that he could obtain adequate relief (i.e., a money damages remedy) once the merger was completed. Where equity jurisdiction may initially exist to determine some claims, this Court may also exercise concurrent jurisdiction over purely legal pendant claims for which an adequate remedy at law exists. *Clark v. Teeven Holding Co., Inc.*, Del. Ch., 625 A.2d 869, 876 (1992). Therefore, in light of the time and effort expended by both sides in drafting briefs and preparing for oral argument on the motion to dismiss, as well as the time and effort spent by the Court in considering these matters, I will address the plaintiff's remaining claims which arise out of the identical operative facts.

specified in that certificate. For the same reason that the express contractual terms of the Shares define the scope of the defendants' fiduciary duties in connection with the cash-out, *Jedwab* at 594, those terms preclude the implication of a more generalized duty of "good faith and fair dealing" to require behavior inconsistent with them.

The Remaining Claims

The remaining claims sound in tort and revolve around plaintiff's core allegation that the Prospectus misrepresented the expected life of the investment. Count I seeks damages from the defendants for having negligently misrepresented facts relating to the offering of the Shares. Count II alleges that the plaintiff was fraudulently induced to purchase the Shares and seeks damages therefor.

[12] There is no dispute that the defendants, or at least those participating in the offering of the Shares, owed plaintiff a duty to exercise reasonable care to see that the statements made in connection therewith were not materially misleading and, of course, owed a duty not to engage in intentional misrepresentations.[9] Plaintiff, however, fails to make out its *prima facie* case for negligent misrepresentation. In order to prevail on a claim for negligent misrepresentation the following elements must be satisfactorily plead:

(1) a pecuniary duty to provide accurate information;
(2) supplying false information;
(3) failure to exercise reasonable care in obtaining or communicating the information; and
(4) a pecuniary loss caused by justifiable reliance upon the false information.

Wolf v. Magness Construction Co., Del. Ch., C.A. No. 13004, Chandler, V.C. (Sept. 11, 1995) Mem. Op. at 3. In the present case, the Prospectus could not state any more clearly the conditions under which a stockholder's interest could terminate. It is true that the Prospectus states that the Shares are non-redeemable. However, it is equally true, as is evidenced by reading the text immediately following the statement that the Shares are non-

[9]Paragraph 42 of the Amended Complaint alleges that the defendants owed plaintiff "a duty of full disclosure, honesty and complete candor" in connection with the statements made in the offering of the Shares. To the extent this allegation implies that defendants stood in a fiduciary relationship with plaintiff in connection with the offering of the Shares, it is not an accurate statement of Delaware law.

redeemable, that the Shares were subject to a cash-out merger "at any time." Therefore, to the extent plaintiff alleges that he formed a misunderstanding of the material facts surrounding the issuance of the Shares, including the likelihood that they would be cashed-out in the future, plaintiff's misunderstanding is not a reasonable one in light of the disclosures actually made by defendants. Therefore, as discussed more fully *infra*, I find that Count I fails to state a claim for relief because it does not allege any actionable misrepresentation on the part of the defendants. [13] It follows that Count II also fails to state a claim for relief, as the existence of a material misrepresentation is an element for recovery under a fraudulent inducement theory as well.[10] Moreover, the Amended Complaint, fairly read, does not allege that the defendants acted with scienter and fails even to set forth facts from which it could reasonably be inferred that the defendants acted with such requisite knowledge. *See Loudon* at 12 (stating conclusions in complaint will not be accepted as true without specific allegations of fact to support them).

Analysis of Disclosure Claims

The statements actually made in the Prospectus about the Shares being non-redeemable are not actionable. These statements are both factually true and, in every instance, accompanied by disclosure about the possibility of a cash-out merger at a fixed price. The Prospectus clearly and unambiguously informed prospective purchasers that the Shares were subject to being cashed-out at any time, for a fixed price, without the consent of the holders thereof. No person who read the Prospectus could reasonably have believed that because the Shares were technically "non-redeemable," he or she was buying an instrument that would remain outstanding perpetually.

The statement allegedly made in the "Dalnet Wires" service that the Shares were "perpetual" in maturity is also factually true, in that the Shares had no fixed maturity. However, when read in light of the disclosures made prominently in the Prospectus about the possibility of a cash-out merger, these statements would not reasonably have caused an investor to believe that the Shares would remain outstanding forever.[11]

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[10]In order to plead the elements of common law fraud plaintiff must allege defendants: (1) with an intent to deceive, (2) made a false statement, (3) of a material fact, (4) upon which plaintiff, (5) reasonably, (6) relief to [his], (7) detriment. *Glaser v. Norris*, Del. Ch., C.A. No. 9538, Chandler, V.C. (Jan. 6, 1992) at 6 (quoting *Simons v. Cogan*, Del. Ch., 542 A.2d 785, 791 (1987) (citations omitted), *aff'd*, Del. Supr., 549 A.2d 300 (1988).

[11]I note, in passing, that the Amended Complaint does not allege that plaintiff Sanders

Boiled down to their essence, the crucial allegations contained in ¶35(a)-(d) of the Amended Complaint are that, if read to allow the understanding alleged by plaintiff that the Shares would remain outstanding forever, the Prospectus misled investors by not disclosing information about Ford's tax strategy which would have put them on notice that "there was a risk" that after 1994 "Ford would reconsolidate Ford Holdings and thereby effectively redeem" the Shares. As pointed out, *supra*, the Amended Complaint makes this allegation plausible only by ignoring altogether the Prospectus' disclosure about the possibility of a cash-out merger.

When viewed in light of the clear and repeated disclosure about the possibility of a cash-out merger, the alleged omissions specified in ¶35 are immaterial as a matter of law. Indeed, the matters alleged in ¶35, if disclosed, might have had the opposite effect of that argued by plaintiff. Rather than advise investors that the Shares might have a shorter existence than plaintiff claims to have understood, the disclosures urged by plaintiff could have caused a reasonable investor, i.e., one who read and understood the cash-out merger disclosure, to conclude that the Shares would remain outstanding for some minimum period of years required by Ford to accomplish its tax objectives and, thus, were not subject to being cashed-out "at any time" as disclosed in the Prospectus.

Perhaps recognizing the untenable nature of the allegations actually found in his Amended Complaint, plaintiff, in opposition to this motion, recharacterizes ¶35 as follows:

> [T] Amended Compliant alleges that defendants fraudulently induced Class Members into purchasing the Depositary Notes by:
>
> (i) marketing these securities as "non-callable" or "nonredeemable perpetual preferreds"; and
>
> (ii) omitting to disclose, among others, the following material facts:
>
> a. Ford <u>planned</u> for the Depositary Shares to remain outstanding for a maximum of four years from the date the [Shares] were first publicly

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saw or read the "Dalnet Wires" report described in ¶33 of the Amended Complaint. This "report" is not attached to the Amended Complaint and was not provided to the Court in connection with this motion.

offered for sale in May 1992 AC ¶35c; and

> b. Ford intended to eliminate public ownership of the Depositary Shares as soon as it was permitted to by "merging" Ford Holdings out of existence upon the conclusion of Ford's five year tax strategy. AC ¶35d.

Plaintiff's Brief in Opposition to Defendants' Motion to Dismiss ("PB") at 21 (emphasis added). In a similar vein, plaintiff's brief asserts as fact that "Ford's long-held secret plan to strip investors of their ownership interests in the 'non-redeemable perpetual preferred' Depositary Shares was publicly revealed for the first time on October 13, 1995." PB at 3.

[14] It should suffice to say that the "facts" alleged in (ii)(a) & (b) above are not found in the Amended Complaint. More broadly, the Amended Complaint never alleges that, at the time the Shares were issued, Ford "planned" to cash-out the Shares at any particular time or had a "secret" plan to "strip" investors of the Shares. Presumably, if plaintiff had a reasonable basis to believe that the "facts" alleged in his brief had evidentiary support, those matters would have been included in the Amended Complaint. As it is, the Amended Complaint is devoid of any allegation that Ford had any plan or fixed intention to cash-out the Shares at any time or after the passage of a fixed period of time. On this motion to dismiss, the Court cannot give credence to "facts" alleged for the first time in briefs.

[15] Moreover, even if the Amended Complaint alleged, on information or belief, that such a fixed and secret plan existed, such an allegation would appear to fall under the rubric of "fraud by hindsight" and be insufficient for that reason under Rule 9(b). The Court refuses to infer such an intent on the part of Ford based solely on the single fact that Ford subsequently cashed-out the shares. The mere fact that Ford cashed-out the Shares, as they were fully entitled to do, cannot now be used, without more, to infer that Ford had formed a "secret" plan back when the Shares were first issued. *See, e.g., Noerr v. Greenwood*, Del. Ch., C.A. No. 14320, Jacobs, V.C. (July 16, 1997) (finding plaintiff's complaint deficient because it failed to allege facts from which it could be inferred that the defendants had no basis for concluding what stock was worth when stock plan adopted eight months earlier). Finally, I note that the "fixed" and "secret" plan relied upon in the plaintiff's brief is inconsistent with the overall allegations of the Amended Complaint to the effect that the tremendous profitability of Ford Holdings, which led to the repeated and ultimately costly issuance of preferred stock, was unanticipated by Ford. One can infer that it was

this signal success and its attendant costs to Ford which caused Ford to reverse its strategy and reconsolidate Ford Holdings. The facts plead, therefore, are legally insufficient and fail to withstand attack on this motion to dismiss.

* * *

For all of these reasons, defendants' MOTION TO DISMISS IS GRANTED and the AMENDED COMPLAINT hereby is DISMISSED WITH PREJUDICE. SO ORDERED.

SIEGMAN v. PALOMAR MEDICAL TECHNOLOGIES, INC.

No. 15,894

Court of Chancery of the State of Delaware, New Castle

March 9, 1998

Plaintiff, a shareholder of common stock, commenced this class action against defendants, a corporation and its directors, alleging that (1) all ten series of preferred stock separately issued by the corporation invalid and therefore void; and (2) as a consequence, the defendants violated their duty of disclosure by not disclosing that fact in the proxy statement disseminated in connection with its annual stockholders meeting. Defendants responded that the preferred stock was validly issued, and alternatively that even if the stock was invalid when originally issued, the invalidity was later cured by the filing of certificates of correction. For that reason, defendants urged that the proxy statement violated no duties of disclosure.

The court of chancery, per Vice-Chancellor Jacobs, concluded that although the ten series of preferred stock were initially invalid when issued, the certificates of correction cured the mistake in the certificate of incorporation upon which the invalidity was predicated. As a consequence, the court held that the ten series of preferred stock are legally valid and the proxy statement did not violate defendants' fiduciary duty of disclosure.

1. Corporations ⟹ 202, 207.1

Claims that preferred stock is invalid and that the proxy disclosures about this subject are defective are individual, not derivative, in character, because they arise out of a contract (the certificate of incorporation), and their enforcement would affect the shareholders individually and unequally.

2. Corporations ⟹ 202, 206(4), 211(5)

The demand requirement of Chancery Court Rule 23.1 is inapplicable to claims that preferred stock is invalid, and that the proxy disclosures about this subject are defective, because the claims are individual, not derivative in character. DEL. CH. CT. R. 23.1.

3. Corporations ⟹ 71, 297, 373

A corporation is duly authorized to issue multiple series of preferred stock by board resolution when neither the original nor the restated certificate of incorporation expressly grants that authority, so long as the filing of certificates of correction cure the defect in both certificates, thereby retroactively supplying the authority to issue the preferred stock in series.

4. Corporations ⟹ 71, 373

As a matter of Delaware corporation law, the term class has a meaning separate and distinct from series; thus, to issue preferred stock in series, a corporation is required to have specific, express authority in its certificate of incorporation.

5. Corporations ⟹ 70, 373

Under Delaware law, blank-check stock authorization, i.e., a corporation's authority to issue stock whose specific preferences, rights, and other attributes are to be designated by board resolution at some future time, must be expressly granted in the certificate of incorporation.

6. Corporations ⟹ 71, 373

A corporation's authority to issue preferred stock in series must be expressly granted in its original or restated certificate of incorporation, and if neither of those certificates expressly grants such authority, then the

corporation does not have that power.

7. Corporations ⟹ 71, 373

The argument that the term class includes series, with the result that the power to issue stock in classes implies the power to issue stock in series, finds no basis in the Delaware statutes or case law because a corporation's authority to issue preferred stock in series must be expressly granted in the certificate of incorporation, and the Delaware General Corporation Law regards classes of stock as separate and distinct from series within a class.

8. Corporations ⟹ 373

When a mistake occurs in the drafting of the original certificate of incorporation, whereby there is an inadvertent omission of the language relating to a corporation's power to issue series of certain classes of stock, the mistake is correctable under section 103(f) and that correction should operate retroactively if the plaintiff class would not be substantially and adversely affected by the certificates of correction having retroactive effect. DEL. CODE ANN. tit. 8, § 103(f) (1996).

9. Corporations ⟹ 373
Evidence ⟹ 584, 594

When (1) the corporation's sole incorporator testifies that he intended for the corporation to have authority to issue preferred stock, (2) consistent with that testimony, the original prospectus that offered preferred stock to the investing public discloses that the corporation is authorized to issue preferred stock in series, and (3) all of the corporation's other public disclosures, including its subsequently filed registration statements for each newly-issued series of preferred stock, repeat that same representation, these uncontroverted facts are clear and convincing evidence that (a) it was always intended that the corporation would have the authority to issue preferred stock in series, (b) the corporation's management and board believed that the corporation did, in fact, have that authority, and (c) the omission to include language creating that authority in the original and restated certificates of incorporation was inadvertent.

10. Reformation of Instruments ⟹ 6

Whenever any instrument authorized to be filed with the Secretary

of State under any provision of Title VIII has been so filed and is an inaccurate record of the corporate action therein referred to, or was defectively or erroneously executed, sealed, or acknowledged, the instrument may be corrected by filing with the Secretary of State a certificate of correction of the instrument which shall be executed, acknowledged, filed, and recorded in accordance with section 103. DEL. CODE ANN. tit. 8, § 103 (1996).

11. Corporations ⟹ 373
Reformation of Instruments ⟹ 6

A certificate of incorporation may be corrected pursuant to section 103(f) without producing an accurate record, meaning a contemporaneous written instrument that documents the parties' actual (correct) intent. DEL. CODE ANN. tit. 8, § 103(f) (1996).

12. Corporations ⟹ 373
Evidence ⟹ 584

Testimony by the sole incorporator that the original certificate of incorporation was in error, which is fully corroborated by a series of publicly filed documents, attested by company officials and submitted to the SEC after the original certificate of incorporation was filed, is highly forceful evidence that the omission to include language expressly authorizing the issuance of preferred stock in series, both in the original and restated certificates, is an inaccurate record of the corporate action therein referred to, and is legally capable of being corrected under section 103(f). DEL. CODE ANN. tit. 8, § 103(f) (1996).

13. Corporations ⟹ 70, 71

When a corporation has always had authority to issue additional shares of common stock, plaintiff class never had a right to maintain its percentage share of equity undiluted by the issuance of additional shares; thus, plaintiff class cannot suffer, in any cognizable legal sense, a substantial and adverse effect from the issuance of preferred stock in separately denominated series.

14. Corporations ⟹ 70, 71, 373

Where (1) the plaintiff class would not be substantially and adversely affected by certificates of correction having retroactive effect,

and (2) the only identifiable substantial and adverse effect would be on the investment of remaining shareholders if the certificates of correction were not given retroactive effect, the certificates of correction may operate retroactively to the date of the original certificate to cure any defect of authority to issue preferred stock in series, and correlatively, to cure any defect in common stock received in exchange for the preferred.

William Prickett, Esquire, Ronald A. Brown, Jr., Esquire, Thomas A. Mullen, Esquire, and Samuel D. Brickley, II, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Arthur T. Susman, Esquire, and Charles R. Watkins, Esquire, of Susman, Buehler & Watkins, Chicago, Illinois, of counsel, for plaintiffs.

Robert J. Valihura, Jr., Esquire, and Mark A. Morton, Esquire, of Duane Morris & Heckscher, L.L.P., Wilmington, Delaware; and Thomas A. Reed, Esquire, of Palomar Medical Technologies, Inc., of counsel, Lexington, Massachusetts, for defendants.

JACOBS, *Vice-Chancellor*

Pamela H. Siegman (the "Plaintiff"), as Trustee for the Pamela H. Siegman Trust and the holder of 2000 shares of common stock of Palomar Medical Technologies, Inc. ("Palomar"), commenced this class action against Palomar and its directors[1] (collectively, the "Defendants") on August 27, 1997. Plaintiff claims that (i) all ten series of Preferred Stock separately issued by Palomar were invalid and therefore void; and (ii) as a consequence, the Defendants violated their duty of disclosure by not disclosing that fact in the proxy statement disseminated by Palomar in connection with its 1997 annual stockholders meeting. The Defendants respond that the Preferred Stock was validly issued, and alternatively that even if that stock was invalid when originally issued, the invalidity was later cured by the filing of Certificates of Correction. For that reason, the Defendants urge, the 1997 proxy statement violated no duties of disclosure.

This action was tried on October 20, 1997, and post-trial briefing was completed on November 24, 1997. This is the Opinion of the Court, after trial, on the merits of the Plaintiff's claims. For the reasons that follow, the Court concludes that although the ten series of Preferred Stock were initially invalid when issued, the Certificates of Correction cured the

[1]The directors of Palomar were Louis P. Valente, Michael H. Smotrich, Steven Georgiev, Buster Glosson, John M. Deutch, A. Neil Pappalardo, and James G. Martin.

mistake in the Certificate (and the Restated Certificate) of Incorporation upon which the invalidity was predicated. As a consequence, the ten series of Preferred Stock are legally valid and the 1997 proxy statement did not violate the Defendants' fiduciary duty of disclosure.

I. FACTS

As of July 17, 1997, the record date for the annual stockholders meeting, Palomar had issued and outstanding (a) 33,108,000 shares of common stock currently traded on the NASDAQ, (b) 6000 shares of Series F Convertible Preferred Stock, (c) 7684 shares of Series G Convertible Preferred Stock, and (d) 16,000 shares of Series H Convertible Preferred Stock. Of the remaining seven series of Preferred Stock issued by Palomar, six had been converted into 4,814,377 shares of common stock before July 17, 1997, and the seventh series had previously been redeemed. The Series G and Series H Preferred Stock have not yet been converted or redeemed, although a portion of the Series F Preferred Stock was converted into an unknown amount of common stock.

Because five different incorporation documents play a central role in this case, it is helpful to identify them at this point. The first Palomar's original Certificate of Incorporation (the "Original Certificate"), was filed with the Delaware Secretary of State when Palomar was incorporated on August 16, 1991. The second, an Amendment to Palomar's Original Certificate (the "Amendment"), was filed with the Delaware Secretary of State on July 22, 1996.[2] The third, Palomar's Restated Certificate of Incorporation (the "Restated Certificate"), was filed on August 14, 1996.[3] And the fourth and fifth, the Certificates of Correction of the Original and the Restated Certificates ("Certificates of Correction"), respectively, were filed on September 23, 1997.

Two of the Certificates had a "blank-check" stock provision which pertinently states that "[a]dditional designations and powers, the rights and preferences and the qualifications, limitations or restrictions with respect to each class of stock of the corporation shall be as determined by the Board of Directors from time to time."[4] That is, the "blank-check" provision of the Original and Restated Certificates expressly authorized

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[2]The Amendment restated and amended Article FOURTH of the Original Certificate in its entirety.

[3]The Restated Certificate restates and integrates and does not further amend the Original Certificate.

[4]Restated Certificate of Incorporation of Palomar Medical Technologies, Inc. p.1, ¶7 (emphasis added).

Palomar to issue stock in classes, but did not expressly authorize the issuance of stock in series.

Despite the absence of that authorizing language, Stephen L. Palmer, Esquire, who was Palomar's sole incorporator, testified that when his law office drafted the Original Certificate, he intended for Palomar to have the power to issue Preferred Stock in series, and that the failure to include express Certificate language designed to achieve that result was a mistake. The record shows that all of Palomar's subsequent public filings contained disclosures that were consistent with Mr. Palmer's testimony. The original Prospectus that Palomar filed with the United States Securities and Exchange Commission ("SEC") in 1992, disclosed to the investing public that Palomar was authorized to issue Preferred Stock in series.[5] In a Form S-3 Registration Statement filed with the SEC in December 1994, Palomar similarly disclosed that it had the authority to issue Preferred Stock in series. And, on all other occasions when Palomar issued another one of what became ten different series of outstanding Preferred Stock, Palomar filed Registration Statements with the SEC disclosing that Palomar was authorized to issue Preferred Stock in series. Lastly, the Palomar Proxy Statement disseminated in connection with the 1997 annual meeting disclosed that the company was authorized to issue Preferred Stock in series. These filings all establish that Palomar's board and management believed (incorrectly, as it turns out) that Palomar was authorized to issue Preferred Stock in series.

After this action was commenced, the Defendants showed the Original and Restated Certificates to Mr. Palmer, who investigated and discovered for the first time that the language "series of such," which he intended to be included, had inadvertently been omitted from the third line of the second paragraph of Article 4 of the Original Certificate.[6] Upon learning of this mistake, the Defendants promptly filed Certificates of Correction with the Delaware Secretary of State, pursuant to 8 Del. C. § 103(f), to include language in both the Original and the Restated Certificates expressly authorizing the issuance of stock in series.

II. THE PARTIES' CONTENTIONS

The Defendants first raise, as threshold procedural arguments, that the claim that the Preferred Stock is legally invalid, is legally insufficient,

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[5]The 1992 Prospectus specifically represented that "The Company is authorized to issue up to 5,000,000 shares of Preferred Stock, $.01 par value per share ("Preferred Stock"). The Preferred Stock may be issued in one or more series."

[6]Trial Transcript, p.28, lines 7-9.

for two reasons: (i) in no event could the relief being requested to enforce that claim (judicial invalidation of publicly traded stock) be granted, because such relief is overly broad and unprecedented, and (ii) the Plaintiff failed to comply with the demand requirement of Chancery Court Rule 23.1.

Alternatively, the Defendants contend that the Plaintiff's claims are insufficient as a substantive matter, because the Preferred Stock was legally valid when issued. The Defendants argue that a corporation's power to issue Preferred Stock in series is implicit and included within its power to issue stock in classes, and that because Palomar possessed the latter, broader power, it necessarily possessed the former, lesser authority as well. Alternatively, Defendants contend that even if the ten series of Preferred Stock were not authorized when originally issued, the Certificates of Correction operated to cure that defect retroactively, with the result that the Preferred Stock was validly issued ab initio and should be so declared. Finally, Defendants argue that should the Certificates of Correction be found legally ineffective to cure the error in the Original and Restated Certificates, then the Court should reform both Certificates to include language that, if originally present, would have authorized the issuance of the different series of Preferred Stock.[7]

In response to the Defendants' procedural arguments, the Plaintiff argues that the demand requirement is inapplicable because her claim is not derivative, and the relief that she requests is not overly broad or unprecedented. Turning to the substance of her claim, Plaintiff argues that the words "class" and "series" are terms of art having distinct meanings in Delaware corporation law. Therefore, a corporation's express authority to issue different classes of Preferred Stock does not automatically imply a lesser included authority to issue different series within a particular class, because a corporation's authority to issue Preferred Stock in series cannot be implied from an express power to issue stock in classes. Rather, that authority must itself be affirmatively and expressly set forth in the Certificate of Incorporation, because no such affirmative expression appears in the Certificates, the issuance of the Preferred Stock in series was void ab initio. For that reason (Plaintiff urges), the defect is not capable of correction by filing Certificates of Correction under 8 Del. C. § 103(f), or

[7]If the Court finds that (i) the Preferred Stock was valid when issued, or (ii) retroactively valid because the Certificates of Correction effectively cured the defect in those instruments, or (iii) valid because the Court determines to reform the Original and the Restated Certificates -- under any of those scenarios there would be no violation of the Defendants' fiduciary duty of disclosure. Because the Court concludes that the Preferred Stock, as issued in multiple series, is valid, the disclosure claim "drops out" and is not addressed in this Opinion.

by a judicial decree of reformation: only a shareholder-approved amendment to the Restated Certificate would suffice.

III. ANALYSIS

[1-2] Preliminarily, the Court concludes that the Plaintiff's claims -- that the Preferred Stock is invalid and that the proxy disclosures about this subject are defective -- are individual, not derivative, in character, because they arise out of a contract (the Certificate), and their enforcement would affect the shareholders individually and unequally.[8] Therefore, the demand requirement of Chancery Court Rule 23.1 is inapplicable to these claims.
[3] The parties' numerous contentions concerning the merits, are reducible to a single question: whether Palomar was duly authorized under the applicable Certificates to issue multiple series of Preferred Stock by board resolution? The Court concludes that (i) neither the Original nor the Restated Certificate expressly granted that authority, but (ii) the filing of the Certificates of Correction cured that defect in both Certificates, and supplied retroactively the authority to issue the Preferred Stock in series.[9]

A. The Preferred Stock was Initially Invalidly Issued

It is undisputed that neither the Original nor the Restated Certificate expressly and affirmatively authorized the issuance of Preferred Stock in series. But, the Defendants say, that is of no legal significance, because Palomar's authority to issue Preferred Stock in series was inherent and implicit in its express authority to issue different classes of stock.
[4] The Plaintiff responds that (i) as a matter of Delaware corporation law, the term "class" has a meaning separate and distinct from "series," and (ii) to issue Preferred Stock in series, Palomar was required to have specific, express authority in its Certificate of Incorporation. To that

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[8]In Re Tri-Star Pictures, Inc. Litig., Del. Supr., 634 A.2d 319, 330 (1993). The invalidation of the Preferred Stock would adversely affect the Preferred stockholders and any common stockholders who received that stock in exchange for the Preferred Stock, but (arguably) would benefit the remaining common stockholders by increasing their underlying equity per share.

[9]Because the Court rules in the Defendants' favor on the merits, it does not reach the Defendants' remaining defenses that (i) the relief the Plaintiff is seeking is unprecedented and overly broad, (ii) laches bars the specific form of relief the Plaintiff seeks, (iii) the Court cannot grant the specific form of relief that the Plaintiff seeks (invalidating 9.7 million shares of stock) without joining, under Chancery Court Rule 19, those shareholders whose stock could be declared void, and (iv) under Delaware's Uniform Commercial Code, Palomar is required to treat as valid the common stock now in the hands of new owners who have no knowledge of any alleged defect in their shares.

extent, at least, the Plaintiff is correct.

[5-7] Although the Original Certificate unambiguously authorized Palomar to issue two separate classes of stock, it did not affirmatively authorize Palomar to issue Preferred Stock in series. Under Delaware law, "blank-check" stock authorization, i.e., a corporation's authority to issue stock whose specific preferences, rights, and other attributes are to be designated by board resolution at some future time, must be expressly granted in the certificate of incorporation.[10] Thus, Palomar's authority to issue Preferred Stock in series had to have been expressly granted in its Original or Restated Certificates, and if neither of those Certificates expressly granted such authority, then the corporation did not have that power. For that reason, and because the Delaware General Corporation Law ("DGCL") regards "classes" of stock as separate and distinct from "series" within a class, the Defendants' argument that the latter term (class) includes the former (series), with the result that the power to issue stock in classes implies the power to issue stock in series, finds no basis in the statute or in Delaware case law.[11]

That, however, does not end the analysis, because here the Defendants filed Certificates of Correction, which (they claim) cured any absence of express authority in the Original and the Restated Certificates, to issue stock in series. That claim raises three separate issues that the Court must decide: (i) was the omission to include in the Original Certificate language authorizing the issuance of Preferred Stock in series, a mistake, (ii) if so, was the mistake one that was capable of correction by filing Certificates of Correction under 8 Del. C. § 103(f), and (iii) if so, did the correction operate retroactively?

[8] For the reasons next discussed, the Court concludes that a mistake did, in fact, occur in the drafting of the Original Certificate, that the inadvertent omission of the language "series of such" class is correctable under § 103(f), and that the correction should operate retroactively, because the Plaintiff class would not be substantially and adversely affected by the Certificates of Correction having retroactive effect.

B. A Mistake Did, In Fact, Occur

[9] Mr. Palmer, Palomar's sole incorporator, testified that at the time he

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[10]See 8 Del. C. §§ 102(a)(4), 151(a), and 151(g); see also Waggoner v. Laster, Del. Supr., 588 A.2d 1127, 1134-35 (1990).

[11]See Scattered Corporation v. Chicago Stock Exchange, Inc., Del. Ch., 671 A.2d 874, 679 (1994). The Defendants admit that "class" does not necessarily mean "series" for other purposes under the DGCL. See also Defendants' Post-Hearing Sur Reply Brief at 23-24.

formed Palomar, he intended for the corporation to have authority to issue Preferred Stock in series. Consistent with that testimony, the original Prospectus that offered Preferred Stock to the investing public disclosed that Palomar was authorized to issue Preferred Stock in series, and all of Palomar's other public disclosures, including its subsequently filed Registration statements for each newly-issued series of Preferred Stock, repeated that same representation. These uncontroverted facts are, in my view, clear and convincing evidence that (a) it was always intended that Palomar would have the authority to issue Preferred Stock in series, (b) Palomar's management and board believed that Palomar did, in fact, have that authority, and (c) the omission to include language creating that authority in the Original and the Restated Certificates was inadvertent.[12]

C. Correctability of The Mistake

[10] 8 Del. C. § 103(f) provides,

> "Whenever any instrument authorized to be filed with the Secretary of State under any provision of this title, has been so filed and is an inaccurate record of the corporate action therein referred to, or was defectively or erroneously executed, sealed or acknowledged, the instrument may be corrected by filing with the Secretary of State a certificate of correction of the instrument which shall be executed, acknowledged, filed and recorded in accordance with this section."

[11] Defendant argues that this is a paradigm case involving an "inaccurate record of . . . corporate action." The Plaintiff disagrees. She contends that a certificate of incorporation may be corrected only if there is (to paraphrase § 103(f)) an "accurate record," meaning a contemporaneous written instrument that documents the parties' actual (correct) intent.[13] I cannot agree.

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[12]Plaintiff also argues that to add the phrase "series of such" before the word "class" (singular) in the Original Certificate and the Restated Certificate would make no sense, because the preceding sentences in those documents creates two classes (plural) of stock. That may indicate poor grammar, but it does not prove that the omission of express language authorizing Palomar to issue Preferred Stock in series was purposeful. Nor is that argument persuasive, given the clear and convincing evidence that the omission of language expressly authorizing Palomar to issue Preferred Stock in series was inadvertent.

[13]Plaintiff also contends that a mistake in an original certificate of incorporation can never be corrected by a certificate of correction, because no "corporate action" can ever be taken

[12] To be sure, a contemporaneous writing documenting an error in a certificate of incorporation would be helpful, as it would provide highly persuasive, if not conclusive, evidence of the mistake. But, Plaintiff cites no authority holding that such a contemporaneous writing is legally mandated. It also must be recognized that cases will arise where the circumstantial evidence clearly establishes an error in a certificate of incorporation, even where no contemporaneous written instrument specifically documents that mistake. That is the case here. The sole incorporator testified that the Original Certificate was in error. That testimony is fully corroborated by a series of publicly filed documents, attested by company officials, and submitted to the SEC after the Original Certificate was filed. This constitutes highly forceful evidence that the omission to include language expressly authorizing the issuance of Preferred Stock in series, in both the Original and the Restated Certificates, was "an inaccurate record of the corporate action therein referred to." Based on that evidence, the Court is persuaded -- and finds -- that an error was made that was both legally capable of being corrected under § 103(f), and was corrected by the filing of the Certificates of Correction.[14]

D. Substantial and Adverse Affects

Finally, Plaintiff argues that even if the mistake is correctable, the Certificates of Correction cannot operate retroactively. The argument runs as follows: section 103(f) states that "[t]he corrected instrument shall be effective as of the date the original instrument was filed, except as to those persons who are substantially and adversely affected by the correction and as to those persons the corrected instrument shall be effective from the filing date." Here it is argued that the Certificates of Correction should not

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before the corporation comes into existence upon filing of that certificate. This argument also misses the mark. "Section 103 provides a simple mechanism to correct a certificate of incorporation or other instrument filed with the Secretary of State . . . ." Balotti & Finkelstein, The Delaware Law of Corporations and Business Organizations § 109 (1997). In any event, the Defendants also corrected the Restated Certificate of Incorporation, which clearly was filed after the corporation had come into existence.

[14]Plaintiff also contends that the Defendants did not correct the applicable Certificates, at least as to Preferred Stock that was issued after July 22, 1996, because the Certificates of Correction were directed only to the Original and the Restated Certificates, but not to the Amendment filed on July 22, 1996, which amended and restated Article FOURTH of Palomar's certificate of incorporation in its entirety. This argument suffers from two fatal deficiencies: (1) it was raised for the first time in the Plaintiff's Post-Hearing Brief in Reply to Defendants' Sur Reply Brief, and comes too late, and (2) the Amendment was superseded by the Restated Certificate, which was filed after the Amendment and was corrected by the Certificate of Correction.