2. Pretrial Procedure ⚿ 622

A complaint will be dismissed as legally defective where under any set of facts consistent with the facts alleged in the complaint the plaintiff would not be entitled to judgment.

3. Torts ⚿ 2

In tort cases, Delaware courts should apply the law of the state where the injury occurred, unless another state has a more significant relationship to the parties or the matter.

4. Corporations ⚿ 216
Torts ⚿ 2

In a case where a Delaware corporation is sued in a class action over a corporate law issue, it is proper to apply Delaware substantive law, except where there was an explicit agreement between the members of the class and the defendant to do otherwise.

5. Corporations ⚿ 216
Torts ⚿ 2

In a class action, the place where the relationship, if any, between the parties is centered is a factor in deciding which state's substantive law should apply.

6. States ⚿ 18.3

Rules promulgated by the National Association of Securities Dealers, Inc. and approved by the Securities and Exchange Commission do not preempt state law, where the rules were not made by Congress or a federal agency.

7. States ⚿ 18.3

Under the Supremacy Clause, the enforcement of a state regulation may be preempted by federal law in several circumstances: (1) when Congress, in enacting a federal statute, has expressed a clear intent to preempt state law; (2) when it is clear, despite the absence of explicit preemptive language, that Congress has intended, by legislating comprehensively, to occupy an entire field of regulation and has thereby

left no room for the states to supplement federal law; and (3) when compliance with both state and federal law is impossible, or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

8. States ⟹ 18.11, 214

Where Congress has directed the administrator of a federal administrative agency to exercise his discretion, and the administrator exercises his discretion by promulgating regulations intended to preempt state law, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily.

9. Corporations ⟹ 307

The directors of a corporation owe a fiduciary duty to the creditors of the corporation when it is dissolving.

10. Corporations ⟹ 320(4)
Courts ⟹ 5
Torts ⟹ 12

Where the directors of a corporation allegedly used the plaintiff customers' funds improperly or tortiously interfered with a contract, the claims plaintiff might have against the directors are not in the nature of fiduciary duty claims, but could be in contract or tort.

11. Brokers ⟹ 19, 21
Principal and Agent ⟹ 48

Where defendant corporation is plaintiffs' agent for the purposes of investing plaintiff's assets, including sweeping the cash balance into a money market fund, the corporation is a fiduciary with respect to matters within the scope of the agency, and the corporations' corresponding fiduciary duties are limited to those issues within its discretion.

12. Brokers ⟹ 19, 21, 22, 23
Principal and Agent ⟹ 48

The relation of an agent to his principal is ordinarily that of a fiduciary, and, as such, it is his duty in all dealings concerning or affecting the subject matter of his agency to act with the utmost good faith and

loyalty for the furtherance and advancement of the interests of his principal.

13. Brokers ⚿ 19

Where defendant corporation switched plaintiffs' nondiscretionary money market sweep accounts from one provider to another in order to obtain an ownership interest in a new money market fund provider, the alleged failure of the corporation to disclose the material fact that their joint venture agreement was made in self-interest did not constitute a breach of the fiduciary duty of loyalty they owed because of plaintiffs' control over the nondiscretionary account and his ability to make investment decisions.

14. Brokers ⚿ 19

Duties associated with a nondiscretionary account include: (1) the duty to recommend a stock only after studying it sufficiently to become informed as to its nature, price, and financial prognosis; (2) the duty to carry out the customer's interests; (3) the duty to inform the customer of the risks involved in purchasing or selling a particular security; (4) the duty to refrain from self-dealing or refusing to disclose any personal interest the broker may have in a particular recommended security; (5) the duty not to misrepresent any fact material to the transaction; and (6) the duty to transact business only after receiving prior authorization from the customer.

15. Brokers ⚿ 19
Principal and Agent ⚿ 48

When a corporation acts as a broker with regards to nondiscretionary accounts, the corporation has no fiduciary duty to their client.

16. Common Law ⚿ 9
Pleading ⚿ 5
Securities Regulation ⚿ 25.20(2)

Aiding and abetting a breach of fiduciary duty requires the breach of a fiduciary relationship.

17. Securities Regulation ⟹ 25.10, 25.17, 25.50

Companies are not required to engage in self-flagellation in their disclosures to shareholders.

18. Federal Civil Procedure ⟹ 2511
Securities Regulation ⟹ 25.17, 25.21(3), 25.50, 49.22(2)

Materiality of a fact required or necessary to make a disclosure not misleading may be decided as a matter of law by summary judgment only if the established omissions are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality.

19. Securities Regulations ⟹ 25.17, 25.21(3), 25.35, 25.50, 49.22(2)

An omission to state a fact required or necessary to make a disclosure not misleading is material if it would have assumed actual significance in the deliberations of the reasonable shareholder.

20. Securities Regulation ⟹ 49.22(3), 49.22(9), 49.23

A cause of action exists under federal securities laws when the management of a corporation has a personal stake in the corporate decision being made or when some special relationship exists between a member of management and some other party with interests adverse to the shareholders.

21. Securities Regulation ⟹ 49.22(3), 60.27(5)

There may be instances where an offeror's duty to disclose information in the offering materials will not be relieved by the public availability of the same information, on the theory that investors may consider information contained in the offering materials as more reliable than if contained in other documents.

22. Securities Regulation ⟹ 25.57, 49.22(9), 60.27(5)

A company is not required to disclose information about competitors where it is not mandated by the federal securities laws.

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Kevin R. Shannon, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware; and Harvey J. Wolkoff, Esquire, Lisa M. Ropple, Esquire, and Ana M. Francisco, Esquire, of Ropes & Gray, Boston, Massachusetts, of counsel, for defendants Wheat First Butcher Singer, Inc.; Wheat First Securities, Inc.; Mentor Investment Group, Inc.; Mentor Investment Group, L.L.C.; Mentor Distributors, Inc.; Cash Resource Trust; and the individual Mentor defendants.

Stephen E. Herrmann, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; A. Robert Pietrzak, Esquire, Elizabeth Storch, Esquire, and Daniel A. McLaughlin, Esquire, of Brown & Wood LLP, New York, New York, of counsel, for Everen Capital Corporation; Everen Securities Holdings, Inc.; Everen Securities, Inc.; Everen Clearing Corporation; and the Everen director defendants.

CHANDLER, *Chancellor*

This case involves a challenge by two plaintiffs who believe they were victimized by a mutual fund company that switched their money market sweep accounts from one provider to another in order to obtain an ownership interest in the new money market fund provider. The plaintiffs have set forth a smorgasbord of claims, grounded in fiduciary duty, contract, and federal securities laws, against all parties even vaguely involved with the change of funds. Although this case was initially filed before any significant time lapsed for comparison of the performance of the two fund families, the plaintiffs claim they "lost and continue to lose substantial money in unearned interest"[1] because the three Mentor Funds underperformed the comparable Kemper Funds by .26 percentage points, .31 percentage points, and .03 percentage points, respectively, in non-identical twelve month periods ending in the summer or fall of 1996. I must decide which of the plaintiffs' claims can withstand the present motion to dismiss.

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[1]Amended Compl. ¶ 63.

I. BACKGROUND AND CLAIMS

Patrick J. and Leatha S. O'Malley ("Plaintiffs") are Illinois residents who have a joint account with Everen Securities, Inc. ("Everen"). Prior to November 1, 1996, Everen offered its customers, including Plaintiffs, the choice of having cash balances in their brokerage accounts automatically invested in the Cash Equivalent Funds, which are money market accounts managed by Zurich Kemper Investments, Inc. (the "Kemper Funds"). Plaintiffs elected to have their free credit balances swept into one of the Kemper Funds at the time they opened their account.[2]

On July 25, 1996, Everen, Everen Capital Corporation, Inc. ("Everen Capital"), Everen Securities Holdings, Inc. ("Everen Holdings"), and Everen Clearing Corporation ("Everen Clearing") (collectively, the "Everen Corporate Defendants") entered into a Joint Venture Agreement (the "JVA") with Wheat First Butcher Singer, Inc. ("WFBS"), Wheat First Securities, Inc. ("Wheat"), a WFBS subsidiary, and Mentor Investment Group, Inc. ("Mentor"), a WFBS subsidiary (collectively, the "Mentor Corporate Defendants"). Pursuant to the JVA, Mentor was to offer asset management services, including money market funds, mutual funds and private account management, to the clients of Everen and Everen Clearing.

Under the JVA, Everen Holdings would acquire a 20.2% ownership interest in the successor to Mentor, Mentor Investment Group, L.L.C. (the "Venture"). WFBS would hold the remaining 79.8% interest in the Venture, subject to a contingent interest that Everen Holdings could acquire at a later date depending on the assets invested in the Venture by clients of the Everen Corporate Defendants, with Everen Holdings not acquiring greater than a 50% interest in the Venture.[3]

By letter dated September 23, 1996 (the "Negative Response Letter"), Everen informed its customers, including Plaintiffs, that on November 1, 1996, it would transfer the cash balances (which it had been investing automatically) in the Kemper Funds to three Cash Resource Trust ("CRT") money market funds sponsored by Mentor (the "Mentor Funds"), unless they notified Everen Clearing by October 25, 1996, that they did not

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[2]Uninvested cash in customer accounts, referred to as "free credit balances," is automatically "swept" into money market funds that pay dividends so that cash does not remain uninvested in a customer's account.

[3]In addition, the JVA provided for the consolidation of several entities into Mentor Investment Advisors L.L.C. ("Mentor Advisors"), which is owned primarily by the Venture, and 1% owned by WFBS. Mentor Advisors is the registered investment advisor to the Cash Resource Trust, an investment company. Finally, under the JVA, CRT's underwriter, Mentor Distributors, Inc., was converted into Mentor Distributors, L.L.C. ("Mentor Distributors") which is also primarily owned by the Venture, and 1% owned by WFBS.

want their assets to be transferred (the "Fund Exchange"). Everen included a prospectus for the Mentor Funds, dated September 23, 1996 (the "Mentor Prospectus"), with the Negative Response Letter. Plaintiffs did not so notify Everen Clearing, and so Everen transferred Plaintiffs' assets to the Mentor Funds on November 1, 1996. The Mentor Funds allegedly underperformed the Kemper Funds during the subsequent period.

The amended complaint asserts common law claims against two distinct groups of defendants: (1) Everen and its directors (the "Everen Directors") for breach of contract and for breach of the fiduciary duties of disclosure and loyalty in connection with the Fund Exchange, and (2) the remaining defendants for inducing and aiding and abetting Everen and the Everen Directors' breach of fiduciary duties.

The same allegations underlie three federal claims, all of which are premised on a failure to disclose material facts in the Mentor Prospectus: (1) a violation of section 11 of the Securities Act by Mentor Distributors, CRT, and certain individuals affiliated with the Mentor Corporate Defendant who signed the Registration Statement for the Mentor Funds; (2) a violation of section 12(a)(2) of the Securities Act by the Everen Corporate Defendants and the Mentor Corporate Defendants other than CRT; and (3) a violation of section 15 of the Securities Act against all the defendants other than Mentor Distributors as "controlling persons" of CRT.

Pending before the Court are two separate motions to dismiss, one submitted by the Everen Corporate Defendants and the Everen Directors, and the other submitted by the Mentor Corporate Defendants, the Venture, Mentor Distributors, CRT, and the directors of the above defendants that have been sued.[4]

II. ANALYSIS

A. Motion to Dismiss Standard

[1-2] On a motion to dismiss for failure to state a claim upon which relief can be granted, this Court assumes the truth of all allegations of fact and all reasonable inferences drawn from those facts that are well-pleaded by plaintiff. Mere conclusory allegations will not be accepted as true.[5] A complaint will be dismissed as legally defective "[w]here under any set of

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[4]Because all of the defendants together often support the same propositions, at times I will refer to them as "Defendants."

[5]*See Grobow v. Perot*, Del. Supr., 539 A.2d 180, 187 n.6 (1988); *Weinberger v. UOP, Inc.*, Del. Ch., 409 A.2d 1262, 1264 (1979).

facts consistent with the facts alleged in the complaint the plaintiff would not be entitled to judgment."[6]

B. Applicable Substantive Law

With regard to the state law fiduciary duty claims, I disagree with the assessment by the defendants that under Delaware's "most significant relationship" test,[7] Illinois substantive law governs.[8] Although the account may have been opened in Illinois, the named plaintiffs may reside in Illinois, and the Everen Corporate Defendants' principal place of business may be in Illinois, I believe the "most significant relationship test" tells me to apply Delaware substantive law.

[3] The Delaware Supreme Court has stated that, in tort cases, Delaware courts should apply the law of the state where the injury occurred unless another state has a more significant relationship to the parties or the matter.[9] Where the injury occurred, however, is unclear in a fiduciary duty case, unlike in a more typical, "everyday" tort case. As this case is filed as a class action, members of the class may be scattered around the United States, or even around the world, so it is not clear "where the injury occurred": Was it at the board meeting that approved the Fund Exchange, at the Virginia offices of the Mentor Corporate Defendants or, most likely, in the opening of the negative action letters that arrived at the homes of the class members?

Second, it was not stated in the briefs where "the place where the conduct causing the injury occurred" was. Again, this may have been in Illinois or it may not have. It is impossible to determine.

[4] Third, "the domicile, residence, nationality, place of incorporation and place of business of the parties" is spread all over the United States. While the Everen Defendants' "principal place of business [may be] in Illinois,"[10] several other factors diminish this fact. This being a class action, the named plaintiffs are not the only ones suing, and so the plaintiffs' places of residency or domicile are likely to extend far beyond Illinois.[11] Furthermore, and more importantly, all of the Everen Defendants

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[6]*In re the Walt Disney Company Derivative Litigation*, Del. Ch., C.A. No. 15452, Chandler, C. (Oct. 7, 1998) (citing *Lewis v. Vogelstein*, Del. Ch., 699 A.2d 327, 338 (1997)).

[7]*See* Restatement (Second) of Conflicts § 145(l), (2) (1971); *see also Turner v. Lipschultz*, Del. Supr., 619 A.2d 912, 914-15 (1992).

[8]Opening Br. Supp. Everen Defs. Mot. Dismiss at 33 n.18.

[9]*See Travelers Indemnity Co. v. Lake*, Del. Supr., 594 A.2d 38, 47 (1991).

[10]Opening Br. Supp. Everen Defs.' Mot. Dismiss at 33 n. 18.

[11]Although I do not base my decision on this, I note that a quick glance at Everen's World Wide Web page shows that it has branch offices in 28 states, so the "place of business as described

are incorporated in Delaware. Presumably they, and hundreds of thousands of other entities, have incorporated in Delaware because they wish to be subject to Delaware corporate law. That is the point. And so, in a case where a Delaware corporation is sued in a class action over a corporate law issue, I think it is proper to apply Delaware substantive law, except where there was an explicit agreement between the members of the class and the defendant to do otherwise (as might be the case in a contractual claim, but could perhaps never be the case in a fiduciary duty claim).[12]

[5] Fourth, "the place where the relationship, if any, between the parties is centered" is a factor in deciding the appropriate substantive law. I think this is a case for the clause "if any." Here there may be class members who bought their shares in any one of numerous states. Merely because the O'Malleys bought their shares from an Illinois branch office does not mean that the entire class should be governed by that state's law.

With regard to the inducing to commit/knowing participation/abuse of confidential relationship/aiding and abetting/conspiracy claims, I apply the same analysis as above, taking note of the Mentor Defendants' incorporations in Virginia, and reach the same conclusion: Delaware substantive law applies.

I do, however, agree with defendants that Illinois law applies to the breach of contract claim because the contract, according to the brief by the Everen Corporate Defendants, explicitly states that Illinois law will apply in the case of a contractual dispute.[13]

C. Preemption of State Law Claims by Federal Securities Law

Defendants claim that Plaintiffs' state law claims are preempted by (1) the federal regulatory background of bulk exchanges of mutual money market funds; (2) the Supremacy Clause; and (3) the Commerce Clause.

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in the "most significant relationship" test (not the "principal" place, as the Everen Defendants argue) is not merely Illinois, but all over the United States. *See* Everen Securities, *Everen Branch Locator* (visited January 12, 1999) <http://www.everensec.com/branch/ branch_fr.htm>.

[12]Defendants cite several cases to support their contention that Illinois substantive law should apply. Each one, however, fails to convince me. In *Alten v. Ellin & Tucker Chartered*, 854 F. Supp. 283, 287 (D. Del. 1994), the court's application of the most significant relationship test merely turned out differently. In *Turner v. Lipschultz*, Del. Supr., 619 A.2d 912, 914-16, the case was one in which an automobile accident occurred in Delaware, and so Delaware law was applied. In *MacLane Gas Co. L.P. v. Enserch Corp.*, Del. Ch., C.A. No. 10760, Chandler, V.C. (Aug. 18, 1992, revised, Dec. 9, 1992), Mem. Op. at 10, it was a Texas limited partnership being sued, and the partnership agreement called for the application of Texas law to any disputes.

[13]*See* Opening Br. Supp. Everen Defs.' Mot. Dismiss at 33 n.18; Opening Br. Supp. Mentor Defs.' Mot. Dismiss at 16 n.15.

I disagree with Defendants' contentions, and I will discuss each of them in turn.

1. Preemption by the Federal Regulation Scheme

Defendants claim that Plaintiffs' state law claims are preempted by rules promulgated by the National Association of Securities Dealers, Inc. ("NASD") and approved by the Securities and Exchange Commission ("SEC"), stating that a written customer authorization need not be obtained (*i.e.*, negative response letters are permitted) for:

> (2) bulk exchanges at net asset value of money market mutual funds ("funds") utilizing negative response letters provided:
>
> (a) The bulk exchange is limited to situations involving . . . exchanges of funds used in sweep accounts . . . .[14]

[6] I disagree that such a regulation preempts state law. These rules were not made by Congress or a federal agency. Although the rules have been approved by the SEC, Defendants have cited no authority stating that federal preemption is a permissible result of such a delegation of authority. In fact, such a holding might imply that *any* delegation of rulemaking authority by a federal agency to an industry group would preempt state law claims even vaguely related, and such a result would plainly be wrong, as it would emasculate much of state law throughout the nation. It is hard to imagine Congress would intend for a private organization such as NASD to preempt substantive state law.

2. Preemption by the Supremacy Clause

[7-8] Defendants' argument here is a more rational one—at least some case law shows examples of the Supremacy Clause[15] acting to preempt state law claims. This, however, is not one of those cases, in fact or in law.

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[14]Opening Br. Supp. Everen Defs.' Mot. Dismiss at 16 (quoting Rules of Fair Practice, NASD Manual (CCH) Rule 2510(d)(2) (May 1996).

[15]U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

With regard to federal preemption, the United States Supreme Court has stated:

> Under the Supremacy Clause, the enforcement of a state regulation may be pre-empted by federal law in several circumstances: first, when Congress, in enacting a federal statute, has expressed a clear intent to pre-empt state law; second, when it is clear, despite the absence of explicit preemptive language, that Congress has intended, by legislating comprehensively, to occupy an entire field of regulation and has thereby "left no room for the States to supplement" federal law; and, finally, when compliance with both state and federal law is impossible, or when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."
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> . . .
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> Federal regulations have no less preemptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited . . . .[16]

So, a federal regulation, such as one promulgated by the SEC, can preempt state law in certain circumstances.

Defendants point to several "order flow" cases as examples of a court finding "conflict preemption arising from the existence of SEC regulations that require disclosure of, but do not prohibit, certain activities by broker-dealers."[17] In the order flow case focused on by Defendants, *Guice v. Charles Schwab & Co.*,[18] the New York Court of Appeals held that a particular SEC regulation, requiring disclosure to clients of certain brokerage transactions that provided benefits to the brokers executing them, preempted state law disclosure claims.[19] An important difference exists, however, between that case and this one: There the SEC had

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[16]*Capital Cities Cable v. Crisp*, 467 U.S. 691, 698-99 (1984) (citations omitted).
[17]Opening Br. Supp. Everen Defs.' Mot Dismiss at 19.
[18]674 N.E.2d 282 (N.Y. 1996), *cert. denied*, 117 S. Ct. 1250, 137 L. Ed. 331 (1997).
[19]*See id.* at 291.

specifically rejected the requirement of additional disclosures after applying a cost/benefit analysis,[20] while Defendants here have demonstrated to the Court no such specific contemplation by the SEC. Defendants have cited the reasons for the SEC approval of the use of negative response letters for bulk exchanges of money market mutual funds,[21] but they have not provided any discussion from the SEC as to whether it considered the requirement of additional disclosure (*e.g.*, whether the bulk exchange is self-interested). Therefore, I cannot determine from the facts presented that Congress intended for the SEC's regulation of bulk exchanges to preempt Delaware's (or any state's) law concerning fiduciary duties of disclosure, and so Defendants' argument fails under a Supremacy Clause analysis.

3. Preemption by the Commerce Clause

Defendants next argue that Plaintiffs' state law claims are preempted by the Commerce Clause.[22] Defendants fear that the failure to hold as such would burden interstate commerce, as other states could "impose different requirements on broker-dealers for bulk exchanges of mutual funds," and national broker-dealers would need to comply with the state's law that was most stringent in order to avoid liability.[23]

I see two weaknesses in this policy argument. First, Plaintiffs seek only that *a* self-interested bulk exchange be disclosed, so that a purely administrative switch would not require additional disclosure. Second, any plaintiff must prove that disclosure was inadequate, something that is not always easy to do. In any case, Blue Sky laws can co-exist with federal securities laws[24] and so can state fiduciary duty laws. I do not believe that Plaintiffs' state law claims are preempted by the federal securities laws or regulations under a Commerce Clause analysis.

D. Breaches of Fiduciary Duty

Plaintiffs allege that Everen and the Everen Directors breached their fiduciary duties of disclosure and loyalty by failing to disclose and misstating the material facts in connection with the transfer of their

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[20]*See id.* at 288 ("[T]he agency-again employing cost/benefit analysis—eliminated the proposed disclosure requirements. . . .").

[21]Opening Br. Supp. Everen Defs.' Mot. Dismiss at 16.

[22]U.S. Const. art. I, § 8, cl. 3 ("Congress shall have Power . . . [t]o regulate Commerce . . . among the several States.").

[23]Opening Br. Supp. Everen Defs.' Mot. Dismiss at 24.

[24]*See, e.g., Hall v. Geiger-Jones & Co.*, 242 U.S. 539 (1917).

investments from the Kemper money market funds to the Mentor Funds. Plaintiffs further claim that Everen and the Everen Directors breached their duty of loyalty to Plaintiff; by using the transfer of Everen's clients' funds to acquire Everen Holdings' ownership in the Venture for their own benefit, rather than for that of the Plaintiffs and the class. Defendants counter that Everen owed no fiduciary duty to Plaintiffs with regard to the Fund Exchange, and even if it did owe such a duty, it did not breach that duty to Plaintiffs.

Plaintiffs also claim that the Everen Corporate Defendants, the Mentor Corporate Defendants, the Venture, and their directors induced each other to commit or knowingly participated in a breach of fiduciary duty or abuse of confidential relationship, and also aided and abetted the commission of or conspired to commit a breach of fiduciary duty or abuse of confidential relationship. The Mentor Corporate Defendants deny playing a role in the Everen Corporate Defendants' alleged breach of duty or in Everen's decisions, and also reply that Everen owed no duty to Plaintiffs, so they could not have participated, induced, or aided and abetted any violations.

1. Jurisdiction of this Court over the Everen Directors

The Everen Directors argue that this Court lacks jurisdiction over them because they are nonresidents of Delaware and have no connection with Delaware outside of their roles as directors, and because the claims against them do not arise out of duties they owe the Everen Corporate Defendants or those companies' shareholders. Plaintiffs counter that Defendants' argument forces too narrow a reading of 10 *Del. C.* § 3114, and that directors' fiduciary duties extend beyond those owed to the company and to shareholders.

[9] As support for their argument, Plaintiffs cite my decision in *Kidde Industries, Inc. v. Weaver Corp.*,[25] in which I held that directors owed a fiduciary duty to creditors of the corporation when it was dissolving. Plaintiffs fail to note, however, the important distinction between the facts of that case and this—namely, that the dissolving company in *Kidde Industries* would have very little left, if anything, to distribute to the shareholders and, as a result, the directors then owed a duty to the debtholders.[26] In fact, in that case I defined the issue as "whether § 3114

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[25]Del. Ch., 593 A.2d 563 (1991).

[26]*See id.* at 566 ("Once a corporation dissolves, however, its assets are held in trust for the benefit of both its creditors and to stockholders." (quoting *Gans v. MDR Liquidating Corp.*, Del.

provides jurisdiction over a defendant who is alleged to have violated a fiduciary duty that he, *as a director or trustee*, owed to a creditor of the corporation upon dissolution."[27] In this case, the corporation is not dissolving or undergoing changes in a way that would require a shift in the party to whom the directors owed a fiduciary duty, so Kidde Industries is inapposite.

[10] I am more convinced that the controlling authority is *Steinberg v. Prudential-Bache Securities*[28] and *Prudential-Bache Securities, Inc v. Franz Manufacturing Company*,[29] which held that any claims plaintiffs might have against the directors were not in the nature of fiduciary duty claims but could be in contract or tort, where the directors allegedly improperly used the plaintiff customers' funds (*Steinberg*) or tortiously interfered with a contract (*Franz Manufacturing*). Again, the directors here are not accused of violating the fiduciary duties they owed to a party traditionally covered by Delaware's corporations laws. Instead, the claims of breach of fiduciary duty arise from the directors' actions with regard to the transfer of deposit funds. Accordingly, I dismiss the claims of breach of fiduciary duty as to the Everen Directors for lack of jurisdiction over them.[30] I do not dismiss the Securities Act violations claims against the Everen Directors.

2. Breach of duty of disclosure against Everen and the Everen Directors

Plaintiffs claim that Everen and its directors breached their duty of disclosure to Plaintiffs by failing to disclose the ownership interest that Everen would obtain in Mentor. Defendants answer that Everen satisfied any duty to disclose that it might have had because the September 23, 1996 Negative Response Letter, mailed to Everen's clients, states—in the second paragraph—"Enclosed is a prospectus that... includes information relating to the EVEREN ownership interest in Mentor."[31] Defendants also note that the Mentor Prospectus clearly states:

Ch., C.A. No. 9630, Hartnett, V.C. (Jan. 10, 1990), Mem. Op. at 21-22)).

[27] *Id.* at 565 (emphasis in original).

[28] Del. Ch., 12 Del. J. Corp. L. 371 (1986).

[29] Del. Super., 531 A.2d 953 (1987).

[30] The following two sections that address the claims of breach of fiduciary duty apply to both Everen and the Everen Directors, despite the fact that I have dismissed these claims as to the directors.

[31] Negative Response Letter at 1.

> [I]t is expected that promptly after [the fall 1996 reorganization of Mentor Advisors], EVEREN Securities, Inc. will acquire 20% of the outstanding shares of the Mentor Investment Group. EVEREN may thereafter acquire additional shares in Mentor Investment Group (not to exceed an additional 30% of the Mentor Investment Group's outstanding shares) depending principally on the amount of assets in investment companies sponsored by Mentor investment Group or its affiliates (including the Funds) attributable to shares held by clients of EVEREN.[32]

As Defendants point out, these disclosures notified Everen's customers that it would soon acquire a 20% interest in the Mentor Investment Group. Plaintiffs argue that it is significant that neither the Negative Response Letter nor the Mentor Prospectus expressly state that Everen would acquire this interest in exchange for providing the Mentor Investment Group access to the cash balances in the Everen clients' accounts. Furthermore, they claim, nothing in the Negative Response Letter or the Mentor Prospectus implies such an arrangement.

Such a *quid pro quo*, however, is strongly implied in the statement disclosing that Everen "may thereafter acquire additional shares in Mentor Investment Group . . . depending principally on the amount of assets in investment companies sponsored by Mentor Investment Group or its affiliates (including the Funds) attributable to shares held by clients of Everen."[33] Although this statement only speaks to subsequent acquisitions by Everen of the Mentor Investment Group and not the initial acquisition, it is difficult to read it in such a way as to miss the point—that the more money that flowed into Mentor, the more of an ownership share Everen would acquire.

Plaintiffs cite to very little case law to support their claim that the disclosure made was inadequate. In one case on which they rely, *Press v. Quick and Reilly*, the court actually found no liability under federal law dismissed the state law claim of a breach of fiduciary duty because it declined to exercise supplemental jurisdiction.[34] The minimum level of disclosure Plaintiffs claim the court established in that case is actually based on federal securities law, and it is not controlling in the context of the state law breach of fiduciary duty to disclose claim here.

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[32]Mentor Prospectus at 12.
[33]*Id.* at 12.
[34]*See Press v. Quick & Reilly*, 1997 WL 458666 (S.D.N.Y.), at *5.

In *Addeo v. Braver*, the court similarly ruled for the defendants on summary judgment with regard to the federal claim and declined to exercise supplemental jurisdiction over the state law claims. More importantly, the court defined "materiality as that term is used in the securities fraud context."[35] Again, this definition is not controlling over this court. Finally, the case was one involving securities fraud, in which the broker bought "inverse floaters," "highly sophisticated and complex securities carrying an extreme risk of loss," for plaintiffs seeking to pursue "a conservative investment strategy" and who had given the broker "full discretion to trade on their behalf."[36] One suspects the court was not as concerned about the level of materiality in such an egregious case.[37] Finally, the commissions received on the sale of certificates of deposit that were required to be disclosed in *Gary Plastic Packaging v. Merrill Lynch*[38] has no controlling effect in this matter for the same reason that *Addeo* has none: the case concerns a federal securities fraud claim.

Plaintiffs have shown no reason why the disclosure in the Negative Response Letter and the Mentor Prospectus was insufficient to explain that Everen was obtaining an interest in the Mentor Funds and that the extent of such an interest was dependent on the amount of funds transferred to Mentor. Therefore, as a matter of law, I must dismiss the breach of duty of disclosure count against Everen (and its directors).

3. Breach of duty of loyalty against Everen and the Everen Directors

[11] Any state law fiduciary duty of Everen and the Everen Directors arose from its agency relationship with Plaintiffs. Everen was Plaintiffs' agent for the purposes of investing Plaintiffs' assets, including sweeping the cash balance into a money market fund. As Plaintiffs' agent, Everen was a fiduciary with respect to matters within the scope of the agency,[39] and Everen's corresponding fiduciary duties were limited to those issues in its discretion.[40] Plaintiffs claim that it was in Everen's discretion to select the

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[35]*Addeo v. Braver*, 1997 CCH Fed. Sec. L. Rep. ¶ 99,426 (S.D.N.Y.), at 99,791.

[36]*Id.* at 99,786.

[37]The federal securities fraud claim was dismissed in that case for failure to demonstrate reliance on the omission concerning the conflict of interest, *i.e.*, a .25% commission that the broker failed to reveal he was receiving. Perhaps this is one reason the present Plaintiffs do not make a securities fraud claim under Rule 10b-5.

[38]756 F.2d 230 (2d Cir. 1985).

[39]*Restatement (Second) of Agency* § 13 (1958).

[40]*See Index Futures Group, Inc. v. Ross*, 557 N.E.2d 344, 348 (Ill. App.) (broker had no duty to inquire into types of transactions ordered by customer's agent), *appeal denied*, 561 N.E.2d

Mentor Funds as the repository of its customers' excess cash balances, and so the fiduciary duty Everen owed its customers was to select a money market mutual fund with the duty of care and loyalty. Plaintiffs' argument, however, is weakened by the undisputed fact that Everen's customers had final decision-making authority with respect to their account and whether their cash balances would be transferred to the Mentor Funds. In addition to choosing among the three funds, customers also had the options of forgoing the sweep service, holding no money market funds, or moving their accounts to another broker with a different sweep fund.[41] So initially I question the veracity of Plaintiffs' claim that the selection of the Mentor Funds was within the sole discretion of Everen at all.

[12] The crux of Plaintiffs' claim of breach of the duty of loyalty is that Everen dealt with Plaintiffs as an adverse party when it developed its scheme to purchase a portion of Mentor by transferring money market balances to Mentor's funds. But the first hurdle Plaintiffs need to clear is whether there is a fiduciary duty owed by Defendants to them at all. If not, then the manner in which Defendants dealt with Plaintiffs is unimportant. Delaware case law on the subject of the fiduciary duty owed by a broker to a customer is slim. In fact, one of the only cases I can find is from 1931, in which the Superior Court stated with regard to a broker:

> The relation of an agent to his principal is ordinarily that of a fiduciary, and, as such, it is his duty in all dealings concerning or affecting the subject matter of his agency to act with the utmost good faith and loyalty for the furtherance and advancement of the interests of his principal.
>
> A broker with the power to buy and sell securities for another is an agent for such person. . . .[42]

That case, however, involved a jury trial to determine the mental capacity of the plaintiff to enter into a contract, and it is not instructive beyond the above quotation here. More importantly, that case did not address a nondiscretionary account,[43] as is at issue here. It does not appear that a Delaware court has addressed this issue to date, and so I rely on the case law developed in other states to guide me.

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692 (1990).

[41]See Opening Br. Supp. Everen Def.' Mot Dismiss at 35.

[42]*Warwick v. Addicks*, Del. Super., 157 A. 206, 207 (1931) (citation omitted).

[43]In a discretionary account, a broker has the discretion to make trades without the customer's advance approval, while in a nondiscretionary account, the customer has sole control over the trades. For more detail, see *infra* text accompanying note 48.

[13] Illinois case law, and it appears much other state law, teaches that "although a fiduciary relationship does exist between broker and client a broker handling a nondiscretionary account is not 'viewed as a fiduciary.'"[44] As noted below, this statement is *generally* followed, but not always. The Fifth Circuit, in finding no breach of the fiduciary duty of loyalty by a commodities dealer who failed to inform his client that he was also active in the silver futures market in which the client was investing, held:

> It is clear that the nature of the fiduciary duty owed will vary, depending on the relationship between the broker and the investor. . . . The evaluation requires consideration of the degree of trust placed in the broker and the intelligence and personality of the customer.
>
> . . . Because of [the client's] control over his nondiscretionary account and his ability to make decisions, we find that defendants did not breach fiduciary duty they owed.[45]

Plenty of other courts have found similarly—that no fiduciary relationship was established between a broker and a client,[46] although other courts have found differently.[47] The holdings are based on the nature of the relationship between the broker and the client. There is no bright-line

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[44]*Refco, Inc. v. Troika Investment Ltd.*, 702 F. Supp. 684 (N.D. Ill. 1998) (quoting *CFTC v. Heritage Capital Advisory Services, Ltd.*, 823 F.2d 171, 173 (7th Cir. 1987)); *see also Index Futures Group*, 557 N.E.2d at 348 ("The duty of care owed by a broker carrying a nondiscretionary account for a customer is an exceedingly narrow one, consisting at most of a duty to properly carry out transactions ordered by the customer. Thus, with respect to such accounts, a broker owes its customers a duty of care in connection with the performance of the functions of a futures commission merchant. . . .—taking orders, executing trades, and dealing with customer funds." (citations omitted)), *appeal denied*, 561 N.E.2d 692 (1990).

[45]*Romano v. Merrill Lynch Pierce, Fenner & Smith*, 834 F.2d 523, 530 (5th Cir. 1987) (internal quotation omitted).

[46]*See, e.g., Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208 (7th Cir. 1994); *Hotmar v. Lowell H. Listrom & Co., Inc.*, 808 F.2d 1384 (10th Cir. 1987); *Leffkowitz v. Smith Barney, Harris Upham & Co.*, 804 F.2d 154 (1st Cir. 1986); *Lebace, S.A. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 709 F.2d 605 (9th Cir. 1983); *Marchese v. Nelson*, 809 F. Supp. 880 (D. Utah 1993); *D'Addio v. L.F. Rothschild, Inc.*, 697 F. Supp. 698 (S.D.N.Y. 1988). In all of these cases, the court found there was not a fiduciary relationship between the broker and his or her client, often because the account was a nondiscretionary one.

[47]*See, e.g., Street v. J.C. Bradford & Co.*, 886 F.2d 1472 (6th Cir. 1989); *Mid-America Federal Sav. & L. Ass'n v. Shearson/American Express, Inc.*, 886 F.2d 1249 (10th Cir. 1984); *Thropp v. Bache Halsey Stuart Shields, Inc.*, 650 F.2d 817 (6th Cir. 1981); *Capalbo v. Paine Webber, Inc.*, 694 F. Supp. 1315 (N.D. Ill. 1988).

answer, even one based on the discretionary versus nondiscretionary nature of the account.

Here, the relationship was a nondiscretionary one, in which the clients relied on the broker to execute orders, primarily, and only after that, to offer accounts that would provide high returns on overnight sweeps. The fact that the investors knew enough to manage their accounts, and even understood what sweep accounts were, suggests to me a sophistication on their part. The investors, including Plaintiffs, had the knowledge that they could earn more for their money by investing their unused money market funds in sweeps, and so they also knew that if the funds did not meet their satisfaction, they could go elsewhere. The sweep funds were not what attracted Plaintiffs (or anyone) to Everen in the first place. Such funds are of secondary importance.

Furthermore, the funds were competitive. Only if they provided so low a profit as to be noncomparable to other funds available for Everen to select, or if the investors were so dependent on the brokers as to be unable to make their own decisions involving sweep funds, would this case fit into the circumstances in which courts have found a fiduciary relationship to exist between a broker and a customer.

[14-15] In a detailed opinion, the United States District Court for the Eastern District of Michigan held:

> In a non-discretionary account each transaction is viewed singly. In such cases the broker is bound to act in the customers interest when transacting business for the account; however, all duties to the customer cease when the transaction is closed. Duties associated with a non-discretionary account include: (1) the duty to recommend a stock only after studying it sufficiently to become informed as to its nature, price and financial prognosis; (2) the duty to carry out the customer's orders promptly in a manner best suited to serve the customer's interests; (3) the duty to inform the customer of the risks involved in purchasing or selling a particular security; (4) the duty to refrain from self-dealing or refusing to disclose any personal interest the broker may have in a particular recommended security; (5) the duty not to misrepresent any fact material to the transaction; and (6) the duty to transact business only after receiving prior authorization from the customer.[48]

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[48]*Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 952-53 (E.D.

Duties one, two, three, five, and six do not apply here. Plaintiffs allege the fourth requirement has been violated. I have, however, dismissed that claim as a matter of law. Therefore, in the absence of authoritative Delaware law on the issue, and in light of the significant guidance provided to me by the federal courts and state courts outside of our own, I have determined as a matter of law that Defendants did not have a fiduciary duty to Plaintiffs with regard to the nondiscretionary money market account and so have not breached their fiduciary duty.[49]

4. Aiding and abetting/conspiracy to commit breach of fiduciary duty and/or abuse of confidential relationship against Everen Corporate Defendants, the Mentor Corporate Defendants, the Venture, and certain directors

[16] Because aiding and abetting a breach of fiduciary duty requires a breach of a fiduciary relationship,[50] and because I have determined that there was no breach of a fiduciary relationship, I dismiss this claim.

5. Induce to commit/knowing participation in breach of fiduciary duty and/or abuse of confidential relationship against the Everen Corporate Defendants, the Mentor Corporate Defendants, the Venture, and certain directors

Because the elements for pleading aiding and abetting a breach of fiduciary duty and inducement to commit a breach of fiduciary duty are the

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Mich. 1978) (*affirmed*, 647 F.2d 165 (6th Cir. 1981)) (citations omitted).

[49]Plaintiffs argue that the *Refco* court held that:

> Even in the most limited type of agency—the nondiscretionary account where the broker is simply called on to carry out its principal's orders—the concept of faithfulness to duty (what the law labels a "fiduciary" duty) operates to preclude the agent's dealing to its own advantage rather than its principal's.

Refco, 702 F. Supp. at 689 n.9. However, that line: (a) is dicta, and (b) followed to its logical conclusion results in a finding that brokers do owe a fiduciary duty to customers on even non-discretionary accounts. I think it is more appropriate to say that brokers owe the duty to carry out their customers' wishes rather than a fiduciary duty, in the corporate bar's sense of the phrase.

[50]*See Endervelt v. The Nostalgia Network, Inc.*, Del. Ch., C.A. No. 11415, Chandler, V.C. (July 23, 1991), Mem. Op. at 10.

same,[51] and because I have dismissed the aiding and abetting a breach of fiduciary duty claim, I dismiss this claim also.

E. Breach of contract against Everen

Because neither Plaintiffs nor Defendants expended much time on this claim, neither will I. Plaintiffs claim, essentially, that the unilateral right of Defendants to terminate the sweep account "does not create a right to change the terms of the contract or to switch plaintiffs' and the Class' funds without proper consent or in self-dealing."[52] Defendants reply that the plain language of the contract, not quoted by Plaintiffs in their complaint, controls: "I understand that you may select another participating money market fund by providing me with prior notice and sending me a copy of the prospectus for such fund or you may terminate the use of a money market fund that is linked to my account."[53]
[17] Companies are not required to engage in self-flagellation in their disclosures to shareholders,[54] and I believe this concept applies equally well to disclosures in this arena. Because this language is clear and unambiguous as to the right of Everen to change the sweep fund provider, and because Plaintiffs have not alleged that Everen failed to provide them with prior notice or a copy of the prospectus, there is no breach of contract, and I dismiss this claim.

F. Securities Act Violations

1. Violations of § 11 of the Securities Act Against Mentor Distributors, CRT, and certain directors, and Violations of § 12(a)(2) of the Securities Act against Mentor Distributors, the Everen Corporate Defendants, and the Mentor Corporate Defendants

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[51]*See E.I. Greenfield v. TeleCommunications, Inc.*, Del. Ch., C.A. No. 9814, Allen, C. (May 10, 1989).

[52]Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 40.

[53]Opening Br. Supp. Everen Defs.' Mot. Dismiss at 52.

[54]*See generally Loudon v. Archer-Daniels-Midland Co.*, Del. Ch., C.A. No. 14638, Jacobs, V.C. (Feb. 20, 1996), Mem. Op. (holding that directors have no duty to "engage in 'self-flagellation' by confess[ing] mismanagement or wrongdoing,' or by admitting to a breach of fiduciary duty 'before it [is] properly determined in a court of law'") (citations omitted).

I will address the §§ 11 and 12(a)(2) claims together, as they both revolve around the question of whether the disclosure provided by Everen to Plaintiffs "omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[55]

In their motion to dismiss these claims, Defendants make three major arguments: (1) Plaintiffs fail to identify a statement rendered misleading by a material omission; (2) Plaintiffs fail to identify any material omissions; and (3) Plaintiffs fail to allege damages. The first two arguments can be merged together in my analysis. The third argument is indefensible, I believe, as Plaintiffs have clearly alleged damages—namely that they received a lower return on the money market investment through the Mentor Funds than they would have had Everen maintained the investment in the original funds. Whether these damages are the result of a violation of the federal securities laws is what I will now determine.

Defendants argue that the claims under §§ 11 and 12(a)(2) should be dismissed because Plaintiffs have failed to identify a statement rendered misleading by a material omission or have failed to identify any material omissions.[56] Plaintiffs counter that Defendants' failure to disclose Everen's interest in the transfer of the money market funds was material, as was its failure to compare performances between the old funds and the new funds.[57]

[18] Initially, however—and most, pertinently for purposes of this motion to dismiss—Plaintiffs claim that the question of materiality is a mixed question of fact and law, and so, they argue, their claims cannot be dismissed at this stage of the proceedings.[58] Plaintiffs cite *In re Westinghouse Securities Litigation*[59] for this proposition. Westinghouse's comment on the issue of law versus fact as the basis for materiality gains its support from the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, in which it stated:

> The issue of materiality may be characterized as a mixed question of law and fact, involving as it does *the application of a legal standard to a particular set of facts*. In considering whether summary judgment on the issue is

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[55]15 U.S.C. § 77k(a) (West 1998). Section 12(a)(2) contains the phrasing, "omits to state a material fact necessary in order to make the statements, in the fight of the circumstances under which they were made, not misleading." 15 U.S.C. § 77l(a)(2) (West 1998). I consider these statements to be equivalent in their meaning.

[56]*See* Opening Br. Supp. Everen Defs.' Mot. Dismiss at 56-62.

[57]*See* Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 41-46 & n.27.

[58]*See id.* at 41 n.27.

[59]90 F.3d 696, 714 (3d Cir. 1996).

> appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.[60]

This quotation, rather than the out-of-context statement, "Materiality is a mixed question of law and fact,"[61] is the correct assessment of whether materiality may be decided as a matter of law. Because "the application of a legal standard to a particular set of facts" is what this Court, and any court, does in ruling on a motion to dismiss—in fact, any question of law on a motion to dismiss might be characterized as a "mixed question of law and fact" under this description—I find as a matter of law that I do potentially have the authority to determine the materiality of the statements at issue from the facts presented.

Now I turn to whether Defendants' failure to disclose Everen's interest in the conversion of the funds was material. But as a preliminary matter, I cannot see how Everen hid from its money market shareholders the fact that it was obtaining an ownership share in Mentor in exchange for the transfer of funds, when it states in the Mentor Prospectus accompanying the Negative Response Letter that it will acquire 20% of the shares of Mentor, and "may thereafter acquire additional shares of Mentor Investment Group . . . depending principally on the amount of assets . . . [in the Funds] attributable to shares held by clients of Everen."[62] No reasonable shareholder would be unable to determine that the purchase of the Mentor shares was in exchange for the transfer of the money market funds. Even if it is not entirely clear that the 20% share was being obtained in exchange for the conversion, it is abundantly clear that the next 30% was being obtained that way, and the inference would be that the first 20% came the same way.

[19-20] Assuming *arguendo*, however, that somewhere a reasonable

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[60]426 U.S. 438, 450 (1976) (footnotes omitted) (emphasis added).
[61]Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 41 n.27.
[62]Mentor Prospectus at 12.

shareholder exists that did not understand the *quid pro quo* nature of the transaction, I will address whether the omission was material. Plaintiffs claim it was, as "Everen was expected to transfer its clients' funds to Mentor as a condition to receiving its 20.2% interest in the Venture,"[63] yet it failed to disclose this in the notice. Plaintiffs do not explain exactly *why* this is material. The best reasoning I can detect in their brief is that either "it would have assumed actual significance in the deliberations of the reasonable shareholder,"[64] or that "there is a cause of action under the federal securities laws where management 'has a personal stake in the corporate decision being made or that some special relationship exists between a member of management and some other party *with interests adverse to the shareholders*.'"[65]

Addressing the second reason first, management did not have a personal stake in the conversion of the money market funds—perhaps Everen received a benefit from the conversion, but it was not a personal benefit that belonged to the managers. Furthermore, no special relationship is alleged between "management and some other party with interests adverse to the shareholders," and I am not even sure which party that would be. Perhaps it would be Mentor, although I do not see how their interests were adverse to those of the Everen money market fund shareholders. In fact, they were probably similar—to obtain a high return on the money market funds—because if they were adverse, the money market fund shareholders would be disappointed in their returns and transfer their money elsewhere.

Furthermore, the language in the JVA cited by Plaintiffs to attempt to prove the materiality of the omission—namely, "if the Money Market Conversion Date has not occurred by December 31, 1996, the Venture shall have the right to call the [20.2%] Interests held by EVEREN Holdings at no cost to the venture,[66] *i.e.*, without the conversion, Everen would not get an ownership share in the Mentor Funds—does not mean that the omission was material. Plaintiffs do not allege, nor can I locate in it, that the JVA requires any minimum amount of money market funds to be transferred. In fact, the term "Money Market Conversion" is defined therein as "the investment in the Mentor Money Market Funds of all sweep account assets held at EVEREN Clearing and introduced by EVEREN Securities (except: . . . (ii) sweep account assets with respect to which the client of such

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[63]Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 44.

[64]*Id.* at 41 (quoting *TCS Industries*, 426 U.S. at 449).

[65]*Id.* at 42 (quoting *Kas v. Financial General Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986) (emphasis added in brief)).

[66]*Id.* at 44 (quoting JVA at 9).

account has not consented to the Money Market Conversion)."[67] From this, I conclude that if even *all* of the shareholders of money market funds refused to move their investments, the 20% ownership would be transferred to Everen. Clearly this was not the hope or the expectation of Mentor when it entered into the JVA, but it could have happened, and my reading of the JVA indicates that the transfer of ownership would still have occurred. Therefore, the alleged omission could not have any materiality, because the ownership transfer to Everen would have occurred with or without any funds actually being transferred.

Finally, Plaintiffs have failed to cite any cases in which the presence of a "carrot" for the "non-disclosing" company such as the one herein constituted such a material conflict of interest that it had to be disclosed because it would have affected a shareholder's decision-making process. The two cases Plaintiffs cite, *Kas v. Financial General Bankshares, Inc.*[68] and *Gould v. American Hawaiian Steamship Company*,[69] are both factually very different from this case, and nearly all of the alleged omissions, addressed therein were found to be not material.

Plaintiffs also claim that Defendants' failure to compare performances between the old funds and the new funds was material. I do not, however, agree that Defendants did not compare the performances between the funds. In the Negative Response Letter, Defendants compared the projected portfolio expenses in chart form. In the prospectus for the Mentor Funds that accompanied it, Defendants followed SEC requirements in setting out the return on the Mentor Funds. And all money market fund shareholders receive as a matter of course (and as a matter of law, as the SEC requires it) an annual report on their money market funds—here, the Kemper Funds. If shareholders wanted to compare the returns on the funds, all they needed to do was open both the Mentor Prospectus and the annual report at the same time. The information that Plaintiff's needed to make an informed decision was readily available to them, and the "total mix" of information was sufficient, as a matter of law, to make that decision.[70]

[21] Plaintiffs argue that this Court's holding in *Weinberger v. Rio Grande* is controlling here: "[Tlhere may be instances where an offeror's duty to disclose information in the offering materials will not be relieved

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[67]JVA at 6.

[68]796 F.2d 508, 513 (D.C. Cir. 1986).

[69]535 F.2d 761 (3d Cir. 1976).

[70]*See Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 952 (undisclosed information is immaterial, as a matter of law, where any reasonable shareholder had the information readily available).

by the public availability of the same information, on the theory that investors may consider information contained in the offering material as more reliable than if contained in other documents."[71] That holding, however, does not apply in the present matter. Here, the information provided about the returns on the Kemper Funds was available, not merely in the public domain, but also in annual reports filed with the SEC and specifically delivered to the Plaintiffs and other shareholders by Everen. It is hard to see how investors could consider the information provided to them by Everen in the Mentor prospectus to be "more reliable" than that provided in the annual reports, since they were both from the same source.

Plaintiffs also discount the applicability of *Cinerama, Inc. v. Technicolor*[72] and *Siebert v. Sperry Rand Co.*,[73] in which the alleged omission was a failure to disclose information that was widely disseminated in the media, claiming that the distribution of the Kemper annual reports cannot be characterized as being "the same degree of widespread dissemination" as in those cases.[74] I disagree entirely with Plaintiffs' interpretation in this area—while the media reports might be more "widespread," the annual reports were directed specifically to the only people who matter in this case, those who must decide whether the Kemper Funds or the Mentor Funds are a better investment. In fact, the media reports might go unnoticed by the shareholders, and then their effectiveness would be far less than that of the annual reports.

[22] Finally, Everen was not under a duty to disclose anything about the Kemper Funds, as the point of the Negative Response Letter and the Mentor Prospectus was to announce to shareholders of the money market funds that the Funds were being changed to the Mentor Funds, and so at that point the Kemper funds were, effectively, competitors. This Court will not add a new requirement that a company disclose information about competitors where it is not mandated by the federal securities laws.[75] Everen followed what was required under the disclosure requirements of

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[71] *Weinberger v. Rio Grande*, Del. Ch., 519 A.2d 116, 126 (1990).

[72] Del. Ch., C.A. No. 8358, Allen, C. (June 21, 1991), Mem. Op. at 55-56.

[73] 586 F.2d 949 (2d Cir. 1978).

[74] Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 46 n.31.

[75] *See In re Donald J Trump Casino Secs. Litig.*, 793 F. Supp. 543, 559 (D.N.J. 1992) ([T]here [is no] legal obligation for management to compare itself, favorably or otherwise, to industry competitors. Comparison shopping is the responsibility of the reasonable investor."), *aff'd* 7 F.3d 357 (3d Cir. 1993).

the NASD and the SEC.[76] This is enough in the present situation, where the claim is one for violation of a securities law.

Therefore, I dismiss all of Plaintiffs' claims alleging violations of §§ 11 and 12(2) of the Securities Act.

2. Violations of § 15 of the Securities Act the Everen Corporate Defendants, the Mentor Corporate Defendants, CRT, and certain directors

Because I have dismissed the counts alleging violations of §§ 11 and 12(a)(2) of the Securities Act, this count must fall as well, as a § 15 violation by control persons cannot occur if no underlying violation has occurred.

III. CONCLUSION

I hereby dismiss all seven counts of Plaintiffs' complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

IT IS SO ORDERED.

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[76]Plaintiffs do not dispute this latter point. They argue, however, that "[t]his argument is a weary reprise of defendants' preemption argument." Pls.' Answer Br. Opp'n Defs.' Mot. Dismiss at 45 n.30. I fail to see how it is "weary" (and presumably incorrect) when here Plaintiffs' claim is one of *federal securities law*, the same law with which Defendants are stating that they complied. It would seem an appropriate argument, in this section of Defendants' brief, even if I did not dismiss Defendants' claim of federal preemption of the state law issues.

PAINEWEBBER R&D PARTNERS II, L.P. v. CENTOCOR, INC.

No. 14,405

Court of Chancery of the State of Delaware, New Castle

March 15, 1999

Plaintiff submitted a settlement offer to the court of chancery for approval. Objectors raised questions concerning (1) the adequacy of a class representative under the proposed settlement offer, (2) certification of the action under Chancery Court Rule 23(b), and (3) the fairness and reasonableness of agreement. The court granted the plaintiff's motion for approval of the proposed agreement.

The court of chancery, per Vice-Chancellor Steele, concluded that (1) the proposed settlement agreement met the requirements of Chancery Court Rule 23(a), as Chancery Court Rules 23(a)(1)-(3) were not at issue, and in its analysis of 23(a)(4) the proposed class representative's conflicts were only hypothetical; (2) the agreement satisfied the requirements of Chancery Court Rule 23(b)(2) because of the equitable and injunctive nature of the requested specific performance and declaratory judgment, compensatory damages were not the predominant remedy, and the actions of the defendant warranted the type of relief sought, and (3) in an application of the court's rational business judgment the agreement was found to be fair and reasonable.

1. Compromise and Settlement ⟹ 52

Class certification is appropriate under Chancery Court Rule 23 if the action satisfies the four requirements of subsection (a) and at least one of the three requirements of subsection (b). DEL. CH. CT. R. 23(a)-(b).

2. Parties ⟹ 35.33

A plaintiff has the burden of establishing it has satisfied the requirements of Chancery Court Rule 23. DEL. CH. CT. R. 23.

3. Federal Civil Procedure ⟹ 164

Adequate representation of a class depends on two factors: (a) plaintiff's attorney must be qualified, experienced, and generally able to

conduct the proposed litigation, and (b) plaintiff must not have interests antagonistic to those of the class.

4. Corporations ⚿ 207.1

In making a determination concerning adequate representation of a class, the court can and should examine any extrinsic factors, that is, outside entanglements which make it likely that the interests of other class members will be disregarded in the prosecution of the suit.

5. Corporations ⚿ 207.1

Purely hypothetical, potential, or remote conflicts do not render a plaintiff an inadequate class representative.

6. Corporations ⚿ 207.1

Before a plaintiff can be found to be disqualified to maintain an action under Chancery Court Rule 23 or 23.1, an objector must show that a serious conflict of interest exists, and the plaintiff cannot be expected to act in the interests of others because doing so would harm his other interests. DEL. CH. CT. R. 23, 23.1.

7. Corporations ⚿ 207.1

Where plaintiff does not have interests, either through itself or parent company, that could reasonably be characterized as antagonistic to those of the class, and where plaintiff has vigorously and diligently prosecuted action, the court will find plaintiff to be an effective and adequate representative.

8. Attorney and Client ⚿ 32(2), 106

The professional oath taken by attorneys as well as the rules governing the professional responsibilities of attorneys ensure that an attorney's vigorous representation of his client overrides any previous or current business or social relationship that the attorney might have with counsel representing other parties in an action.

9. Compromise and Settlement ⟹ 52

A Chancery Court Rule 23(b)(2) designation is appropriate where the defendant's actions or inactions have made a final injunction or corresponding declaratory judgment the appropriate relief with respect to a class as a whole. DEL. CH. CT. R. 23(b)(2).

10. Parties ⟹ 35.61

The presence of a request for compensatory damages does not prohibit class certification under Chancery Court Rule 23(b)(2) where compensatory damages are not the predominant remedy. DEL. CH. CT. R. 23(b)(2).

11. Damages ⟹ 15

Compensatory damages are damages intended to compensate an injured party for the injury sustained, and nothing more.

12. Parties ⟹ 35.61

A class action is certifiable under Chancery Court Rule 23 (b)(1) where the prosecution of separate actions by individual members of the class would create a risk of inconsistent or varying adjudication with respect to those individual members of the class and establish incompatible standards of conduct for the party opposing the class. DEL. CH. CT. R. 23(b)(1).

13. Parties ⟹ 35.61

For a class to be certified under Chancery Court Rule 23(b)(1)(A), there must be a realistic likelihood of multiple litigation and a total absence of individual issues among the class. DEL. CH. CT. R. 23(b)(1)(A).

14. Compromise and Settlement ⟹ 63

It is well established that Delaware law favors the voluntary settlement of contested issues.

15. Compromise and Settlement ⚷ 63

The parties proposing a settlement agreement must show that it is fair and reasonable.

16. Compromise and Settlement ⚷ 56.1, 57

When reviewing a motion to approve a settlement agreement, the court is to consider the nature of the claim, the defenses thereto, the legal and factual circumstances of the case, and then apply the court's own business judgment in deciding whether the settlement is reasonable in light of these factors.

17. Compromise and Settlement ⚷ 63

The principal focus in a reviewing a settlement agreement is upon the benefits provided in the settlement, in light of the nature of the claims and the likelihood of success on the merits.

18. Compromise and Settlement ⚷ 57

It is well established that general releases of liability can be fair and reasonable elements in a settlement agreement, and an important consideration warranting approval of the court.

19. Constitutional Law ⚷ 309(1.5)
Parties ⚷ 35.5

When a portion of the relief sought is monetary, a member of a class certified under Chancery Court Rule 23(b)(2) has a constitutional due process right to notification but not a right to opt out of the class. DEL. CH. CT. R. 23(b)(2).

20. Parties ⚷ 35.51

The court of chancery has discretionary power, under Chancery Court Rule 23(d)(2), to provide for an opt out right and to require that notice thereof be given, if it believes that an opt out right is necessary to protect the interest of absent class members. DEL. CH. CT. R. 23(d)(2).

21. Constitutional Law ⚷ 309(1.5)

Class members in actions certified under Chancery Court Rule 23(b)(1) do not have a constitutional due process right to opt out of the action as long as notice and an opportunity to appear are afforded. DEL. CH. CT. R. 23(b)1.

22. Constitutional Law ⚷ 309(1.5)

When an action is certified under Chancery Court Rule 23(b)(3) constitutional due process requires that dissenting class members be given the opportunity to opt out of the class. DEL. CH. CT. R. 23(b)(3).

Bruce L. Silverstein, Esquire, and John W. Shaw, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; Thomas H. Sear, Esquire, and A. Michael Covino, Esquire, of Jones, Day, Reavis & Pogue, New York, New York, of counsel, for plaintiff, PaineWebber R&D Partners II, L.P.

Douglas R. MacGray, Esquire, of MacGray & Associates, Bear, Delaware; and Ann M. Caldwell, Esquire, of Greenfield & Rifkin, Ardmore, Pennsylvania, of counsel, for plaintiff/objector John Abdo.

Stephen E. Jenkins, Esquire, and Amy A. Quinlan, Esquire, of Ashby & Geddes, Wilmington, Delaware, for defendant Centocor Partners III, L.P.

Vernon R. Proctor, Esquire, Phebe S. Young, Esquire, John H. Newcomer, Jr., Esquire, and Kurt M. Heyman, Esquire, of The Bayard Firm, Wilmington, Delaware, for objector, Pharmaceutical Partners II L.P.

Jesse A. Finkelstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; Robert B. Mazur, Esquire, and Andrew C. Houston, Esquire, of Wachtell, Lipton, Rosen & Katz, New York, New York, of counsel, for defendants PaineWebber Group, Inc., PaineWebber Inc., and PaineWebber Development Corporation.

STEELE, *Vice-Chancellor*

Issues Presented

A motion to approve a proposed settlement of this derivative and class action law suit raises issues regarding the adequacy of a class

representative under Court of Chancery Rule 23(a)(4), certification of this action under Rule 23(b), and the fairness and reasonableness of the proposed settlement agreement.

Can a proposed class representative be an adequate class representative under Rule 23(a)(4) when the entities controlling it have alleged conflicts of interest arising out of (i) their contractual obligation to indemnify potential defendants in this action, (ii) their status as third-party defendants in this action, and (iii) their control over another entity that is the class representative in a pending Delaware Superior Court action in which the Defendant is the same defendant as one of the defendants in this action, the claims arise out of the same transaction as the claims in this action, and the Class claims it has a right to a portion of the same funds to which the Class in this action claims it has a right?

Do requests for specific performance of a contract that could result in the Defendants making future monetary payments to the Class and an accompanying request for a declaratory judgment stating the proper calculation of those payments constitute equitable claims or injunctive and equitable relief that would permit certification of this action under Rule 23(b)(2)?

In light of numerous objections regarding the sufficiency and allocation of consideration, releases of liability, and the absence of an opt-out provision, can a proposed settlement agreement that provides an estimated $44 million gain for the Class be fair and reasonable when the complaint asserted two legally strong claims worth between $4.5 million and $35.7 million and between $15.8 million and $18.4 million, respectively, and another legally weak claim worth between $44.8 million and $125 million?[1]

Because the proposed class representative's alleged conflicts are either hypothetical or only potential conflicts or not even conflicts at all, the proposed class representative is an adequate class representative under Rule 23(a)(4). I also find this action and the proposed class representative to satisfy the other requirements of Rule 23(a). Because the request for specific performance and a declaratory judgment is truly injunctive and equitable in nature and compensatory damages are not the predominant remedy, and because the defendants' actions make this type of relief appropriate with respect to the entire class, this action can be certified properly under Rule 23(b)(2). Finally, given the relative strength and estimated value of the separate claims as well as the Defendants' defenses

[1]The range in value of these claims arises from the difference in the parties' opinions and analyses.

and cross-claims, I, after the exercise of rational business judgment, find that the terms of the settlement agreement are fair and reasonable. I, therefore, approve the proposed settlement agreement.

Factual Background

A. The Parties

Defendant Centocor., Inc. ("Centocor") is a biotechnology company incorporated in Pennsylvania. As a part of its business, Centocor develops and sells pharmaceutical drugs.

Third-Party Defendant PaineWebber, Inc., the familiar financial company, is a publicly traded holding company and provides various brokerage and investment banking services to its clients through wholly-owned operating subsidiaries. Third-Party Defendant PaineWebber Group, Inc. (collectively with PaineWebber Inc.,"PaineWebber") is one of PaineWebber, Inc.'s wholly owned subsidiaries. Third-Party Defendant PaineWebber Development Corporation ("PWDC") is a wholly owned subsidiary of PaineWebber Group, Inc. PWDC is the general partner of limited partnership PaineWebber Technologies II, L.P. ("PWT II") which, in turn, is the general partner of Plaintiff PaineWebber Research & Development II, L.P. ("PWR&D II"). PWR&D II now seeks approval of the proposed settlement. PWDC formed PWR&D II to invest in high tech projects, including projects sponsored by the investment banking and financial advisory clients of PaineWebber and its subsidiaries. Between 1985 and 1992, PaineWebber, through subsidiaries including PWDC, provided investment banking services to Centocor.

PWDC advised Centocor to establish Derivative Plaintiff and nominal defendant Centocor Partners, L.P., III ("CP III") a Delaware limited partnership in order to help Centocor finance the research and development of the drug ReoPro.[2] PWR&D II purchased Class C and Class A CP III limited partnership units and PWDC purchased a Class B unit.

Defendant Centocor Development Corporation III ("CDC III") is a wholly owned subsidiary of Defendant Centocor. Centocor formed CDC III to serve as CP III's managing general partner.

Mr. Abdo and Pharmaceutical Partners II, L.P. ("PP II") *(Abdo and PPII* collectively, *the "Objectors")* are both former owners of CP III Class A limited partnership units. Objectors urge rejection of the proposed

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[2]CP III also was to finance the research and development of another drug — Capiscint. ReoPro, however, is the only drug at issue in this litigation.

settlement agreement. Abdo also is the Plaintiff in an another action in this Court which asserts, with a few exceptions, the same claims as this action.

B. Formation of CP III

In December 1987, CDC III, PWR&D II, PWT II, and PWDC executed the Agreement of Limited Partnership (the "L.P. Agreement") and formed CP III. CP III's purpose was to research and develop ReoPro and obtain the regulatory approval necessary to market it. CP III was to finance this process with the funds it raised from the sale of its limited partnership interests to investors. In return for its investment in the research and development of ReoPro, CP III would receive a certain percentage of the income stream, if any, from the eventual sale of ReoPro. CP III would then distribute that income to its limited partners in accordance with the L.P. Agreement.

Pursuant to the L.P. Agreement, CDC III was CP III's managing general partner and CP III had three classes of limited partnership units: Classes A, B, and C. Persons acquiring their CP III interests through the sale and distribution of the CP III interests underwritten and managed by PaineWebber and its subsidiaries became Class A limited partners. In total, 431.25 Class A units were sold, each unit costing $100,000. Abdo and PP II bought Class A units. PWDC purchased the only Class B unit for $150,000. PWDC caused PWR&D II to purchase 111 Class C units for a total of $9,900,000 and eventually some Class A units. In exchange for generating PWR&D II's investment in CP III, PWDC obtained, pursuant to an agreement among Centocor, CP III, CDC III, PWR&D II, PWDC and PaineWebber, the right to nominate one-half of the CDC III Board (two out of four directors). PWDC has indemnification agreements with its representatives to the CDC III Board.

A series of agreements defined the rights and obligations of CP III, its limited partners, CDC III and Centocor. In order for CP III to accomplish its purpose, Centocor and CP III entered the Cross License Agreement under which Centocor licensed to CP III its intellectual property and technology relating to ReoPro. CP III, in turn, agreed to further research and develop ReoPro up to the limit of the funds raised by CP III in the sale of its limited partnership units.

Centocor and CP III also entered the Development Agreement under which CP III contracted with Centocor for Centocor to research and develop ReoPro to the extent necessary to obtain regulatory approvals. The Development Agreement required Centocor to use its best efforts to research and develop ReoPro with the funds provided by CP III. Centocor had no obligation under the Development Agreement to continue funding

the research and development of ReoPro after exhaustion of the CP III funds. The Development Agreement provided, however, that, if it wanted, Centocor could fund the further research and development of ReoPro in the event that the CP III funds were exhausted before ReoPro obtained the necessary regulatory approval. The Development Agreement provided that in the event Centocor funded this further research and development of ReoPro *and it was approved by CP III,* the budget for ReoPro's research and development would be amended by agreement between the parties to include this additional funding.

Centocor and CP III also entered the Joint Venture Agreement forming Centocor Ventures III ("CV III"), a joint venture that would manufacture, market and sell ReoPro once Centocor, acting on behalf of CP III under the Development Agreement, had obtained the necessary regulatory approvals. Under the Joint Venture Agreement, CDC III was the managing venturer and was to be paid a 10% commission on CVIII's revenues for administrative costs. The Joint Venture Agreement also provided that the parties were to share CV III's profits and losses in the proportion of 74.97% to Centocor and 25.03% to CP III. The Joint Venture Agreement further provided that CV III would contract with Centocor for Centocor to manufacture and market ReoPro. The Joint Venture Agreement required the CDC III Board annually to approve unanimously Centocor's plans and projections for the marketing and distribution of ReoPro. The Joint Venture Agreement also provided that if Centocor wished to alter the marketing and distribution program it set forth in the Private Placement Memorandum by which the CP III units were offered for sale, the CDC III Board would have to consider the likely impact of any such deviation upon CV III and make any appropriate adjustment in the CV III profit sharing scheme for that impact.[3] Under the Joint Venture Agreement, CV III was to reimburse Centocor for its costs of manufacturing on a dollar-for-dollar basis. For Centocor's marketing expenses, CV III was to pay Centocor 17% of CV III's revenues.

Centocor, CP III, CDC III, and the CP III limited partners also entered the Partnership Purchase Option Agreement (the "PPOA"). The PPOA provided Centocor an option to purchase the CP III limited partners' interests in CP III upon certain events. These same parties entered into the Partnership Purchase Agreement (the "PPA"). The PPA became effective after a buyout under the PPOA and specifies the rights of the CP III investors for the period after Centocor buys out their interest in CP III.

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[3]The Private Placement Memorandum represented that Centocor itself would develop a sales force to market and distribute ReoPro in the United States and utilize distributors to market ReoPro outside the United States.

Specifically, under the PPA the former CP III limited partners are entitled to a 6.5% royalty on Centocor's sales of ReoPro through the year 2007 (the "Trailing Royalty"). In addition, the former Class C limited partners are entitled to .975% of Centocor's revenues from ReoPro sales.

C. Centocor Partners II

Centocor Partners II ("CP II") is another research and development limited partnership, with a structure almost identical to that of CP III. PWDC helped Centocor set up CP II to finance the research and development of Centocor's drug Centoxin. PaineWebber Research & Development, L.P. ("PWR&D") is a CP II limited partner. PWDC is the general partner of PaineWebber Technologies, L.P. I ("PWT I") which, in turn, is PWR&D's general partner.

D. The Exhaustion of CP III Funds

ReoPro's research and development exhausted the CP III funds in 1990, before Centocor had completed the research and development of ReoPro. As already discussed, the Development Agreement provided that in the event CP III's funds were exhausted, Centocor could, at its option, fund further development of ReoPro on terms to be agreed upon by CP III and Centocor. In September of 1997, Centocor allegedly had contributed $164 million to the further research and development of ReoPro and expected its ultimate contribution to exceed $200 million. It is disputed whether Centocor obtained the CDC III Board's approval for, and therefore CP III's endorsement of, these contributions.

E. The Centocor-Lilly Transactions

On or about July 15, 1992, Centocor and Eli Lilly and Company ("Lilly") entered into a series of agreements (the "Lilly Agreements" or the "Lilly Transactions") relating to the marketing rights of both ReoPro and Centoxin (the drug that CP II was researching and developing). Under the Lilly Agreements, Lilly paid Centocor at least $100 million. Centocor and Lilly allocated $50 million of the $100 million as payment for Lilly's purchase of two million shares of Centocor common stock, $49,500,000 as payment for Lilly's purchase of rights in Centoxin, and $500,000 as payment for Lilly's purchase of an option to acquire exclusive marketing rights to ReoPro. Lilly could exercise the ReoPro option without further payment if the FDA failed to approve Centoxin by January 1, 1994. If the

FDA approved Centoxin by January 1, 1994, Lilly could exercise the ReoPro option for $25 million.

In early 1993, Centocor abandoned its efforts to obtain FDA approval of Centoxin, and, in July 1993 Lilly and Centocor amended the Lilly Agreements providing Lilly with the right to exercise its option to purchase the exclusive marketing rights to ReoPro for no additional payment. Lilly then exercised its option. As a result, Centocor manufactures ReoPro, sells it to Lilly, and then Lilly markets and resells ReoPro to end users for a higher price. Following Lilly's exercise of its option, CDC III has calculated CV III's profits using the revenues from Centocor's sales of ReoPro to Lilly. These revenues are about one-half the total of Lilly's revenues from end sales of ReoPro.

F. The Fujisawa Agreement

In June 1996, Centocor and Lilly further amended the Lilly Agreements and Centocor paid Lilly $17 million for the rights to market ReoPro in Japan. In August 1996, Centocor and Fujisawa Pharmaceutical Company, Ltd. ("Fujisawa") entered into an agreement (the "Fujisawa Agreement"), under which Fujisawa acquired certain Japanese rights with respect to ReoPro in exchange for $15 million (which Centocor received in October 1996) and two contingent milestone payments of $6 million each. The CDC III Board approved the Fujisawa Agreement, subject to a later determination of the exact portion of the consideration that Fujisawa paid and would pay to Centocor that should be distributed to CP III and its limited partners.

G. The Buyout of the CP III Limited Partners

Under the terms of the PPOA and the PPA, on January 31, 1997, Centocor purchased the Class A and Class C limited partnership interests and on May 1, 1997, Centocor purchased the Class B limited partnership interest (collectively, the "Buyout"). Following the Buyout, the PPA has governed the former CP III limited partners' rights to profits from ReoPro sales. Since the Buyout Centocor has calculated the Trailing Royalties using revenues from Centocor's ReoPro sales to Lilly.

H. The CP III Litigation

1. The PWR&D II Complaint

On July 12, 1995 (before the Fujisawa Agreement or the Buyout), PWR&DII brought this action derivatively on behalf of CP III challenging the propriety of actions taken by Centocor and CDC III causing Centocor to enter into the Lilly Agreements. On September 2, 1997, PWR&D II filed for leave to amend its Complaint to add two class claims and to request relief additional to that demanded in the original Complaint. This amendment responded to the Buyout. As a result of the Buyout, the former CP III investors had direct claims with respect to the Trailing Royalty period where earlier the former CP III investors had only derivative claims.

The PWR&D II Complaint makes claims that essentially fall into two categories: claims arising out of Centocor's entering the Lilly Agreements and Centocor's calculation of the Trailing Royalty payments.

a. Claims arising out of the Lilly Agreements

The PWR&D II Complaint alleges that the purported allocation of the $100 million Centocor received in the Lilly Transactions was intentionally designed to avoid paying CP III its fair and full share of the portion of the $100 million that constituted consideration for Lilly's purchase of the marketing rights to ReoPro. The PWR&D II Complaint further alleges that at least $25 million of the $100 million was Lilly's payment for the marketing rights to ReoPro, and, as evidence in support of this allegation, points to the fact that under the Lilly Agreements Lilly would have had to pay $25 million for the ReoPro marketing rights if the FDA had approved Centoxin. The PWR&D II Complaint claims that Centocor's failure to apportion properly the proceeds from the Lilly Transaction violated the Joint Venture Agreement, which provides CP III with a right to 25.03% of all profits from the manufacturing, marketing and sales of ReoPro. The PWR&D II Complaint seeks compensatory damages in the amount of 25.03% of $25 million or 25.03% of such greater amount as the proof would show that Lilly paid Centocor for the marketing rights to ReoPro.[4]

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[4]PWR&D II's argument that its claim is not limited to the $100 million Centocor received in the Lilly Transactions is unpersuasive. Its Complaint specifically seeks "compensatory damages of 25.03% of $25 million or such greater amount as the proof will show and its fair share of all *other profits* related to [ReoPro] . . . ." By using the phrase *other profits*, PWR&D II indicates that the 25.03% of $25 million or such greater amount as the proof will

The PWR&D II Complaint also alleges that the marketing and distribution plan embodied in the Lilly Agreements substantially reduced the revenues to be received by CV III and, therefore, the profits that CP III and the former limited partners would receive from ReoPro sales. The PWR&D II Complaint further alleges that Centocor neither sought nor obtained a unanimous vote of the CDC III Board nor presented the new marketing and distribution plan to the CDC III Board for adjustments to the CV III profit sharing scheme to compensate CP III for the negative impact that the new plan would have on CV III's potential profits. PWR&D II claims that Centocor's failure to obtain approval or even present the new marketing and distribution plan to the CDC III Board breached the Joint Venture Agreement. As relief for these claims, the PWR&D II Complaint appears to seek compensatory damages in an amount equal to the difference between the amount CP III would have received if the CV III profits had been calculated using the total revenues from Lilly's ReoPro sales, which presumably would be representative of the CV III's revenues if Centocor had marketed and distributed ReoPro itself, and the amount CP III actually received, which was based on CV III's profits from Centocor's ReoPro sales to Lilly.

The PWR&D II Complaint claims Centocor's and CDC III's actions and omissions listed above constituted breaches by those entities of their fiduciary duties to CP III. The PWR&D II Complaint, however, does not advance fiduciary duty claims against the individual CDC III directors.

b. Claims Arising Out of Centocor's Calculation of the Trailing Royalty Payments

The PWR&D II Complaint alleges that under the PPA the Trailing Royalties are to be calculated using the revenues from all ReoPro sales, and not just revenues from Centocor's sales. The PWR&D II Complaint further alleges that since the Buyout Centocor has calculated the Trailing Royalties using the revenues from Centocor's ReoPro sales to Lilly, as opposed to the revenues from Lilly's end sales of ReoPro, in violation of the PPA. As relief for this claim, the PWR&D II Complaint seeks compensatory damages, a judgement declaring that the Class is entitled to Trailing Royalties based on all sales of ReoPro, an order requiring Centocor to specifically perform its obligations under the PPA in accordance with the declaratory judgement and injunctive relief preventing Centocor from

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show is limited to Centocor's profits from ReoPro, or the $100 million related to this specific claim.

continuing to calculate the Trailing Royalties using revenues from Centocor's sales of ReoPro to Lilly.

2. Defendants' Answer, Cross-Claim and Third-Party Claim

On September 15, 1995, Defendants filed an Answer, Cross-Claim and Third-Party Claim, denying the material allegations of the Complaint, asserting a defense and cross-claim against nominal defendant CP III to set off any amounts awarded to CP III under the Complaint with contributions Centocor voluntarily made to the development of ReoPro, and asserting third-party claims against PaineWebber and PWDC for, among other things, breach of fiduciary duty and negligence for, as its investment advisor, failing to advice them that the proceeds from the Lilly Transactions would be substantially diverted from Centocor to CP III. Furthermore, in their defenses, Defendants alleged that PaineWebber was aware of the Lilly Transactions, its representatives supported it, PWDC's representatives to the CDC III Board did not object to the Lilly Agreements when formally presented to the CDC III Board after they had been executed on September 17, 1992, and that the CDC III Board unanimously endorsed Centocor's proposal to permit Lilly to exercise the option to obtain the right to purchase ReoPro at no additional cost to Lilly. By later amendment, Defendants also asserted a cross-claim against CP III for indemnification and additional third-party claims against PaineWebber. On November 20, 1995 PaineWebber and PWDC filed Answers denying the material allegations of the Third-Party Claim.

3. The Abdo Action

On November 1, 1995, John E. Abdo filed an action in this Court on behalf of CP III. The Complaint in the Abdo action contains claims and seeks relief substantially similar to this action. Initially, Abdo did not sue Lilly, the PaineWebber entities or, PWDC's representatives to the CDC III Board. Unlike PWR&D II, however, Abdo sued Centocor's representatives to the CDC III Board. Abdo later sued PWDC's representatives to CDC III's Board by amendment to his Complaint. The PWR&D II action and the Abdo Action were coordinated for the purposes of discovery but were not consolidated.

4. Motion to Disqualify PWR&D II as Derivative Plaintiff & the Settlement Announcement

On July 12, 1996 CP III filed a Motion to Disqualify PWR&D II from serving as a derivative plaintiff. Defendants Centocor, CDC III, and Abdo supported CP III's motion while Plaintiff PWR&D II and Third-Party Defendants PaineWebber and PWDC opposed the motion. On the eve of my ruling on CP III's motion, PWR&D II and Defendants announced they had reached a settlement. As a result, I did not issue my ruling on CP III's motion to disqualify PWR&D II from serving as a derivative plaintiff.

On June 27, 1997, I ordered that for purposes of settlement only, this action was properly maintained under Rule 23.1 as a derivative action; that pending the Settlement Hearing, this action would be temporarily maintained as a class action under Rule 23(a), 23(b)(1) and 23(b)(2) on behalf of the Class; and that under Rule 23(c) PWR&D II was temporarily certified as Class Representative and its counsel was temporarily designated as Class counsel. In the same Order, I defined the Class as all holders of CP III Class A or Class C Limited Partnership Interests as of the close of business on January 31, 1997, and the holders of the CP III Class B Limited Partnership Interests as of the close of business on May 1, 1997, and their transferees, successors and assigns, immediate and remote, excluding Defendants (the "Class"). I also scheduled a settlement hearing for September 4, 1997.

Before the Settlement Hearing, the Objectors, PWR&D II and Defendants filed extensive briefs explaining their respective positions regarding approval of the settlement agreement. After the September 4, 1997 Settlement Hearing, I allowed Objectors to take limited discovery related to the fairness and reasonableness of certain terms of the settlement agreement. The follow-up discovery, itself, resulted in numerous additional submissions to this Court regarding the settlement agreement. The settlement agreement was amended to reflect some of Objectors' concerns (the settlement agreement, as amended, the "Settlement Agreement").

I. The CP II Litigation

On the same date that PWR&D II filed the Complaint in this action, PWR&D filed a class action suit against CP II in New York which asserted claims arising out of the Lilly Transactions. The New York Court dismissed the complaint on *forum non conveniens* grounds and PWR&D refiled in New Castle County, Delaware, Superior Court. The Complaint alleges that the class in that action is entitled to a greater percentage of the

$100 million Centocor received in the Lilly Transactions, arguing that the additional money was attributable to advance sales of Centoxin or to licensing of CP II rights. When it first discussed the possibility of filing the CP II and CP III actions, PWDC recognized a potential conflict between the PWR&D and PWR&D II actions. As a result, PWDC hired separate counsel to represent PWR&D and PWR&D II in their respective actions.

J. The Settlement Agreement

The Settlement Agreement provides for the Class to receive an initial payment of $10.8 million, less any attorneys' fees and expenses awarded by this Court. The balance of the $10.8 million existing after deducting attorneys' fees and costs will be distributed to the former CP III limited partners as follows: 63.382% to Class A; 0.245% to Class B; and 36.373% to Class C. Within the Classes, these amounts will be divided pro rata.

The Settlement Agreement also provides that if total end sales of ReoPro reach $600 million, Centocor will make an additional payment of $5,009,757 to the Class. This amount will be distributed as follows: 61.198% to Class A; 0.236% to Class B; and 38.566% to Class C. Distributions within the Classes will be pro rata. While the Settlement Agreement does not itself tie the $15.8 million in payments to specific aspects of CP III's claims, PWR&D II considers $12.4 million of the $15.8 million to represent what CP III would have received from Centocor had CP III received distributions during CV III's existence calculated on profits from Lilly's end sales of ReoPro, rather than Centocor's ReoPro sales to Lilly. PWR&D II considers $.6 million of the $15.8 million as interest upon the amounts otherwise due for distribution to CP III but which will not be paid until the ReoPro sales reach $600 million and $2.8 million of the $15.8 million to relate to payments Centocor received under the Fujisawa Agreement.

Under the Settlement Agreement, Centocor also will pay the Class $1,111,111 from each milestone payment it receives from Fujisawa. These payments will be distributed as follows: 69.691% to Class A; 0.269% to Class B; and 30.040% to Class C. Distributions within the Classes will be pro rata.

The Settlement Agreement also provides the Class with royalty payments in lieu of the Trailing Royalties Centocor otherwise would be obligated under the PPA to pay the former CP III limited partners. For each quarter of the calendar years 1997 and 1998, the Class will receive 6.5% of the first $175 million of end sales revenues from sales within the United States for each of those calendar years and 3.25% of any end sales

revenues from sales within the United States above $175 million for each of those calendar years, and 3.25% of end sales revenues from sales outside the United States. For each quarter of the calendar years 1999 through 2007, the Class will receive 6.5% of the first $250 million million of end sales revenues from sales within the United States for each of those calendar years and 4.00% of end sales revenues from sales within the United States above $250 million for each of those calendar years, and 3.25% of end sales revenues from sales outside the United States. These royalty payments would be apportioned among the Classes in the proportion that they would have shared in the total payments Centocor would have made under the PPA through the Trailing Royalties and the additional .975% royalty payment to PWR&D II as the Class C limited partner, calculated on the basis of Centocor's revenues and not end sales revenues. The Settlement Agreement provides that in no event shall the royalties paid to the Class under the Settlement Agreement be less than what the Class would have received under the PPA without the Settlement Agreement. PWR&D II estimates that these royalty payments provided for in the Settlement Agreement provide the Class with a $27.8 million net present value improvement over Centocor's current calculation of the Trailing Royalty payments.

The Settlement Agreement provides no consideration for the claims relating to CP III's right to a greater portion of the $100 million Centocor received in the Lilly Transactions.

Analysis

Analysis of the proposed settlement of this derivative and class action requires two distinct steps. First, while I certified this action as a provisional class action and PWR&D II as provisional class representatives, I must determine whether, under Court of Chancery Rule 23, the action is certifiable as a class action.[5] Second, if Rule 23's requirements are fulfilled. I then must determine whether the terms of the Settlement Agreement are fair and reasonable.[6]

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[5]*See Prezant v. DeAngelis*, Del. Supr., 636 A.2d 915, 925 (1994) ("we hold that, *in every class action settlement*, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and(b)"). There does not appear to be, nor did the parties argue the existence of, an obligation for this Court to carry out a similar exercise with regard to the derivative aspects of this action. *See* DONALD J. WOLFE, JR., MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY 665 (1998).

[6]*See Polk v. Good*, Del. Supr., 507 A.2d 531, 535 (1986).

A. Certification As Class Action Under Court of Chancery Rule 23

[1] Class certification is appropriate under Court of Chancery Rule 23 if the action satisfies the four requirements of subsection (a) and at least one of the three requirements of subsection (b).[7] Rule 23(a) requires that:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.[8]

Rule 23(b) requires that:

> (1) The prosecution of separate actions by or against individual members of the class would create a risk of:
>
> (A) Inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class; or
>
> (B) Adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
>
> (2) The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
>
> (3) The Court finds that the question of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matter pertinent to the findings include:

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[7] *Van de Walle v. Salomon Brothers, Inc.*, Del. Ch., C.A. No. 9894, Steele, V.C., slip op. at 3 (September 30, 1997) *(citing Prezant v. DeAngelis*, Del. Supr., 636 A.2d 915, 920(1994)).

[8] Del.Ct.Ch.R. 23(a).

> (A) The interest of members of the class in individually controlling the prosecution or defense of separate actions;
> (B) The extent and nature of any litigation concerning the controversy already commenced by or against members of the class;
> (C) The desirability or undersireability of concentrating the litigation of the claims in the particular forum;
> (D) The difficulties likely to be encountered in the management of a class action.[9]

[2] A plaintiff has the burden of establishing it has satisfied the requirements of Rule 23.[10]

1. Rule 23(a)(1)-(3)

The Objectors do not contest that PWR&D II has met its burden of proof with regard to the first three requirements of Rule 23(a) — (1) numerosity of the class members, (2) common questions of law and fact, and (3) typicality of the claims of the Class. After reviewing PWR&D II's pleadings, I agree that PWR&D II unquestionably satisfies the first three requirements of Rule 23(a).

2. Rule 23(a)(4)

While PWR&D II is the proposed class representative in this action, PWDC and, ultimately PaineWebber, control PWR&D II, which itself has no independent employees. The Objectors claim that PWR&D II cannot adequately represent the class because PaineWebber and PWDC allegedly have several interests that conflict with the interests of the Class. Because PWR&D II does not contest the fact that PWDC and PaineWebber representatives are supervising this action, I must address PWDC's and PaineWebber's alleged conflicts even though PWR&D II is the proposed class representative.
[3-6] "Adequate representation [of a class] depends on two factors: the plaintiff's attorney must be qualified, experienced, and generally able to conduct the proposed litigation, and (b) the plaintiff must not have interests

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[9]Del.Ct.Ch.R. 23(b).

[10]*Rosen v. Juniper Petroleum Corp.*, Del. Ch., C.A. No. 7016, Berger, V.C., mem. op. at 2 (Apr. 11, 1986).

antagonistic to those of the class."[11] In making this determination, the Court "can and should examine any extrinsic factors, that is, outside entanglements which make it likely that the interests of the other [class members] will be disregarded in the prosecution of the suit."[12] "[P]urely hypothetical, potential or remote conflicts," however, do not render a plaintiff an inadequate class representative.[13] Rather, "before a plaintiff can be found to be disqualified to maintain an action under Rule 23 or 23.1 a[n objector] must show that a serious conflict of interest exists, by virtue of one factor or a combination of factors, and that the plaintiff cannot be expected to act in the interests of others because doing so would harm his other interests."[14]

a. PWDC's Indemnification of Its Representatives to the CDC III Board

The first conflict of interest which Objectors claim renders PWR&D II an inadequate class representative is PWDC's obligation to indemnify their appointees to the CDC III board of directors (Pitt and Diaz). Objectors claim that Centocor's representatives to the CDC III board should be sued for breach of their fiduciary duties resulting from their involvement in or failure to act during the Lilly Transactions. Objectors argue that these claims could prove to be especially valuable to the Class in the event that Centocor is successful on its defense or cross-claim that any damages suffered by CP III should be set-off in an amount equal to the money Centocor has invested in the development of ReoPro since the CP III's funds were exhausted. In that case, Objectors argue, the Class' only available avenue to recover damages from the Lilly Transactions would be the claims against the CDC III directors. PWR&D II, however, did not sue any of the CDC III directors in this action. Objectors claim PWDC's obligation to indemnify Pitt and Diaz controlled PWR&D II's decision not to sue any of the CDC III directors. As a result, Objectors argue, PWR&D II was unable to act in the best interests of the Class.

PWR&D II responds by arguing that its decision not to sue *any* of the CDC III directors results from a carefully considered litigation strategy

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[11] *Barbieri v. Swing-N-Slide Corp.*, Del. Ch., C.A. No. 14239, Steele, V.C., mem. op. at 11 (May 7, 1996) (*quoting Wetzel v. Liberty Mutual Ins. Co.*, 508 F.2d 239, 247 (3rd. Cir. 1975), *cert denied*, 421 U.S. 1011 (1975).

[12] *Van de Walle v Unimation, Inc.*, Del. Ch., C.A. No. 7046, Hartnett, V.C., slip op. at 9-10 (Dec. 6, 1983) (*quoting Youngman v. Tahmoush*, Del. Ch., 457 A.2d 376, 379 (1983)).

[13] *See Youngman*, 457 A. 2d at 380.

[14] *Id.* at 381.

and not from its obligation to indemnify Pitt and Diaz. PWR&D II claims, in fact, that it was in the best interest of the Class not to sue any of the CDC III directors because the potential claims against the CDC III directors would unnecessarily complicate the issues and cause added delay and expense to the action without increasing the chance of a larger recovery for the Class. PWR&D II explains that it views Centocor as the primary culprit in this action and financially able to satisfy any judgement obtained on behalf of the Class. PWR&D II also points out that each of the CDC III directors also are indemnified by CP III, which potentially could undermine the value of any judgement entered against the CDC III directors in this action. As a result, it concluded that claims against *any* of the CDC III directors would constitute only a sideshow to the primary claims against Centocor and impede and delay any recovery while increasing the Class' litigation costs without increasing the chances of recovering. PWR&D II further explains that it considered the claims against Pitt and Diaz particularly meritless. In support of this conclusion, PWR&D II refers to its Complaint and the Abdo Complaint. Both Complaints allege that Centocor entered the Lilly agreements without any approval by CDC III or CP III, and that because Centocor controlled CDC III, any action by the CDC III directors would have been meaningless. Both Complaints also allege that when Diaz expressed concern about the Lilly Transactions, Centocor's representatives to the CDC III board refused to take any action to deal with these concerns.

While Objectors posit several scenarios under which CDC III's directors might be liable to CP III and claim that PWR&D II's failure to pursue all possible avenues of recovery prejudices the interests of the other members of the Class, I am not convinced that the interests of CP III and the Class are necessarily best served by maintaining an "open choke" broad pattern approach to litigation. PWR&D II's sound rationale behind its decision not to make claims against the CDC III directors and the Objectors' failure to point to any definitive monetary value CP III or the Class would receive by naming the CDC III directors as defendants eliminate any genuine concern a reasonable person might have that PWR&D II would not vigorously pursue the interests of the Class because of PWDC's obligation to indemnify Pitt and Diaz. While some conflict may exist arising out of PWDC's obligation to indemnify Pitt and Diaz, it is purely hypothetical and does not render PWR&D II an inadequate representative. PWR&D II and the Objectors simply have a legitimate difference in opinion regarding the best legal strategy for this action. The mere existence of these differing views does not render PWR&D II an inadequate representative.

b. The CP II Action

Objectors also claim that PWR&D II cannot adequately represent the Class' interests when PWR&D, which PWDC and PaineWebber also control, is the class representative in the CP II Action pending in Superior Court. Objectors argue PaineWebber's interest in and supervision of both actions results in a conflict on PWR&D II's behalf because both actions seek recovery from the same pool of money, the $100 million Centocor received in the Lilly Transactions. Presumably, the Objectors concern is that PWDC and PaineWebber will cause PWR&D II to compromise its claim to a portion of the $100 million in this action in favor of PWR&D's claim to a portion of the $100 million in the CP II Action.

Again, however, this is merely a hypothetical or potential conflict that does not render PWR&D II an inadequate class representative. The PWR&D II claims do not necessarily conflict in their theories or requested remedies. It is clear from the terms of the Lilly Agreements that the Lilly Transactions involved both Centoxin and ReoPro. In the CP II action, PWR&D claims the Class is entitled to $35 million of the $100 million Centocor received in the Lilly Transactions on the theory that sum is attributable to Centocor's sale of the licensing or sublicensing rights to Centoxin or, in the alternative, Centocor's outright sale of Centoxin. In this action, PWR&D II seeks, on behalf of the Class, "25.03% of $25 million or such greater amount as the proof will show" of the $100 million on the theory that sum was attributable to Centocor's sale of the ReoPro marketing rights. It is entirely possible for both PWR&D and PWR&D II to prevail on their claims to a portion of the $100 million without a conflict arising.[15] In fact, a conflict would only arise if PWR&D and PWR&D II both prevailed on their claims to portions of the $100 million and received judgements for those claims that, in total, exceeded $100 million. As a result, it is unlikely that prosecution of either action would detrimentally effect the other action. Furthermore, Objectors advance no evidence that PWDC or PaineWebber has a greater interest in the PWR&D action than in the PWR&D II action.[16] Since the PWR&D action does not prevent

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[15]Objectors also fail to convince me the PWR&D action influenced the damages related to its claim for a portion of $100 million that PWR&D II sought in this action. PP II's claim that PWR&D II capped the damages it sought at 25.03% of $25 million is wrong. PWR&D II sought damages of "25.03% of $25 million *or such greater amount as the proof will show.*" (emphasis added). PWR&D II chose 25.03% of $25 million as the minimum amount because $25 million was the amount that Centocor and Lilly agreed in the Lilly Agreements that Lilly would pay for the marketing rights to ReoPro if the FDA did approve Centoxin and 25.03% is the percentage of ReoPro profits to which the Class is entitled under the Joint Venture Agreement.

[16]*Cf. DuPont v. Wyly*, 61 F.R.D. 615, 622 (D.Del. 1973) (finding plaintiff to be an

PWR&D II from acting in the best interests of the Class by vigorously prosecuting this action, the contemporaneous existence of these actions does not render PWR&D II an inadequate class representative in this action.[17]

c. PWDC's and PaineWebber's Status as Third-Party Defendants

Objectors also claim that PWR&D II is an inadequate class representative because PWDC and PaineWebber are third-party defendants in this action. While PWDC and PaineWebber have an interest in limiting their liability arising from the third-party claims asserted against them, this interest is not antagonistic to the interests of the Class. Centocor's third-party claims against PWDC and PaineWebber cannot change the fact that PWR&D II held a twenty-two percent interest in CP III nor PWR&D II's incentive to maximize its recovery in this action resulting from its substantial investment in CP III. In any event, a conclusion that the third-party claims against PWDC and PaineWebber rendered PWR&D II an inadequate class representative would allow a Defendant in any class action to disqualify an otherwise qualified class representative simply by asserting a cross-claim against it or a third-party claim against an affiliate of the proposed class representative, regardless of the merits of those cross claims or third-Party claims. This result would be deleterious to the efficient and effective prosecution of class actions. Therefore, I do not consider the existence of these third-party claims, without any definitive evidence that these claims influenced prosecution of the Class' claims to the detriment of the Class, to be a sufficient factor to disqualify a proposed class representative. While Objectors cite deposition testimony that PWR&D II's counsel and PaineWebber's counsel exchanged drafts of filings and communicated with each other regarding the prosecution of the case, they present no evidence, and I am aware of none, that PaineWebber's counsel in any way influenced PWR&D II's counsel in its prosecution of this action. The third party claims against PaineWebber and PWDC, therefore, do not disqualify PWR&D II as an adequate class representative.

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inadequate class representative where he was also a plaintiff in an action in which he had a greater financial interest and which, if successful, would render the defendant unable to pay any recovery in the class action).

[17]Because of the non-conflicting nature of the PWR&D action and the PWR&D II action, I am not concerned with the fact that the separate counsel PWDC hired to prosecute each action has shared information. It is fairer to conclude they did so to aid advancing their clients' interests in each action.

[7] As a result, I do not find PWR&D II to have interests, either itself or through PWDC or PaineWebber, that could reasonably be characterized as antagonistic to those of the Class and that would, therefore, render PWR&D II an inadequate class representative. PWR&D II's vigorous and diligent prosecution of this action, in fact, more than sufficiently supports my conclusion that PWR&D II is and has been an effective as well as adequate representative.

d. PWR&D II's Legal Counsel

Objectors also claim that PWR&D II's legal counsel, Jones, Day, Reavis and Pogue ("Jones Day"), is inadequate counsel to the Class because of several alleged conflicts of interest. To establish these alleged conflicts, Objectors cite the following facts: (i) Jones Day has an attorney-client relationship with PaineWebber in connection with other legal matters; (ii) Mr. Sear, the attorney at Jones Day leading the prosecution of this action, has expressed a desire to PaineWebber's in-house counsel that she refer additional matters to him; and (iii) Mr. Sear and Mr. Mazur, PaineWebber's outside counsel who contacted Mr. Sear to represent PWR&D II in this action and who represents PaineWebber as a third party defendant in this action, once worked together and have a social relationship that spans more than twenty years. Without more, these facts do not establish that Jones Day or Mr. Sear cannot effectively and adequately represent the Class.

[8] First, the Class is not taking action that is adverse to PaineWebber. Admittedly, the PaineWebber representatives to the CDC III Board were potential defendants in this action. PWR&D II convincingly articulated legitimate reasons supporting the decision that advancing claims against them would not be in the best interest of the Class. These reasons for not suing the PaineWebber representatives to the CDC III Board and the Objectors' lack of any evidence that PWR&D II's decision not to sue these directors was influenced by Jones Day's representation of PaineWebber on other matters, renders Jones Day's representation of PaineWebber on other matters a mere hypothetical conflict that cannot disqualify it as adequate counsel to the Class. Second, Mr. Sear, like almost all attorneys in private practice, has an interest in pursuing business for his practice. An avowed interest in future referrals from PaineWebber expressed during this action, when PWR&D II, for legitimate reasons, is not taking a position adverse to PaineWebber, cannot realistically be characterized as inappropriate. Finally, the fact that Mr. Sear has a former colleague and current friend who represents a client in the same case that may have additional or different interests in this litigation is of absolutely no significance to his