Unreported Cases

INTRODUCTION

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AMERICAN LEGACY FOUNDATION
v. LORILLARD TOBACCO CO.

No. 19,406

Court of Chancery of the State of Delaware, New Castle

January 30, 2003

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LAMB, *Vice Chancellor*

I.

This action arises out of a landmark settlement agreement between the nation's largest tobacco companies and almost all the U.S. states and territories. As part of that settlement agreement, the signatories provided for the creation and funding of a foundation whose mission is to educate youth about the harms associated with tobacco use and to reduce levels of youth tobacco use. This campaign has proven successful. As part of the settlement agreement, however, the signatories agreed to certain restrictions placed on the content of the foundation's educational programs. The most significant restriction, and the one that is at issue here, provides that the foundation may not engage in the "vilification" of or a "personal attack" on the tobacco companies or their executives. The same restriction appears verbatim in the foundation's bylaws as well.

After its creation, the foundation sponsored a series of television, radio and print advertisements aimed at reducing youth tobacco use and

educating youth about health risks associated with tobacco. Thereafter, one of the tobacco companies threatened suit against the foundation for allegedly violating the anti-vilification provisions in the settlement agreement and the foundation's bylaws. Concerned about the possibility of the tobacco company filing suit in several jurisdictions, the foundation brought suit in this court against the defendant tobacco company seeking declaratory judgment on four counts, three of which are the subject of this motion for summary judgment. The foundation seeks a judicial declaration that the defendant has no standing to sue the foundation based on the settlement agreement or the foundation's bylaws. The foundation also seeks corresponding injunctive relief barring the defendant from bringing any claims against the foundation under either the settlement agreement or the bylaws.

The court concludes that summary judgment in favor of the foundation is not appropriate, and that summary judgment should instead be granted in favor of the defendant tobacco company with respect to its ability to sue the foundation under a contract theory based on the settlement agreement. This is due to the fact that the settlement agreement itself contemplates that the foundation will ultimately adopt it, and that the foundation in fact adopted the agreement. Because the identical anti-vilification provisions appear in both the settlement agreement and the foundation's bylaws, and because the court holds that the defendant tobacco company can bring an action against the foundation to enforce the settlement agreement, the court need not address whether the defendant tobacco company has standing to sue based on a breach of the foundation's bylaws.

II.

A. ALF's Creation

Plaintiff American Legacy Foundation ("ALF") was formed in 1999 as a Delaware non-profit corporation with the stated goal of creating advertising to reduce youth tobacco product usage in the United States. ALF exists by virtue of a Master Settlement Agreement (the "MSA") reached in 1998, whereby the nation's largest cigarette companies settled lawsuits brought against them by the attorneys general of 46 states (the "Settling States") seeking monetary and injunctive relief for the injuries inflicted by tobacco products upon the states and their citizens. Defendant Lorillard Tobacco Company ("Lorillard") is the oldest tobacco company in the United States and is a party to the MSA.

The MSA itself clearly states that one of its principal objectives is to reduce the level of smoking by youth and increase the level of awareness in the country through the creation of ALF. The preamble of the MSA specifically provides:

> WHEREAS, the Settling States and Participating Manufacturers wish to avoid further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation [*i.e.*, ALF] dedicated to significantly reducing the use of Tobacco Products by Youth.[1]

To achieve the educational goals of the MSA, the Settling States and the tobacco companies provided for the formation of ALF. The Settling States were responsible for the mechanics of forming ALF, and they effected its incorporation through the National Association of Attorneys General ("NAAG").[2] On March 4, 1999, ALF was incorporated as a non-profit, non-member corporation, organized under the laws of Delaware, with its principal place of business in Washington, D.C.[3] ALF's primary mission was "to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the

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[1]Payton Aff., Ex. 2 (hereinafter, the "MSA") § I. The tobacco companies clearly endorsed the public education mission expressed in the MSA. *See* MSA § I ("WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and preventing Youth access to Tobacco Products . . ."); MSA § VIII(a)(2)) (requiring tobacco companies to meet with the attorneys general of the Settling States and with the Foundation to assess the success of the MSA and to coordinate efforts to continue to reduce youth tobacco use).

[2]NAAG itself is not a signatory to the MSA. NAAG is described in the MSA as an "organization that is directed by the Attorneys General to perform certain functions under this Agreement." *Id.* at § II(bb).

[3]ALF was originally incorporated under the name "MSA National Foundation," but it amended its certificate of incorporation on August 2, 1999 to change its name officially to the American Legacy Foundation. Vargyas Aff., Ex. 1 at Tab C.

use of Tobacco Products in the States."[4] The MSA also sets forth the anticipated functions and activities of ALF, one of which is to "carry[] out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products."[5]

Consistent with the MSA, and as specified in ALF's bylaws, ALF is governed by a particular board of directors meeting certain criteria. The eleven directors include two governors selected by the National Governors' Association, two state attorneys general selected by NAAG, and two state legislators selected by the National Conference of State Legislators. Those six directors select five additional directors, one of whom must have public health expertise, and four of whom must have expertise in medical, child psychology, or public health disciplines.[6] The MSA did not provide for the tobacco companies to be given any role in the governance of ALF, either through the appointment or selection of its directors or otherwise.

B. ALF's Funding

Once created, ALF's primary source of funding was the tobacco companies, which are required to make two types of payments under the MSA for the benefit of ALF. Pursuant to Section VI(b) of the MSA, the tobacco companies are required collectively to make "base foundation" payments of $25,000,000 per year for a period of nine years. These payments are used to "fund" ALF, and, pursuant to ALF's bylaws, ALF may use these funds to pay its administrative expenses.[7] In addition, Section VI(c) of the MSA requires the tobacco companies collectively to make payments in the amount of $250,000,000 in 1999, and $300,000,000 per year for the next four years "for the benefit" of ALF's National Public Education Fund ("NPEF"). These NPEF payments are expended by ALF in its public advertising and education campaign.[8] Further, Section IX(e) of the MSA provides that, if the tobacco companies' market share exceeds 99.05 % in 2004, and any year thereafter, the tobacco companies shall continue to make NPEF payments "for the benefit of" ALF.

The tobacco companies are required to make payments into an

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[4]MSA § VI(a).

[5]*Id.* at §§ VI(a) & (f)(l).

[6]*Id.* § VI(d); Vargyas Aff., Ex. 1 at Tab B, (hereinafter, "Bylaws") §3.2.

[7]Bylaws § 12.1.

[8]MSA § VI(c)(l). ALF may also use this money to make grants to states so that they may conduct similar campaigns. *Id.* at § VI(g).

escrow account before the funds are ultimately distributed to ALF.[9] The MSA explicitly provides that the tobacco companies' payments of these funds into the escrow account are "made at the direction and on behalf of the Settling States."[10] Thus, ALF argues that the MSA intended that the funds paid to the escrow agent be the property of the Settling States, and not the tobacco companies.[11] There can be little doubt, however, about where the money to fund ALF comes from. Sections VI and IX(e) of the MSA unambiguously require the tobacco companies to pay the money used to fund ALF. The Settling States are not given any discretion or authority to choose what to do with these payments or to decide to direct them to any destination other than ALF.[12] Thus, even though the Settling States are interposed between the tobacco companies and ALF as money flows from the former to the latter, the MSA is clear that this money is for the benefit of ALF and may go nowhere else but to ALF.

C. ALF's Restrictions

As part of the long and arduous negotiations between the Settling States and the tobacco companies, the signatories to the MSA agreed upon certain restrictions on what ALF could do with the money it receives.[13] Most of these limitations are found in Section VI(h) of the MSA, which

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[9]*Id.* at § VI(a). An Escrow Agreement governs the escrow account, which is to be considered part of the MSA as a fully integrated agreement. *Id.* MSA § XVIII(y). The parties to the Escrow Agreement are the attorneys general of the Settling States (acting on behalf of their Settling States), the tobacco companies, and the escrow agent. ALF is not a party to the Escrow Agreement. Payton Aff., Ex. 2 at Tab C (hereinafter, the "Escrow Agreement").

[10]*Id.* at § VI(h).

[11]As support for this argument, ALF points to a revenue ruling obtained from the Internal Revenue Service. An issue arose related to whether interest earned on the funds in the escrow account was subject to federal income tax—which it would be if funds belonged to the tobacco companies. The IRS ultimately ruled that income earned on funds deposited into the escrow account is excluded from income tax because the underlying funds belonged to entities not required to pay federal taxes—that is the Settling States, and not the tobacco companies. Payton Aff., Ex. 2 at Tab D.

[12]*See* MSA §§ VI(b) & (c) (providing that base foundation payments and NPEF payments "shall be disbursed" to ALF by the escrow agent when the MSA settlement has been consummated in at least one Settling State).

[13]The circumstances in which the MSA arose explain why the MSA places express limitations upon ALF's activities. Before the MSA was executed, Florida had already created a non-profit corporation that was waging a "truth" campaign. This "truth" campaign attacked the tobacco companies and their executives, portraying them as evil and malicious. For example, one of the Florida "truth" campaign advertisements explicitly compared tobacco executives to Adolf Hitler and the Nazis. Another inflammatory advertisement portrayed a tobacco industry executive applauding tobacco's nomination for a "Demon Award" for "most deaths in a single year."

provides generally that ALF "shall not engage in, nor shall any of [ALF's] money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or similar activities." Importantly, Section VI(h) goes on to carefully limit the ways in which the NPEF payments may be used, providing that:

> The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. [ALF] shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner.[14]

In addition to imposing the above-mentioned binding limitations upon ALF's activities, the MSA provides that ALF's organizational documents "shall specifically incorporate the provisions of this Agreement relating to [ALF] . . . ."[15] ALF, through its incorporator and through its initial board of directors, did exactly what it was supposed to do under the MSA in this regard. In ALF's Certificate of Incorporation, Article IV lists the functions of ALF. These functions mirror the first nine obligations listed in Section VI(f) of the MSA. Also, Article III. C of the Certificate provides that ALF shall not engage in political activities, shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner, and shall carry out its activities only within the states. These restrictions are taken directly from Section VI(h) of the MSA.

Similarly, ALF's bylaws contain the anti-vilification provisions required by the MSA. The bylaws provide that ALF shall establish and administer the NPEF, which shall be used "only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of Tobacco Products" and shall not be used "for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively."[16] These provisions were taken directly from

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[14] *Id.* at § VI(h).
[15] *Id.* at § VI(d).
[16] Bylaws § 12.2.

the MSA as well. ALF and the tobacco companies agree that these bylaw provisions meet the requirements of the MSA.

ALF also incorporated other items of the MSA into its bylaws. Article XIII of ALF's bylaws prohibits any amendment to the bylaws or to ALF's Certificate of Incorporation that would render either document inconsistent with the terms of the MSA. In addition, Section 5.7 of ALF's bylaws expressly recognizes the binding nature of the MSA. Section VI(e) of the MSA required ALF to affiliate itself formally with an educational or medical institution. Section 5.7 of ALF's bylaws satisfies this requirement, providing that "the programs of [ALF] may be affiliated with one or more educational institutions selected by the Board of Directors from time to time *as required by the Master Settlement Agreement attached hereto as Exhibit A*."[17]

D. The MSA's Enforcement Mechanism

The enforcement provision of the MSA is relatively straightforward and simple. It provides that "any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ('Declaratory Order')) with respect to disputes, alleged violations or alleged breaches within such Settling State."[18] Nothing in Section VII or any other provision of the MSA prohibits suit from being filed against ALF or suggests that a tobacco company may not sue a non-signatory that later adopts or otherwise becomes bound by the MSA. An ancillary agreement to the MSA, the Model State Fee Payment Agreement, contains just such an exclusion.[19]

E. ALF's Activities

Since its formation, ALF has run "a nationwide public health campaign to educate the public, with a particular emphasis on youth, about the harms associated with tobacco products."[20] ALF's primary advertising campaign, entitled "the truth," includes the use of trade and service marks including "truth," "the truth," "infect truth," the truth. com and the like.[21]

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[17]*Id.* at § 5.7 (emphasis added).

[18]MSA § VII(c)(l) (The Court "means the respective court in each Settling State to which [the MSA] . . . [is] presented for approval and/or entry as to that Settling State." MSA § II(p)).

[19]*See* MSA, Ex. O § 24 ("Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity").

[20]Vargyas Aff. ¶ 4.

[21]Florida's "truth" campaign, described in note 13, *supra*, is wholly separate and

One of ALF's first advertisements featured people stacking body bags outside the headquarters of another signatory to the MSA, Phillip Morris USA ("Phillip Morris"). Phillip Morris, along with other tobacco companies expressed their belief that this advertisement and others made in similar fashion violated the MSA. In addition, the then-attorney general of North Carolina wrote to the other attorneys general expressing his concern that ALF's advertisements violated the MSA. In response to these complaints, ALF temporarily pulled certain advertisements. Throughout this time period, ALF never suggested that it was free from the obligations set forth in the MSA or that Phillip Morris or the other tobacco companies lacked standing to challenge the allegedly vilifying advertisements. Rather, ALF argued that its advertisements complied with the MSA.[22]

III.

Lorillard first threatened litigation against ALF in July 2001, related to whether a particular radio advertisement called "Dog Walker"[23] complied with federal and state communications laws.[24] In November 2001, Lorillard sent a draft complaint to ALF based on allegations of defamation and unfair business practices related to the truth of factual assertions made in the "Dog Walker" advertisement. In January 2002, Lorillard changed the focus of its potential lawsuit. Rather than relying on common law or statutory claims for defamation and unfair business practices relating solely to the "Dog Walker" advertisement, Lorillard threatened to assert a contract claim based on the MSA to attack the entire "truth" campaign.

By letter sent to ALF on January 18, 2002, Lorillard purported to invoke the enforcement mechanism of the MSA against ALF by providing

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distinct from the "truth" campaign employed by ALF.

[22]*See* Gamble Aff., Ex. B (Bill Furmanski, Communications Manager for ALF, stating that the advertisements challenged by Phillip Morris "talk about the addictiveness of tobacco, the health effects of tobacco and the social cost of tobacco use. As long as we talk about those items and communicate effectively with young people, we are well within the limits of the settlement").

[23]The "Dog Walker" advertisement, which aired for six weeks in the summer of 2001 depicted a telephone call between an actor and two Lorillard employees. In the advertisement, the young man who plays the "dog walker" offers to sell dog urine to "you tobacco people" because dog urine contains urea, which is "one of the chemicals you guys put into cigarettes." Vargyas Aff., Ex. ¶ 6.

[24]For example, on October 1, 2001, Lorillard filed a Motion for a Declaratory Ruling with the Federal Communications Commission seeking a declaration that the "Dog Walker" advertisement violated an FCC rule regarding the broadcasting of recorded telephone calls. ALF opposed the motion, arguing that the FCC's rule, by its plain language, extends only to conduct of broadcast licensees and therefore does not apply to ALF, which is not a licensee, or its advertisements. The FCC has yet to issue a ruling on the motion.

30-days notice of its "intent to initiate a proceeding against [ALF] to enforce the terms of the MSA," as required by Section VII(c)(2) of the MSA.[25] Lorillard's January 18 letter alleged that ALF's truth campaign had engaged in a "personal attack" on or "vilification" of Lorillard in violation of the MSA.

In response to the potential uncertainty relating to the potential for numerous lawsuits in various jurisdictions,[26] ALF filed suit against Lorillard in this court on February 13, 2002.[27] ALF's complaint contains four counts: Count I seeks a declaration that Lorillard has no basis to sue ALF under the MSA; Count II seeks a declaration that Lorillard has no basis to sue ALF under its bylaws; and Count III seeks corresponding injunctive relief barring Lorillard from bringing any claims against ALF under either the MSA or the bylaws. Count IV of the complaint, which is not a subject of ALF's motion for summary judgment, seeks, in the alternative, a declaration that ALF's truth campaign has been and is in full compliance with the MSA and the bylaws.

On February 19, 2002, Lorillard filed a two-count complaint against ALF in the Superior Court of Wake County, North Carolina, seeking declaratory and injunctive relief, as well as damages in the amount of one dollar, for alleged breach of contract under the MSA. Also on February 19, 2002, ALF filed a motion with this court to expedite proceedings, and on February 22, 2002, this court issued an Order setting a schedule for briefing and argument on ALF's motion for summary judgment on its complaint.[28] Lorillard subsequently filed a motion for discovery pursuant to Court of Chancery Rule 56(f) in the event that this court finds that ALF is entitled to summary judgment on any of the counts contained in ALF's complaint. After briefing and oral arguments, and after the matter was stayed at the parties' request, the pending motions are now ripe for decision.

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[25]Vargyas Aff., Ex. 1 at ¶ 20 & Tab A, Jan. 18 Letter.

[26]Although Lorillard has not sued ALF anywhere other than North Carolina, the potential existed that Lorillard could bring separate lawsuits in every state that was a party to the MSA. In the *New York Times* on January 23, 2002, Lorillard spokesperson Steve Watson alluded to the possibility of "enforcement actions" against ALF in any or all of the 46 state courts with continuing jurisdiction over the MSA and the related consent decrees. *See* Bernard Stamler, *Lorillard Tobacco Threatens Legal Action Against a Foundation for Its Tough Antismoking Campaign*, N.Y. TIMES, Jan.23, 2002, at C12 ("It is conceivable that Lorillard might have to sue in all of those states, which it has not yet decided to do, Mr. Watson said").

[27]*See generally American Legacy Foundation v. Lorillard Tobacco Co.*, 2002 WL 927383, at *2-3 (Del. Ch. Apr. 29, 2002), for a more detailed account of the dealings between ALF and Lorillard leading up to this litigation.

[28]Lorillard moved to stay or dismiss this action in favor of its action in North Carolina. The court denied that motion. *American Legacy Foundation*, 2002 WL 927383, at *5. As of the date of this opinion, the North Carolina action is still pending.

IV.

Court of Chancery Rule 56 provides that summary judgment should be granted if the record evidence demonstrates "that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[29] The burden falls upon the moving party "to prove clearly the absence of any genuine issue of material fact which would affect the result," and in considering a motion for summary judgment, the court must resolve all doubt in favor of the non-moving party.[30] If, however, the evidence demonstrates that the *non-movant* is entitled to summary judgment, the court may grant summary judgment to the non-movant.[31]

V.

A. ALF Is Bound By The MSA Because It Has Adopted The Agreement

There is no doubt that a fundamental principal of contract law[32] provides that only parties to a contract are bound by that contract.[33] There is also no doubt that ALF was not a signatory to the MSA. One does not have to be a signatory to a contract, however, to become bound by it. Third parties to an agreement may become parties to it, and thus bound by it, by either expressly or implicitly adopting the agreement.[34] A recent federal

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[29]Ch. Ct. R. 56(c); *see also Williams v. Geier*, 671 A.2d 1368, 1375 (Del. 1996).

[30]*Stroud v. Grace*, 1990 WL 176806, at *5 (Del. Ch. Nov. 1, 1990), *aff'd in part, rev'd in part on other grounds*, 606 A.2d 75 (Del. 1992).

[31]*See Bank of Del. v. Claymont Fire Co. No. 1*, 528 A.2d 1196, 1199 (Del. 1987).

[32]It is undisputed that "[b]asic contract principles apply to settlement agreements." *Williams v. Metzler*, 132 F.3d 937, 946 (3d Cir. 1997).

[33]*See, e.g.*, *Wallace v. Wood*, 752 A.2d 1175, 1180 (Del. Ch. 1999); *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002) ("It goes without saying that a contract cannot bind a nonparty"); *see also Parker v. W. Dakota Insurors, Inc.*, 605 N.W.2d 181 (S. D. 2000); *Dawson v. Temps Plus, Inc.*, 987 S.W.2d 722 (Ark. 1999); *Plaza Props., Ltd. v. Prime Bus. Inv., Inc.*, 524 S.E.2d 306 (Ga. Ct. App. 1999); *Am. Rock Mechanics, Inc. v. Thermex Energy Corp.*, 608 N.E.2d 830 (Ohio Ct. App. 1992); *Nat'l Survival Game of New York, Inc. v. NSG of LI Corp.*, 565 N.Y.S.2d 127 (N.Y. App. Div. 1991); *Mueller v. Penobscot Valley Hosp.*, 538 A.2d 294 (Me. 1988); *Bernard Johnson, Inc. v. Cont'l Constructors, Inc.*, 630 S.W.2d 365 (Tex. Ct. App. 1982); *Gambles v. Perdue*, 572 P.2d 1241 (Mont. 1977); *Kahn v. Prahl*, 414 S.W.2d 269 (Mo. 1967).

[34]*See, e.g.*, *Wiggins Ferry Co. v. Ohio & Mississippi Ry. Co.*, 142 U.S. 396, 408 (1892) (holding non-signatory adopted contract "and made it its own"); *Ayala v. Murrell*, 97 So.2d 13 (Fla. 1957); *Central of Georgia Ry. Co. v. Woolfolk Chem. Works, Ltd.*, 178 S.E.2d 710 (Ga. Ct. App. 1970); *Peoples Sav. & Loan Ass'n v. Brinkoetter*, 263 Ill. App. 391 (Ill. App. Ct. 1931); *Burnett v. Greenwood*, 298 P.2d 256 (Kan. 1956); *Porter v. Gen. Boiler Casing Co.*, 396 A.2d 1090 (Md. 1979); *Residential Warranty Corp. v. Bancroft Homes Greenspring Valley, Inc.*, 728 A.2d 783 (Md. Ct. Spec. App. 1999), *cert. denied*, 735 A.2d 1107 (Md. 1999) (TABLE); *Mehul's*

case explains:

> The general rule is that one cannot be held to a contract to which he is not a party. However, a party may later accept or adopt a contract and thus be bound by it. Thus, what constitutes acceptance becomes the threshold question. Acceptance can be accomplished by acts as well as words; no formal acceptance is required.[35]

The contract itself, however, must contemplate that non-signatories may adopt it. Thus, whether a non-signatory can nevertheless be bound to a contract through adoption is, in the first instance, a question of contract interpretation—that is, whether the original parties intended to create or permit future contractual obligations through adoption by non-signatories.[36] In this case, nothing in the MSA precludes ALF from adopting, and the MSA in fact contemplates that ALF will adopt.

1. The MSA Contemplates Adoption By ALF

As both parties admit, no single provision in the MSA expressly subjects ALF to enforcement actions by the tobacco companies under the MSA. ALF argues the text and design of the MSA demonstrate that the MSA does not contemplate any contractual relationship between ALF and Lorillard.[37] As support for this argument ALF points to certain provisions in the MSA relating to the treatment of non-signatories other than ALF.

For example, the MSA explicitly provides that it will bind the

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Inv. Corp. v. ABC Advisors, Inc., 130 F. Supp. 2d 700 (D. Md. 2001); *White v. Nat'l Football League*, 92 F. Supp.2d 918 (D. Minn. 2000); *Bronx Store Equip. Co. v. Westbury Brooklyn Assocs., L.P.*, 721 N.Y.S.2d 28 (N.Y. App. Div. 2001); *Lurido Corp. v. Crusader Mfg. Co.*, 155 N.Y.S.2d 715 (N.Y. Sup. Ct. 1956); *Hann v. Nored*, 378 P.2d 569 (Or. 1963); *Great W. Theatre Equip., Inc. v. M. & E. Theatres, Inc.*, 3 P.2d 1003 (Wash. 1931), *aff'd on reh'g en banc*, 7 P.2d 1119 (Wash. 1932) (per curiam).

[35]*Mehul's Inv. Corp.*, 130 F. Supp. 2d at 707-08 (citations omitted).

[36]*See, e.g.*, *White*, 92 F. Supp. 2d at 920 (stating that the first "fundamental issue[]," which "involves a purely legal question of contractual interpretation," is "whether the contracting parties intended to bind [non-signatory] player agents to the [original contract]"); *Central of Georgia Ry. Co.*, 178 S.E.2d at 712-13.

[37]It bears noting that well established canons of contract interpretation require courts to read a contract as a whole, and consistent with its purposes. *See, e.g.*, *Northwestern Nat'l Ins. Co. v. Esmark, Inc.*, 672 A.2d 41, 43 (Del. 1996) ("[c]ontracts must be construed as a whole, to give effect to the intentions of the parties"); *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 498 A.2d 1108, 1113 (Del. 1985) ("In upholding the intentions of the parties, a court must construe the agreement as a whole, giving effect to all provisions therein"); *USA Cable v. World Wrestling Fed'n Entm't, Inc.*, 2000 WL 875682, at *8 (Del. Ch. June 27, 2000).

"successors" of the original tobacco company signatories.[38] In addition, in anticipation that additional tobacco companies would join the settlement, the parties to the MSA provided specific procedures to permit and facilitate those non-party tobacco companies' adoption of the MSA. No similar procedures or references were made with respect to ALF. Because the MSA specifically identifies certain future non-signatories who will be bound by the contract while remaining silent as to other future non-signatories such as ALF, the argument goes, the maxim of *expressio unius est exchsio alterius* (the expression of one thing is the exclusion of another) requires that only the specifically identified non-signatories may become bound to the MSA.[39] This argument is not persuasive.

First, the examples ALF relies upon do not support the application of the *expressio unius* maxim to ALF. To begin with, the statement that successors-in-interest to the signatory tobacco companies shall be bound by the contract is little or nothing more than a statement of the law. It certainly does not imply that others may not become bound by the MSA. Additionally, the fact that the MSA both (i) recognizes that non-signatory tobacco companies may later elect to join the MSA and (ii) provides an express mechanism for them to do so hardly suggest an intention to exclude the adoption of the MSA by ALF. Certainly, those provisions suggests an intention that those other tobacco companies could only become parties to the MSA by following the prescribed procedure. ALF's relationship to the MSA is, however, quite different.

In contrast to non-signatory tobacco companies, the nature of ALF and its relationship to the MSA is discussed in significant detail throughout that contract. Indeed, to a large extent, the legal conclusion that ALF has "adopted" the MSA flows directly from the parties' performance of their obligations under that contract. One could almost conclude that the MSA *expressly* contemplates ALF's adoption because it provides for ALF's creation and funding, it requires ALF's board to be comprised of a predetermined group of people, and it places significant restrictions on ALF's activities. The Settling States (through NAAG) then obligated ALF, through provisions in ALF's bylaws and Certificate of Incorporation, to

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[38] *See, e.g.*, MSA ¶ II(jj) (defming "Participating Manufacturer" as a "Tobacco Product Manufacturer that is or becomes a signatory to this Agreement," which will "also include the successor of a Participating Manufacturer").

[39] *See* 5 CORBIN ON CONTRACTS § 24.28 (rev. ed. 1998); *Delmmva Health Plan, Inc. v. Aceto*, 750 A.2d 1213, 1216 (Del. Ch. 1999) (recognizing the applicability of *expressio unius* to contract interpretation, though ultimately not choosing to apply it); *Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc.*, 1999 WL 743479, at *11 (Del. Ch. Sept. 10, 1999) (holding that omission of a term "speaks volumes" when considered next to included terms and citing to *expressio unius* maxim).

comply with the MSA, and the tobacco companies performed their part by providing the required funds.

In addition, there are several express provisions of the MSA that manifest the MSA's signatories' expectation that ALF would ultimately adopt it. A clear example is Section IX of the MSA, which provides that if the Participating Manufacturers' market share exceeds 99.05 % on April 15, 2004:

> each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of [ALF] its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). *Such payments shall be utilized by [ALFJ to find the national public education functions of [ALF] described in subsection VI(f)(I), in the manner described in and subject to the provisions of subsections VI(g) and VI(h).*[40]

This Section's requirement that the Section IX(e) funds "shall be" used by ALF "in the manner described in and subject to" Section VI of the MSA certainly appears to be directed at ALF. The same is true for Section VI(h) of the MSA, which instructs that ALF "shall not engage" in certain activities and that the NPEF funds shall not "be used to engage in" certain activities. Similarly, Section VI(e) of the MSA provides that ALF "shall be formally affiliated with an educational or medical institution." For these reasons, the MSA should be viewed, as a matter of law, as *expressly* contemplating ALF's adoption.[41]

Second, there are other agreements, executed contemporaneously with the MSA, that show that the parties to the MSA knew how to avoid any question regarding whether non-signatories could become bound to the parties' contracts.[42] Exhibit O to the MSA is a Model State Fee Payment

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[40]MSA §' IX(e) (emphasis added).

[41]The fact that the tobacco companies may be able to pursue enforcement actions against ALF under the MSA is of significant importance because the only other parties that might seek to enforce the restrictions on ALF's conduct are conflicted or are otherwise unwilling to do so. Both the Settling States and the various attorneys general involved in the MSA negotiations bargained against the tobacco companies in arriving at the limitations on ALF's activities. Further, NAAG served as ALF's incorporator, and attorneys general from NAAG's membership sit on two of the eleven seats on ALF's board of directors. Finally, the Settling States have expressed to Lorillard that they do not intend to bring an enforcement action against ALF.

[42]In this regard, the court notes that the parties to the MSA are sophisticated persons

Agreement. Section 24 provides:

> No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the state of STATE. *Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.*[43]

The italicized language from the Model State Fee Payment Agreement would support ALF's position, were it present in the MSA. It is not.

In fact, there are no provisions in the MSA that foreclose adoption, ratification, or assumption of the MSA by third parties or by ALF. There is also no provision in the MSA precluding the tobacco companies from bringing breach of contract claims or enforcement actions against ALF under the MSA. Moreover, the language used in the MSA's enforcement provision appears conspicuously unrestrictive. Section VII(c)(l) provides that "any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ('Declaratory Order')) with respect to disputes, alleged violations or alleged breaches within the Settling States."[44] Nothing in this Section provides that the tobacco companies may not pursue enforcement with respect to alleged violations or alleged breaches by entities other than the Settling States.

ALF also makes a series of other arguments that the text of the MSA affirmatively supports its argument that the signatories never intended ALF to be bound. For example, ALF quotes a passage from Section VII(e) of the MSA, the relevant portion of which provides that liability "shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach . . . ."[45] However, the language "[s]uch breach"

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who can be expected to have considered the interaction of provisions across the MSA (and accompanying agreements) and the implications of including or excluding various terms and language in the MSA. *See Telcom-SNI Investors, L.L.C. v. Sorrento Networks, Inc.*, 2001 WL 1117505, at *5 (Del. Ch. Sept. 7, 2001) ("I start with the plain meaning of the words chosen by sophisticated parties advised by experienced counsel"); *Insituform Technologies, Inc. v. Insitu, Inc.*, 1999 WL 240347, at *11 (Del. Ch. Apr. 19, 1999).

[43]MSA, Ex. O § 24 (emphasis added).

[44]*Id.* at § VII(c)(1).

[45]*Id.* at § VII(e).

refers to a breach of the MSA by a tobacco company and not to breaches by the Settling States or other persons or entities. Thus, Section VII(e) only relates to the protection of directors, officers, employees, etc. from personal liability under the MSA. It has no effect on whether or not the MSA signatories intended to bind ALF to the MSA.

ALF points to other passages that allegedly lend support to its textual argument. None of them do. The first collection of passages quoted by ALF merely identifies the Settling States and the tobacco companies as the entities entering into the MSA.[46] These passages are not relevant to this dispute because Lorillard readily admits that ALF was not an original signatory to the MSA. Similarly, a second group of Sections quoted by ALF are boilerplate pronouncements providing that the original parties to the MSA entered into the MSA freely and voluntarily, were represented by counsel, and had the requisite capacity to execute the MSA.[47] Again, these Sections have little relevance because there is no dispute regarding whether ALF was an original party to the MSA.

2. Express And Implied Adoption

Lorillard makes two arguments to support ALF's adoption of the MSA, thus making ALF amenable to suit from its breach: (1) explicit adoption through inclusion in ALF's organizational documents of mandates and restrictions relating to ALF that are set forth in the MSA as well as various public statements made by certain directors and officers of ALF, and (2) implicit adoption through the receipt of funds paid to the Escrow Account by the tobacco companies. It is undisputed that ALF included such restrictions in its bylaws and that certain public statements were made by directors and officers of ALF. It is also undisputed that ALF received and used funds from the Escrow Account. The only dispute is a pure question of law as to the legal significance of these actions in light of the language and purpose of the MSA.[48]

Express adoption arises in a variety of contexts, one of which is

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[46]*See, e.g.*, Pl. Op. Br. at 21-22 (citing MSA Preface (the MSA "is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers"); § I ("the Settling States and the Participating manufacturers, acting by and through their authorized agents, memorialize and agree as follows . . .")).

[47]*See, e.g.*, *id.* at 22 (citing MSA §§ XV ("The Settling States and the Participating Manufacturers acknowledge and agree that this Agreement is voluntarily entered into . . ."); XVIII(g) ("Each Settling State and each Participating Manufacturer hereby represents that this Agreement has been duly authorized . . .")).

[48]*See DeCarlo v. Gerryco, Inc.*, 264 S.E.2d 370 (N. C. App. 1980) (observing that whether uncontroverted facts constitute adoption is a question of law).

when a successor adopts a contract of a predecessor as its own.[49] In addition, adoption often occurs when an agent acts or purports to act on behalf of the principal, but does so without authority, and the principal subsequently agrees to be bound by the agent's acts.[50] Adoption in the preincorporation context is quite common as well.[51] These situations are roughly applicable to the present dispute. Essentially, ALF is the alter ego or successor-in-interest to the Settling States in carrying out the obligations required by Section VI of the MSA, as well as in receiving the benefits prescribed therein. Viewed differently, the Settling States acted as agents for ALF in securing benefits for ALF and in committing it to certain obligations under the MSA.

There are no magic words required to expressly adopt a contract.[52] Here, as discussed above, provisions in ALF's bylaws expressly recognize that ALF is bound by the MSA. ALF also has barred itself from changing its Certificate of Incorporation and bylaws in any way that would render them inconsistent with the terms of the MSA. Further, there are various public statements by ALF, including statements by its president and chairperson of its board of directors, that provide persuasive evidence that ALF believed it is restricted by and must comply with the MSA. These include the following statements:

- "Ms. Gregoire said she rejected a recommendation to run the 'Demon Award' spot as potentially violating the agreement. 'I want to be in absolute compliance with the settlement,' she said, adding that some proposed ads appeared to be 'vilification' of the industry."[53]

- "They talk about addictiveness of tobacco, the health effects of tobacco and the social cost of tobacco use. As long as we talk about those items and communicate effectively with young people, we are well within the limits of the settlement."[54]

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[49]*See, e.g.*, *Hillard v. Guidant Corp.*, 37 F. Supp. 2d 379, 381-82 (M. D. Pa. 1999) (holding successor bound by contract of predecessor where successor accepted benefits of agreement).

[50]RESTATEMENT (SECOND) OF AGENCY §§ 82, 84, 98 & 104(1957).

[51]*See* note 63, *infra*.

[52]*Mehul's Inv.*, 130 F. Supp. 2d at 707-08 ("Acceptance can be accomplished by acts as well as words; no formal acceptance is required").

[53]Gamble Aff., Ex. C.

[54]Gamble Aff., Ex. B.

- "[T]he MSA enumerates the constraints under which the foundation must operate."[55]

- "Anyone who has seen truth ads know that they educate young people about the addictiveness, health effects, and social costs of tobacco, which is exactly what the Master Settlement Agreement says they must do."[56]

- "[ALF] will have resources in excess of $1 billion over the next four years for a public education campaign as directed by the Master Settlement Agreement between 46 states and the tobacco industry."[57]

Statements made by a non-signatory confirming that it is bound by a contract may establish that it has adopted the contract.[58] ALF's bylaw provisions and public statements of ALF's officers and directors, both to the effect that ALF is bound by or must comply with the MSA, reflect ALF's explicit intent and consent to be bound by the MSA.

In addition to express adoption, non-signatories may implicitly adopt a contract through their conduct, rather than through words.[59] Furthermore, courts have found that acceptance of the benefits of a contract made for a third party's benefit may constitute implicit adoption.[60] A common situation in which courts have found implicit adoption by third parties is when a third-party beneficiary accepts the benefits of a contract made for

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[55]Gamble Aff., Ex. D.

[56]Gamble Aff., Ex. A.

[57]Gamble Aff., Ex. E.

[58]*See, e.g.*, *Donnelly v. Power Tech Sys., Inc.*, 1991 WL 158973, at *4 (E.D.N.Y. July 23, 1991) (finding adoption where the corporation referred to the contract in question in the corporation's prospectus); *Bronx Store Equip.*, 721 N.Y.S.2d at 29 (denying motion to dismiss contract claim against non-signatory to agreement, where defendant wrote a letter to plaintiff stating, "[w]e acknowledge that we owe you a balance of $300,000").

[59]*See Mehul's Inv.*, 130 F. Supp. 2d at 707-08 ("Acceptance can be accomplished by acts as well as words; no formal acceptance is required"); *Central of Georgia Ry.*, 178 S.E.2d at 713 (in considering whether there has been adoption by implication, the court should consider all circumstances, including "subject matter of the contract, the third person's acts and words, whether he acquiesced in the terms of the contract, performed its obligations, or accepted its benefits").

[60]*See, e.g.*, *Westendorf v. Gateway 2000, Inc.*, 2000 WL 307369, at *4 (Del. Ch. Mar. 16, 2000), *aff'd*, 763 A.2d 92 (Del. 2000) (TABLE) ("[O]ne who knowingly accepts the benefits intended as the consideration, coming to him or her under a contract voluntarily made by another in his or her behalf, becomes bound by reason of such acceptance to perform his or her part of the contract") (quotation and citations omitted).

its benefit, while attempting to avoid the contract's burdens.[61] For example, in *Westendorf* a non-signatory brought contract claims under a sales contract executed between the defendant and another party. The contract contained an arbitration clause, which the defendant sought to enforce against the non-signatory plaintiff. The plaintiff argued that the arbitration clause could not be enforced against her because she had not executed the contract containing it. Then Vice Chancellor Steele rejected the plaintiff's argument and held that she was bound by the contract in all respects.[62]

The reasoning in *Westendorf* is persuasive, and is applicable to the facts of the present dispute. This is particularly apparent given that the MSA signatories plainly intended that Section VI of the MSA would benefit ALF, and ALF plainly has accepted those benefits. The *Westendorf* court quoted *Corpus Juris Secundum* for the general proposition that "one who knowingly accepts the benefits intended as the consideration, coming to him or her under a contract voluntarily made by another in his or her behalf, becomes bound by reason of such acceptance to perform his or her part of the contract."[63] This is precisely what has happened here, as ALF has knowingly accepted benefits under the MSA conferred by the tobacco companies in consideration of the promise that ALF would conduct its activities in certain specified ways.[64]

3. Preincorporation Agreements

Although not directly equivalent, an analysis of agreements executed by promoters in the preincorporation context provides significant guidance for deciding the current dispute. The preincorporation environment is perhaps the most common situation in which the doctrine of adoption is applied. The doctrine of adoption as it is applied to preincorporation

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[61]ALF argues that under Section XVIII(p) of the MSA, ALF is not an intended third-party beneficiary of that Agreement. This is a misreading of Section XVIII(p). Section XVIII(p) provides, "[n]o portion of this Agreement shall provide any *rights* to, or be enforceable by, any person or entity that is not a Settling State or a Released Party." *Id.* (emphasis added). Section VIII(p) of the MSA merely provides that ALF does not enjoy the *right* to enforce the MSA. This does not diminish the fact that ALF receives and has received intended *benefits* under the MSA. In fact, Sections VI(b), VI(c) and IX(e) unambiguously provide that the tobacco companies' base foundation and NPEF payment obligations are for the *benefit* of ALF.

[62]*Westendorf*, 2000 WL 307369, at *4.

[63]17B C.J.S. § 631 (1999).

[64]The *Westendorf* court also cited with approval *Shelter Ins. Co. v. Frohlich*, 498 N.W.2d 74 (Neb. 1993). Frohlich held that a non-party to a medical pay provision in an automobile insurance policy was bound by a subrogation clause the policy contained, because the non-party accepted a contractual benefit of the insurance policy, namely payment of his medical bills. *Id.* at 78.

agreements is straightforward. According to a leading treatise:

> American courts generally hold that promoters' contracts made on the corporation's behalf may be adopted, accepted or ratified by the corporation when organized, and that the corporation is then liable, both at law and in equity, on the contract itself, and not merely for the benefits which it has received. *Accordingly, if the corporation accepts the contract's benefits, the corporation will be required to perform its obligations.*[65]

Under Delaware law, if the subsequently formed corporation expressly adopts the preincorporation agreement or implicitly adopts it by accepting its benefits with knowledge of its terms, the corporation is bound by it.[66]

The Settling States are highly analogous to promoters of ALF for purposes of the preincorporation agreement doctrine.[67] There is little doubt that ALF was created and formed by the Settling States. After all, it was the Settling States and the tobacco companies who came together and agreed that ALF be formed, and it is they who articulated ALF's mission, listed in detail its permissible functions, determined its funding sources, and set forth restrictions on its activities.[68] Furthermore, the Settling States achieved ALF's formation through NAAG, as was required by the MSA.[69]

There can also be little doubt that ALF's promoters (*i.e.*, the Settling States) entered into the MSA, at least in part, for the benefit of ALF. Without the MSA, there would be no ALF. Most significantly, ALF's promoters secured a binding commitment for ALF's funding, and agreed to

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[65]Carol A. Jones and Britta M. Larsen, 1A FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 207 (perm. ed., rev. vol. 2002).

[66]*See Spering v. Sullivan*, 361 F. Supp. 282, 286 (D. Del. 1973); *Stringer v. Elec. Supply Co.*, 2 A.2d 78, 79 (Del. Ch. 1938) ("a promoter's contract is not a corporate obligation of its own force, but only when a statute or the charter makes it become such, or some subsequent corporate act adopts it or assumes the liability").

[67]"Promoter" is a broad and flexible term, with no precise definition. *See* 18 AM. JUR. 2D *Corporations* § 98 (1985) (stating that "promoter" has no precise and inflexible meaning" and that it encompasses "one who actively assists in creating, projecting, and organizing a corporation"). *See also Blish v. Thompson Automatic Arms Corp.*, 64 A.2d 581, 595 (Del. 1948) (holding promoters are "those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do its business"); *Tin Cup Pass Ltd. P'ship v. Daniels*, 553 N.E.2d 82, 84 (Ill. App. Ct. 1990) (promoter is "one who actively assists in creating, projecting and organizing a corporation").

[68]*See* MSA §§ I & VI.

[69]*See id.* at § VI(d).

limits on how those funds could be used.[70] Courts have held that when a corporation's promoters enter into an agreement—either with each other or with third parties—to provide capital or funding for the corporation in exchange for performance by the corporation, it is a "clear-cut factual pattern" calling for application of the preincorporation agreement doctrine.[71]

Under the preincorporation agreement doctrine, a corporation implicitly adopts a preincorporation agreement by accepting its benefits with knowledge of its terms.[72] Further, under Delaware law, a corporation may adopt a preincorporation agreement in its organizational documents.[73] As discussed earlier, both forms of adoption took place here. In sum, the requirements of the preincorporation agreement doctrine appear easily met. ALF's promoters entered into the MSA on ALF's behalf and for its benefit, and after its formation ALF expressly adopted the MSA though corporate acts and explicit statements. ALF also implicitly adopted the MSA by accepting its benefits with knowledge of its terms.

For all the foregoing reasons, the court concludes that the MSA contemplates ALF's adoption, and that ALF in fact adopted it, thus becoming bound by its provisions and amenable to suit for its breach.

B. Lorillard's Standing To Enforce Section 12.2 Of ALF's Bylaws

ALF initiated this litigation because Lorillard threatened to pursue an enforcement action under the MSA as a result of ALF's alleged violation of the MSA's anti-"vilification" provision. ALF's motion for summary judgment on Count II relates directly to the anti-"vilification" provision in the MSA as incorporated in ALF's bylaws. Specifically, ALF's bylaws incorporate verbatim the MSA provision banning use of the NPEF for "personal attacks" or "vilification."[74] ALF seeks to prevent Lorillard from obtaining standing to sue over ALF's bylaws because ALF

> does not wish—and should not have to—operate under the specter that Lorillard or any other tobacco company may commence putative enforcement actions against [ALF] in a

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[70]*See, e.g.*, MSA § IX(e) (NPEF payments "shall be utilized by [ALF] to fund the national public education functions of [ALF] . . . and subject to the provision of subsections VI(g) and VI(h)").

[71]*DeCarlo*, 264 S.E.2d at 374; *see also Stolmeier v. Beck*, 441 N.W.2d 888, 891 (Neb. 1989).

[72]*See Spering*, 361 F. Supp. at 286; *Donnelly*, 1991 WL 158973, at *3.

[73]*Stringer*, 2 A.2d at 79.

[74]Bylaws § 12.2.

> multiplicity of judicial fora every time any one of them reaches the self-interested determination that [ALF's] advertising is having a detrimental effect upon their business and allegedly is "vilifying" them.[75]

Thus, ALF concedes that its biggest concern is really the anti-"vilification" provision of the MSA, and nothing unique that may be contained solely within its bylaws.

Because it is abundantly clear that the only provisions of its bylaws that ALF seeks shelter from are the same provisions taken verbatim from the MSA, and because the court has determined that ALF may be sued under the MSA itself for violation of those provisions, the court need not determine at this juncture whether Lorillard has standing to bring an action based on ALF's breaches of its bylaws.

C. Lorillard's Motion For Discovery Pursuant To Rule 56(f)

Because this court finds that ALF is not entitled to summary judgment on its claims, Lorillard's motion for discovery pursuant to Court of Chancery Rule 56(f) will be dismissed as moot.

VI.

The parties shall consult and present a conforming order to the court ten (10) days from the date of this Opinion.

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[75]Complaint ¶ 8.

A.R. DEMARCO ENTERPRISES, INC. v. OCEAN SPRAY CRANBERRIES, INC.

No. 19,133

Court of Chancery of the State of Delaware, New Castle

November 26, 2002
Revised December 4, 2002

Daniel V. Folt, Esquire, and Gary W. Lipkin, Esquire, of Cozen O'Connor, Wilmington, Delaware; and H. Robert Fiebach, Esquire, David M. Doret, Esquire, and Kristine Maciolek, Esquire, of Cozen O'Connor, Philadelphia, Pennsylvania, of counsel, for plaintiff.

Jesse A. Finkelstein, Esquire, Catherine G. Dearlove, Esquire, and J. Travis Laster, Esquire, of Richards, Layton & Finger, P.A., Wilmington, Delaware, for defendants.

CHANDLER, *Chancellor*

The crux of this action is a dispute over the strategic vision of Ocean Spray, Inc. Plaintiff believes that selling or merging all or part of the company would best serve the interests of the shareholders. Defendants believe they can continue to operate Ocean Spray as an independent entity and conduct a viable turnaround of the company.

Plaintiff filed a complaint alleging various breaches of disclosure, fiduciary duties, and implied contractual duties, as well as common law fraud. Defendants moved to dismiss the complaint and to strike one of the plaintiff's requested forms of relief, characterized as an order directing the sale of the company. For reasons set forth in this opinion, I deny in part defendants' motion to dismiss Count I. The motion is granted, however, with respect to all other counts, as well as Count I in part, except that Counts III, V, and VI are dismissed without prejudice. Since plaintiff's request for an order instructing the directors to pursue a sale or merger, and to fully cooperate with a bona fide purchaser, is not an available remedy in these circumstances, the motion to strike is moot and is also denied.

I. BACKGROUND FACTS[1]

Ocean Spray is a Delaware Corporation that operates as an agricultural cooperative. Ocean Spray processes, markets, and distributes the products of its growers. There are approximately 750 cranberry growers and 150 citrus growers who own shares in Ocean Spray. Plaintiff A. R. DeMarco Enterprises, Inc. ("DeMarco") is one of the larger cranberry growers and a (roughly) three percent shareholder of Ocean Spray.

The shares of Ocean Spray are not traded publicly. The growers are the shareholders. Growers obtain shares at par value in proportion to the average amount of crop produced over a three-year period. The number of shares is adjusted every three years to account for changes in production. Shares are purchased or redeemed at par value. Ocean Spray's certificate of incorporation requires each grower to be party to a cooperative marketing agreement with Ocean Spray. The cooperative marketing agreement provides for the issuance and redemption of shares at par value.

Growers are required to deliver to Ocean Spray all agricultural products ("product") grown on designated lands in return for their proportion of shares. Ocean Spray then processes, markets, and distributes the product. Ocean Spray also lobbies for legislation in support of its growers, seeks to develop new markets for its products, and works to expand its current markets and increase the consumption of Ocean Spray products.

During the mid-1990's, the cranberry business was booming and reached a high of $60 per barrel in 1996. As in most agricultural markets, however, the boom did not last forever. At the time of the complaint, there was an oversupply of cranberries, a stagnant market, and increased competition by producers of other fruits. In addition, cranberry growers who are not Ocean Spray stockholders have been competing aggressively with Ocean Spray. The result was that the return from the 1999 crop was $10.75 per barrel, with no real change in sight. The cost of production is around $35 per barrel, so plaintiff was operating at a loss at the time the complaint was filed.

In response to the problems in the cranberry market, the United States Department of Agriculture ("USDA") reduced the amount of cranberries allowed to be produced by thirty-five percent.[2] Ocean Spray

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[1]As required under Court of Chancery Rule 12(b)(6), the facts alleged in plaintiff's complaint are assumed to be true for the purposes of defendants' motions. Therefore, all facts are drawn from that complaint and the materials incorporated by reference in the complaint.

[2]The USDA is responsible for setting allowable levels of production for several crops, including cranberries and citrus products. The complaint only addresses the USDA production order as it relates to cranberries. Citrus products are covered by other USDA production orders

lobbied the USDA for this reduction in an effort to counter the over-supply of cranberries because Ocean Spray's business has suffered during the product glut. Furthermore, an important distribution contract with PepsiCo was lost when PepsiCo purchased Tropicana, and the increasing competition in the beverage and food industry has stifled growth. Ocean Spray has countered by introducing a new product line, the Craisin, but that has not been enough to reverse the downward trend.

Ocean Spray's board of directors retained several consultants in 1999 to help determine a course of action for the company. Plaintiff's president and chief executive officer, J. Garfield DeMarco ("Mr. DeMarco"), was on the board of Ocean Spray at that time. All of the consultants allegedly encouraged a sale or merger transaction for Ocean Spray, including Bain & Company, a financial consulting firm, and Merrill Lynch, an investment banking firm.

The board at that time consisted of twenty-five directors. By a vote of thirteen to eleven, the board voted against pursuing a sale or merger and for keeping the consultants' reports confidential. As a board member, Mr. DeMarco voted for a sale or merger and against keeping the reports confidential. The board also later decided not to follow a recommendation for a straw poll of the shareholders as to the consideration of a sale or merger because the poll would be purely hypothetical and not based on a concrete transaction.

In 2000, the board proposed resolutions reducing the number of directors from twenty-five to fifteen and allowing the removal of directors without cause. Mr. DeMarco voted against changing the composition of the board and allowing removal of directors without cause. The shareholders, however, voted to approve the change and Mr. DeMarco was removed from the board.[3] The board now consists of eleven growers, the Ocean Spray CEO, and three persons not affiliated with Ocean Spray.[4] According to the complaint, the board consists primarily of persons "known

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not addressed in the complaint.

[3]After the 2000 annual meeting where the shareholders approved the change in board composition, Mr. DeMarco refused to resign. He was then removed from the board without cause. Compl. ¶ 96.

[4]Three different slates of directors were nominated—a company slate, a pro-merger slate, and an anti-merger slate. It is unclear from the pleadings which slate of nominees was elected. Also, defendants state that the actual resolution reduced the board to nine to twelve directors with the authority to increase the board to fifteen, which they later did by appointing the three directors not affiliated with Ocean Spray. The facts in the complaint, however, are all that the Court is allowed to consider upon a motion to dismiss. Recognizing that the end result was the fifteen directors mentioned in the complaint, the difference between plaintiff's assertions and defendants' is inconsequential.

to be unsympathetic to sale or merger"[5]

DeMarco, along with other shareholders equaling approximately fifteen percent of Ocean Spray, offered proposed resolutions to be placed on the ballot for the 2001 annual meeting. Ocean Spray resisted the resolutions and sought to rewrite them. The shareholders brought suit against the board in Massachusetts (the "Massachusetts action") to place their resolutions on the agenda. The suit was later withdrawn without prejudice in light of a settlement with Ocean Spray to include the resolutions on the agenda for the 2001 annual meeting. The agreement allegedly provided that representatives of both Merrill Lynch and Bain would be present, as well as an independent teller to participate in counting the votes. Nevertheless, none of these representatives were present at the 2001 annual meeting.

The resolutions to be presented to the shareholders involved directing the board to pursue a sale or merger of Ocean Spray. At the 2001 meeting, management made presentations in opposition to the resolution. Management also presented the information Merrill Lynch and Bain had provided to the board. As will be discussed later, the information the board presented was allegedly misleading, incomplete, and inaccurate with respect to Merrill Lynch's and Bain's recommendations. Management's prospects for a turnaround were also allegedly misleading in that they failed to highlight Ocean Spray's reserve supply of cranberries.[6]

After the presentations were made, a vote was taken and the shareholders rejected the resolution to pursue a sale or merger by a vote of sixty-two percent to thirty-eight percent. The vote tally for the directors, however, appeared flawed in that one director was said to have received all but just under 55,000 votes in his favor, even though DeMarco alleges that it voted, but did not vote its 120,000 votes for that candidate.

In September of 2001, plaintiff filed this action. Defendants moved to strike plaintiff's request for a court order directing the board to pursue a sale or merger of the company, and moved to dismiss all seven counts of the complaint.

II. STANDARD OF REVIEW

The standard governing a motion to dismiss is well established. A party is entitled to dismissal of the complaint only where it is clear from its

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[5]Compl. ¶ 96.

[6]Plaintiff argues that even if Ocean Spray's actions decreased the cranberry glut, the reserve supply would still prevent the growers from increasing their yield and obtaining the benefit of Ocean Spray's actions to decrease the glut. Compl. ¶ 117(b).

allegations that the plaintiff would not be entitled to relief under any set of facts that could be proven to support the claim. Moreover, the Court is required to accept all of plaintiff's factual allegations as true and give plaintiff the benefit of all inferences that may be drawn from the facts.

III. ANALYSIS

Plaintiff's complaint lists seven counts against defendants. All of the counts allege direct claims except for Count II, which alleges a derivative claim.

A. Defendants ' Motion to Strike

Defendants move to strike plaintiff's request for an order compelling the sale of Ocean Spray. Rule 12(f) requires that the matter to be stricken be "any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter."[7]

Section 141 of the Delaware General Corporation Law ("DGCL") provides that the board of directors shall manage the business and affairs of the corporation. A request for an order to compel the sale of Ocean Spray cannot be granted. Plaintiff cites no authority for the proposition that this Court might properly order a sale of a company in these circumstances, and this Court is aware of none.

Plaintiff's request, however, does not fall under the criteria listed in Rule 12(f). Instead, I believe the motion to strike is unnecessary, as the underlying claim for relief itself must be dismissed under Rule 12(b)(6). I therefore deny the motion to strike.

B. Count I—Breach of the Duty of Disclosure

Plaintiff alleges that the management of Ocean Spray presented false and misleading information to the shareholders with respect to the vote on a shareholder proposal for a resolution directing the board to research the viability of a sale or merger. Specifically, the complaint alleges:

(1) Shareholders were misled by a statement that Merrill Lynch concluded Ocean Spray had not lost value over the past year. Plaintiff adequately alleges that that statement is misleading because a Merrill Lynch report clearly states that cranberry prices dramatically affect the

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[7]Court of Chancery Rule 12(f).

corporation's value. Since cranberry prices had changed over the past year, it is reasonable to infer that the value of Ocean Spray changed as well.

(2) Shareholders were misled by a statement that the Bain report did not state that a sale was the best financial move, when plaintiff alleges that the report in fact said otherwise.

(3) Shareholders were misled by a management statement that Bain presented a dismal view of a post-sale Ocean Spray, when, allegedly, Bain never addressed that issue in its report.

(4) Shareholders were misled by management as to the viability of its predictions regarding the turnaround plan, including the existence of the two-year cranberry reserve.

These four allegations state a claim that survives a motion to dismiss under Rule 12(b)(6). The complaint also alleges misleading disclosures with respect to board nominees, legal requirements for merger or sale, and issues related to those topics. These broad and conclusory characterizations that almost all of the board's communications with the shareholders were materially false do not state a claim upon which relief can be granted. Therefore, the motion to dismiss Count I is granted except for the four allegations listed above. These four allegations survive for the following reasons.

Defendants request dismissal on the grounds that the resolution was precatory, and did not constitute shareholder action. Thus, defendants state that no duty to disclose existed, so no duty of disclosure violation occurred. Defendants also state that if a duty to disclose existed, the information was stale because it was two years old. The age of the information, defendants argue, made it no longer material.

Directors owe a duty not to mislead or deceive shareholders.[8] "The directors' fiduciary duties include the duty to deal with their stockholders honestly. Shareholders are entitled to rely upon the truthfulness of all information disseminated to them by the directors they elect to manage the corporate enterprise."[9] "Delaware law also protects shareholders who receive false communications from directors even in the absence of a request for shareholder action. When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty."[10]

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[8]*See Malone v. Brincat*, 722 A.2d 5, 10-11 (Del. 1998).

[9]*Id.* (citing *Marhart, Inc. v. CalMat Co.*, 1992 Del. Ch. LEXIS 85 at *9 (Del. Ch.)).

[10]*Id.* at 14. *Malone* states that the only difference resulting from the presence or absence of shareholder action involves what elements the plaintiff must prove. If shareholder

Thus, the presence or absence of shareholder action in this context is irrelevant. Even if no duty of disclosure existed, once the board decided to provide information to the shareholders, it had to do so honestly and in good faith. In addition, the fact that some of the information may have been dated does not mean the board may pick and choose from information (based on its age) and thereby arguably present a less than complete picture regarding an issue of great interest to stockholders. Qualifying the information because of its age, or adding appropriate disclaimers may have been appropriate.

In any event, accepting the truth of these allegations, as I must at this stage, plaintiff has adequately stated a claim upon which relief can be granted for the above four disclosure allegations. It is important to note, however, that of the relief requested, the only relief available under these allegations is a new vote on the shareholder proposal, should plaintiff prevail in its disclosure claim. Accordingly, the motion to dismiss is denied with respect to those four allegations in Count I. The motion to dismiss is granted as to the remaining alleged disclosure violations in Count I.

C. *Count II—Breach of Fiduciary Duties (Derivative Claim)*

Plaintiff alleges a derivative claim, but did not make demand upon the board. Since it is a derivative claim, demand must be made on the board, or be excused based upon futility.[11]

To determine "demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[12]

Plaintiff alleges that the directors fail to meet the first prong of *Aronson v. Lewis* because they voted against the shareholder resolution to pursue a sale or merger of Ocean Spray. According to plaintiff, the directors must be acting in their own self-interest because they are not pursuing a sale or merger. A mere allegation that the board decided not to pursue a sale or merger is not enough to show that the individual directors were not independent or were interested. There must be allegations of interest or lack of independence that lead an individual board member to

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action is present, then plaintiff need not prove reliance, causation, or damages. When shareholder action is absent, plaintiff must show reliance, causation, and damages. Therefore, the board's duty to be honest has not changed, only what the plaintiff must show at trial to prove a breach of the duty of disclosure. *Id.* at 11.

[11]*See* Court of Chancery Rule 23.1.

[12]*Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

reject pursuing a sale or merger. A presumption that the directors must be self-dealing simply because they have not done what a plaintiff wants them to do is not a proper basis for demonstrating demand futility. These allegations fail to show demand futility as required under *Aronson*.

Plaintiff also alleges lack of independence because the directors receive compensation for serving on the board. It is well established in Delaware law that ordinary director compensation alone is not enough to show demand futility.[13] Accordingly, demand is not excused under the first prong of *Aronson*.

As for the second prong of *Aronson*, plaintiff alleges that the board's failure to pursue a sale or merger is beyond the scope of what a reasonable person would decide. Plaintiff alleges that failure to pursue a sale or merger will result in less affluent shareholders going out of business and having to redeem their Ocean Spray stock. The fact that not all shareholders may survive in the current economic climate does not meet *Aronson*'s standard, since the board is to act for the benefit of Ocean Spray as a whole and may not advance the interests of a few shareholders exclusively. No facts are alleged which even suggest that the Ocean Spray directors' actions were not in the best interest of the corporation except that plaintiff thinks they are not. Finally, the naked allegation that management is entrenched is not enough to meet *Aronson*'s second prong.[14] That, again, is too conclusory to warrant excusal of demand.

Plaintiff has failed to show demand futility. Accordingly, Count II is dismissed under Rule 23.1 for failure to make demand upon the board.

D. Count III—Breach of Fiduciary Duties (Direct Claim)

Plaintiff alleges a direct claim based on special injuries:

(1) Plaintiff is adversely affected by defendants' actions in not pursuing a sale or merger, which will result in a forced redemption of its shares. Plaintiff's specific geographical, distributive, and product situations, as compared to other shareholders, causes it to have specific and individual money damages not borne by other shareholders.

(2) Defendants' actions in lobbying to reduce the amount of product plaintiff could grow without reducing the amount of production

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[13]*See Grobow v. Perot*, 539 A.2d 180,188 (Del. 1988). This is true as long as the compensation does not exceed customary bounds, but "the disqualifying effect of such fees might be different if the fees were shown to exceed materially what is commonly understood and accepted to be a usual and customary director's fee." *Orman v. Cullman*, 794 A.2d 5, 29 n.62 (Del. Ch. 2002).

[14]*Grobow*, 539 A.2d at 188.

needed for it to maintain its shares results in a forced divestiture of its stock to the benefit of the unaffected shareholders.

(3) The forced divestiture causes plaintiff to suffer voting power dilution.

The basis of plaintiff's allegations is that Ocean Spray will redeem its shares and cause plaintiff to lose economic and voting rights. But, nothing in the complaint alleges that Ocean Spray actually has sought to redeem plaintiff or any other shareholder. Section 8(f) of the Cooperative Marketing Agreement ("CMA") between Ocean Spray and DeMarco provides that "[a]t the written request of the Cooperative, the Grower agrees to present for redemption at par value any Common Shares of the Cooperative in excess of one hundred percent (100%) of the shareholdings required under Subsection (a) of this Section 8."[15]

Until redemption is actually sought, these allegations are not ripe. As mentioned above, nothing in the complaint alleges that Ocean Spray has attempted (or even threatened) redemption. This asserted harm is, therefore, entirely hypothetical. "Courts in this country generally, and in Delaware in particular, decline to exercise jurisdiction over cases in which a controversy has not yet matured to a point where judicial action is appropriate."[16] Because this Court cannot issue advisory opinions that purport to decide an issue before it is ripe, Count III is dismissed without prejudice.

E. Count IV—Election Relief under § 225

Count IV fails to state a claim upon which relief can be granted. Plaintiff alleges that the 2001 elections were improper because

(1) the slate of nominees was improperly chosen;
(2) the proxy statement was false and misleading;

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[15]Section 8(a): "The Common Stock Equity Quota currently is Twenty-Six Dollars ($26.00) per barrel delivered. During the term of this Agreement, Grower agrees to work toward, achieve, or maintain (as the case may be) holdings of Common Shares of the Cooperative having a par value equal to the amount resulting from multiplying the Common Stock Equity Quota by the average of the number of barrels of the three (3) most recent crops produced by the Grower on the land described in Exhibit A. The Common Stock Equity Quota may be increased or decreased in reasonable amounts by the Board of Directors of the Cooperative and any changes shall become effective upon written notice to the Grower."

[16]*Stroud v. Milliken Enterprises, Inc.*, 552 A.2d 476, 480 (Del. 1989) ("Unless a controversy is 'ripe for judicial determination,' a court may simply be asked to render an advisory opinion. The law is well settled that courts will not lend themselves 'to decide cases which have become moot, or to render advisory opinions.')(*citing State v. Mancari*, 223 A.2d 81, 82-83 (Del. 1966)).

(3) misrepresentations/omissions occurred in connection with the votes at the meeting;

(4) the shareholders were not given enough information to make an informed vote;

(5) management denied supporters of the proposed sale or merger access to corporate records;

(6) Ocean Spray failed to honor the agreement in the Massachusetts action by

(a) failing to fairly disseminate the consultants' information regarding sale and merger;

(b) failing to disclose the directors favoring each approach; and

(c) failing to allow an independent observer to serve as teller of the votes;

(7) the vote tabulation was flawed.

The first allegation—that the slate of nominees was improperly chosen—does not state a claim because the board has the authority to submit its own slate of nominees and is not required to disclose why other nominees were not selected. Also, opposing slates were available to the shareholders; the board did not give the shareholders an all or nothing choice. Thus, this allegation in Count IV fails to state a claim and is dismissed.

The allegations relating to the Massachusetts action also fail to state a claim. The Massachusetts agreement was not part of the complaint, and the complaint fails to allege any nonconclusory details as to how that agreement was binding upon Ocean Spray. Plaintiff fails to allege that a failure to honor the alleged agreement constitutes a proper § 225 claim. This portion of Count IV is also dismissed.

The remaining allegations in Count IV fare no better. I note, initially, that rather than bring an action challenging the results immediately and seeking expedited review as § 225 contemplates, plaintiff waited eight months after the election process to file its complaint. Thus, the allegations regarding the allegedly flawed vote tabulation and the misrepresentations/omissions in connection therewith are insufficient as a matter of law. Specifically, plaintiff states that it voted over 120,000 shares, and none of them were for Director Pietersen. The voting results from the 2001 election, however, indicate that Pietersen received all but just less than 55,000 of the votes cast, or 3,486,084 votes, which constituted 98% of the vote. Even assuming for the sake of argument that plaintiff is correct regarding its 120,000 votes, Pietersen still received 95% of the vote, far in excess of the majority needed to prevail in the election.

Ultimately, the complaint fails to assert any flaws that would call the 2001 election into question. No improprieties in the election process are alleged. Nor is it alleged that the opposition slate in fact won the election. The only allegation is that an immaterial number of votes were miscounted. That is not sufficient, in my opinion, to state a claim under § 225.

The remaining parts of Count IV—alleging that the shareholders were misinformed when voting—are just reiterations of the four allegations that survive under Count I. Count IV does not properly allege a § 225 claim with respect to these allegations since the appropriate relief—a new vote on the shareholder proposal—is properly requested under Count I and not Count IV. Thus, Count IV is dismissed.

F. Count V—Declaratory Judgment

Count V fails to state a claim upon which relief can be granted because the allegations are not yet ripe. Plaintiff seeks a declaratory judgment that:

(1) only a simple majority is needed to sell the assets of the company; and

(2) the provisions requiring involuntary redemption by plaintiff due to changes by the USDA and short term market conditions are invalid because they conflict with the certificate of incorporation.

The first request is not ripe because no transaction has been proposed against which to assess this statement. Any decision by this Court on this question would be advisory. The Court can only determine the vote required when a transaction is proposed and the board takes a position regarding the required vote.[17]

The second request is also not ripe. Ocean Spray has yet to ask for an involuntary redemption of Plaintiff's shares. As noted earlier, until that occurs the issue is not ripe. Accordingly, Count V is dismissed without prejudice.

G. Count VI—Contractual Remedies

Count VI fails to state a claim upon which relief can be granted because it is not yet ripe. Plaintiff alleges Ocean Spray violated its implied contractual duties of good faith and fair dealing by lobbying for a reduction in the amount of crop that plaintiff can produce and then implementing a provision that will cause forced divestiture of plaintiff's shares due to

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[17]*See Stroud*, 552 A.2d at 480 (discussed *supra* at n.16).

decreased production. Plaintiff also alleges that Ocean Spray failed to exclude the 2001-2002 growing year in the calculations to determine share ownership, as requested, even though it had done so in the past. The harm of these actions, however, does not occur until Ocean Spray seeks redemption. Plaintiff concedes in its complaint that no redemption has occurred.[18]

Until Ocean Spray seeks redemption, the allegations in the complaint are not ripe. The Court will not determine if a contract violation occurred before the alleged violation is even attempted.[19]

Additionally, plaintiff states in its complaint that "Ocean Spray functions as an industry trade association, promoting the legislative agenda of growers."[20] If Ocean Spray is required to lobby on behalf of the cooperative, it seems incongruous to suggest that such lobbying violates an implied duty. Plaintiff admits that there is a glut of cranberries,[21] so it is reasonable to expect Ocean Spray to lobby to reduce that glut. Plaintiff agreed to comply with any federal regulations concerning the production of cranberries in paragraph six of the Cooperative Marketing Agreement. In fact, paragraph six states that "the Grower specifically agrees that it will not be entitled to any compensation or proceeds for cranberries not complying with the above requirements . . ." Where an express provision that has not been violated discusses the area of the alleged implied breach, it is unlikely that such a breach occurred.[22]

The complaint fails to allege any implied contractual breach. The harm alleged has also not occurred. Accordingly, Count VI is dismissed without prejudice.

H. Count VII—Common Law Fraud and Misrepresentation

Count VII fails to state a claim upon which relief can be granted. Plaintiff alleges fraud by the defendants through material misrepresentations and omissions designed to cause plaintiff to vote against the shareholder resolution to direct the board to pursue a sale or merger of Ocean Spray. Plaintiff also alleges that the fraud caused it to rely on that information to its economic detriment. Plaintiff admits that it voted *for* the shareholder resolution to direct the board to pursue a sale or merger. Plaintiff also admits that it knew the correct information in light of the

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[18]*See* Compl. ¶ 197-198.

[19]*See Stroud*, 552 A.2d at 480 (discussed *supra* at n.16).

[20]Compl. ¶ 29.

[21]Compl. ¶ 47.

[22]*See, e.g.*, *Shenandoah Life Ins. Co. v. Valero Energy Corp.*, 1988 Del. Ch. LEXIS 84 (Del. Ch.).

material misrepresentations because Mr. DeMarco, plaintiff's CEO, was on the Ocean Spray board when the board learned the allegedly correct information.

A claim for fraud must meet the following five elements:

> 1) a false representation, usually one of fact, made by the defendant;
> 2) the defendant's knowledge or belief that the representation was false, or was made with reckless indifference to the truth;
> 3) an intent to induce the plaintiff to act or refrain from acting;
> 4) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and
> 5) damage to the plaintiff as a result of such reliance.[23]

Plaintiff did not act in accordance with the defendants' recommendation, but instead voted *for* the shareholder resolution. Thus, no justifiable reliance can be shown.

Plaintiff argues alternatively that justifiable reliance is shown by the fraud to those shareholders who in fact voted *against* the resolution. But the reason fraud and misrepresentation claims are not suitable for class treatment is because reliance must be established on an individual basis.[24] DeMarco cannot establish reliance here.

IV. CONCLUSION

The motion to dismiss with respect to Count I is denied in part. The four allegations listed earlier in the opinion state a claim for breach of the duty of disclosure. Should the four disclosure allegations prove to be material and false, plaintiff's requested remedy of a new vote on the shareholder proposal is the only relief that survives the motion to dismiss. Count I is dismissed as to all other disclosure allegations.

Plaintiff's allegations with respect to Counts III, V, and VI are not yet ripe. The divestiture alleged by DeMarco has not occurred, so a judicial determination cannot be made on these counts. Count VI also fails to properly plead a breach of any implied contractual duty. Counts III, V, and VI are dismissed without prejudice.

Count II is dismissed for failure to make demand upon the board and failure to adequately plead demand futility. Counts IV and VII are dismissed for failure to state a claim upon which relief can be granted. The

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[23] *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 472 (Del. 1992).
[24] *Id.* at 472-73.

motion to strike is denied because it is moot.

IT IS SO ORDERED.

BRANDYWINE DEVELOPMENT GROUP, L.L.C.
v. ALPHA TRUST

No. 19,321 NC

Court of Chancery of the State of Delaware, New Castle

January 30, 2003

Stephen E. Herrmann, Esquire, Raymond J. DiCamillo, Esquire, and Becky A. Hartshorn, Esquire, of Richards, Layton & Finger, P.A., Wilmington, DE, for plaintiffs.

Melvyn I. Monzack, Esquire, Rachel B. Mersky, Esquire, Edward M. Lilly, Esquire, and Joseph R. Biden, III, Esquire, of Walsh Monzack and Monaco, P.A., Wilmington, Delaware, for defendants.

JACOBS, *Vice Chancellor*

Pending is the defendant's motion for summary judgment in this action, which arises out of the termination of an easement between the parties' adjacent shopping centers. The defendant blocked the easement between the two properties, claiming that the easement had been validly terminated. Contending that the easement is still valid and in force, the plaintiff sued for a declaration to that effect, and for an injunction removing the obstacle blocking the easement's use. For the reasons discussed below, the motion for summary judgment will be granted in part and denied in part.

I. FACTS

The defendant, Alpha Trust ("Alpha"), is a general partnership that owns the Talleyville Shopping Center ("Talleyville"), which is located at

the intersection of Silverside Road and Route 202 in Wilmington, Delaware.[1] The plaintiff, Brandywine Development Group, L.L.C. ("Brandywine"),[2] is a Delaware limited liability company that owns the Concord Square Shopping Center ("Concord Square"), which is adjacent to and abuts Talleyville.[3]

On June 16, 1994, the parties entered into a Cross-Easement Declaration ("Declaration"), wherein they agreed that a portion of the Talleyville parking lot would be used as an easement affording access between Concord Square and Silverside Road.[4] The easement was intended for the exclusive use of the employees and customers of the businesses located in both shopping centers, enabling them to avoid using Route 202 as the access road between the two shopping centers.[5] Construction and service vehicles, however, were forbidden from using the easement under any circumstances.[6]

Paragraph 6 of the Declaration gave Alpha the right to terminate the easement on ninety days notice, under two conditions: (i) if a post office was not constructed at Concord Square before June 16, 1997, or (ii) if the easement posed a "material burden" to Talleyville.[7] Alpha was

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[1]V. Compl. ¶ 2, V. Answer ¶ 2.

[2]Brandywine was formed through a merger and is the successor in interest to BC Development Associates, a Delaware general partnership that entered into the Declaration and Memorandum with Alpha.

[3]V. Compl. ¶ 3, V. Answer ¶ 3.

[4]V. Compl. ¶ 5, V. Answer ¶ 5, Stella Aff. ¶ 4.

[5]Decl. ¶ 6.

[6]*Id.* at ¶ 7.

[7]Paragraph 6, in full text, states that:

In the event that a United States Post Office is not operational on the site at the proposed location within three (3) years from the date of execution of this Agreement, then Alpha reserves the right, upon ninety days (90) written notice, to terminate any and all rights of ingress and egress through its property to Silverside Road granted pursuant to this [Declaration]. Furthermore, if at any time Alpha determines that the easement granted to [Brandywine] is a material burden to its center, regardless of whether a post office is located on [Brandywine's] property, then Alpha shall have the right, at any time, upon ninety (90) days written notice, to terminate any and all rights of ingress and egress through its property to Silverside Road granted pursuant to this [Declaration]. Such determination, if made by Alpha, shall be absolute, binding and not subject to challenge for any reason whatsoever. The term "material burden" is intended, by way of illustration, to included matters such as increased tenant vacancies, increased insurance liability premiums or other costs associated with increased risk, lower rental rates, or increased tenant dissatisfaction at the Talleyville Shopping Center, which are substantial and relate, directly or indirectly, to the easement granted by Alpha to [Brandywine], or a proposed change of use of the Talleyville Shopping Center which proposed

contractually permitted to determine, in its sole discretion, whether a medical burden existed; moreover, Alpha's determination would be binding and not subject to challenge for any reason.[8]

Contemporaneous with the Declaration, the parties executed an Interpretive Memorandum ("Memorandum"). Its purpose was to clarify certain provisions of the Declaration, including the sections relating to Brandywine's maintenance responsibilities and the post office that the parties contemplated would be built in Concord Square.[9]

On May 24, 2001, almost seven years after the Declaration and Memorandum were executed and almost four years after the deadline to construct the post office, Alpha sent to Brandywine a letter giving formal notice of its intent to terminate the easement.[10] Alpha's stated reasons for terminating the easement were that: (i) no post office had been constructed in Concord Square by June 16, 1997 and (ii) the "continuous safety issues, tenant complaints and increased maintenance and repair costs" associated with the easement constituted a "material burden" to Talleyville.[11] Thereafter, in late September 2001, Alpha erected a barrier that blocked all use of the easement.

In response, Brandywine filed this action for a declaration that the easement was valid and in force, and for an injunction requiring Alpha to remove the barrier that currently blocks the right of way.

II. THE CONTENTIONS AND GOVERNING LAW

Alpha has moved for summary judgment under Court of Chancery Rule 56. To grant summary judgment, the Court must determine that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law.[12] The party opposing the motion has the burden of establishing that there are disputed issues of material fact appearing from the evidence of record.[13] All inferences will be resolved in favor of the non-moving party, but those interferences must be drawn from evidence, not suppositions.[14] Evidence may be presented in the form of

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change is inhibited or impaired in any way by the existence of the subject easement. The above referenced examples are for purposes of illustration only and are not to be deemed all inclusive in determining whether in fact a "material burden" results from the easement granted to [Brandywine].

[8] *Id.*

[9] *Id.* at ¶ 2.

[10] V. Compl. ¶8.

[11] *Id.*

[12] *Williams v. Geier*, 671 A.2d 1368, 1375 (Del. 1996).

[13] Ch. Ct. R. 56(e).

[14] *Liboff v. Allen*, 1975 Del. Ch. LEXIS 255, at *14 (Del. Ch. Jan. 14, 1975).

affidavits based on personal knowledge, depositions, answers to interrogatories, or admissions on file. A verified pleading may be treated as an affidavit if it states that the facts recited therein are true to the party's own knowledge.[15]

Alpha contends that it is entitled to summary judgment as a matter of law, because the Declaration empowered it to terminate easement if a post office was not constructed in Concord Square by June 16, 1997, or if the easement were found to constitute a "material burden" to Talleyville. Alpha claims that both of these conditions were satisfied.

Brandywine responds that summary judgment would be inappropriate, because: (i) read together, the Declaration and Memorandum create an ambiguity that defeats a summary judgment resolution of whether Alpha validly terminated the easement; and (ii) in all events, any termination of the easement based on the non-construction of the post office is precluded, because after Alpha learned that no post office would be constructed, it waited over four years to raise that issue. Brandywine also argues that (iii) the current record fails to support Alpha's determination that the easement constituted a material burden; (iv) Alpha's determination was not made in good faith; (v) Alpha's notice of its termination of the easement was untimely; (vi) in any event, New Castle County's consent is required before any termination of the easement could become effective; and (vii) Alpha is liable to Brandywine and its tenants for damages caused by Alpha's wrongful termination of the easement.[16] Alpha vigorously disputes all of these contentions.

These arguments boil down to three principal issues. The first is whether the easement was validly terminated as a matter of law, on the ground that the Declaration and Memorandum unambiguously required the construction of a post office in Concord Square that concedely was never built. The second issue is whether Alpha validly terminated the easement on the basis that it constituted a material burden to Talleyville, and whether that determination was made in good faith. The third issue is whether the Declaration requires the parties to obtain New Castle County's prior consent as a precondition to terminate the easement. Those issues are next addressed.

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[15]*Bruce E. M. v. Dorothea A. M.*, 455 A.2d 866, 869 (Del. 1983).

[16]Brandywine contends that if the termination of the easement is found to be wrongful, Alpha is liable to Brandywine, the tenants of the Concord Square shopping center, or both, for any damages or loss of income resulting from the blocking of the easement. Because the Court concludes that the predicate issue of liability cannot be determined without a trial, the damages issue is premature and will not be addressed in this Opinion.

III. ANALYSIS

A. Whether The Declaration And Memorandum Are Ambiguous And Defeat Summary Judgment

The Declaration states that, "In the event that a United States Post is not operational on the site at the proposed location within three (3) years from the date of execution of this [Declaration], then Alpha reserves the right, upon ninety (90) days written notice, to terminate [the easement]."[17] Alpha relies upon that provision to established its claim that the easement was validly terminated. Brandywine contends that that same language, when read together with other language in the Memorandum, renders ambiguous Alpha's claimed contractual right to terminate the easement for failure to construct a post office in Concord Square, and therefore defeats Alpha's summary judgment motion.

The Memorandum, which was executed the same day as the Declaration, recites as its purpose, to "focus and clarify [and] set forth the parties' understanding with regard to certain provisions of the . . . [Declaration] . . . ."[18] The Memorandum goes on to state:

> With regard to the responsibility of [Brandywine] to maintain its portion of the Shared Area in a commercially reasonable fashion as set forth in Paragraph 3 of the [Declaration], it is understood by the parties that the maintenance obligation of [Brandywine] extends to all areas reasonably visible from the joint boundary line of the properties and specifically includes the obligation to maintain the area that was originally intended as a post office in an appropriate fashion to the extent that a building is not constructed at that site or the building that is constructed is substantially smaller than that originally contemplated.[19]

Brandywine argues that that language renders the Declaration ambiguous for several reasons. The first is that the parties would have had no reason to "clarify their understanding" if their intent, as expressed in the Declaration, was unambiguous and clear.

Next, Brandywine contends that the second paragraph of the

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[17]Declar. ¶ 6.
[18]Mem. Preface.
[19]*Id.* at ¶ 2.

Memorandum creates an ambiguity. Brandywine relies upon the following language: "the area that was *originally intended* as a post office in an appropriate fashion to the extent that a building is not constructed at the site or the building that is constructed is substantially smaller than that originally contemplated." That language, Brandywine argues, can be read to have one of three quite different meanings, namely, that: "(i) a post office will not be built; [or that] (ii) no other building might be built on the space originally intended for the post office; [or that] (iii) if some building other than a post office is constructed at that site, the area it occupies might be smaller than the area that would have been occupied if the post office were built."[20]

Alpha responds that the only intent and effect of the above-quoted Memorandum language is to clarify Brandywine's maintenance responsibilities (as set forth in Paragraph 3 of the Declaration) respecting the post office site, land the sole import of that language is that the post office, if built, might be reconfigured[21] or located in a different area within Concord Square.[22] That, Alpha urges, is the only fair reading of the relevant language in the Memorandum, and it creates no ambiguity whatsoever. I agree.

Having read the plain language of the two contemporaneous agreements, the Court concludes that Alpha's interpretation of the Memorandum is reasonable, but that Brandywine's is not. Brandywine construes the words "*originally intended*" to mean that the parties agreed that no post office would be built.[23] That contortive interpretation would lead to a perverse result, because it presupposes that the parties would have executed two contradictory agreements at the same time—one requiring the construction of a post office and the other excusing it. But the Memorandum, fairly read, clarifies, rather than confuses or contradicts the Declaration. Indeed, Brandywine's argument cannot be reconciled with the Memorandum's second paragraph, which addresses Brandywine's maintenance obligations (as outlined in Paragraph 3 of the Declaration) with respect to the proposed site of a post office, which, if and when built, might be smaller than originally proposed.

That conclusion does not dispose of the summary judgment issue, however, but for a quite different reason. After the deadline for building the post office had passed, Alpha waited four years before terminating the easement on that ground. That conduct, Brandywine argues, precludes

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[20]V. Compl. ¶ 14; Brandywine Ans. Br. at 10.
[21]V. Compl. ¶ 14; Alpha Reply Br. at 3.
[22]Alpha Reply Br. at 3.
[23]Mem. ¶ 2 (emphasis added).

Alpha from terminating the easement by reason of the doctrines of acquiescence, waiver, and estoppel.

Under the doctrine of acquiescence, a party may be precluded from asserting a claim where it has knowledge of an improper act by another, yet stands by without objection and allows the other party to act in a manner inconsistent with the claimant's property rights.[24] Here, Alpha knew that the post office would not be built, yet Alpha waited several years before terminating the easement on that ground. That conduct warrants the inference that Alpha acquiesced in the continuation of the easement, despite its knowledge that no post office would be constructed. That inference is sufficient to defeat summary judgment on Alpha's claim that the easement was validly terminated on the basis that no post office had been constructed. Resolution of that issue must await a trial.[25]

B. Whether The Unauthorized Traffic And Property Damage Constituted A "Material Burden"

The second issue raised by Alpha's motion is whether the record supports Alpha's detennination that the easement constituted a "material burden" to the Talleyville Center. Brandywine contends that summary judgment must be denied, because the present record does not support that determination, and also because there is evidence that Alpha made its determination in bad faith. I find Brandywine's argument to be without merit.

1. Is There Sufficient Evidence Of A Material Burden?

The Declaration states that, "if at any time Alpha determines that the easement granted to [Brandywine] is a material burden to [Talleyville] . . . Then Alpha shall have the right . . . to terminate [the easement]. Such a determination if made by Alpha, shall be absolute, binding and not subject

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[24] *Papaioanu v. The Comm'rs of Rehoboth*, 186 A.2d 745, 749 (Del. Ch. 1962).

[25] Brandywine also argues that Alpha's notice of termination of the easement was untimely, because Alpha waited over six years to terminate the easement after learning that a post office would not be built (and four years after the deadline date by which the post office had to be built). If Alpha acquiesced in the non-construction of the post office, then the timely notice requirement becomes moot. If, however, Alpha is not precluded from exercising its termination rights, then Alpha's notice was timely because the letter would have been sent early enough to provide the requisite ninety-day written notice to Brandywine.

to challenge for any reason whatsoever."[26] The provision then recites examples (which are deemed not exclusive) of scenarios that might constitute a "material burden."[27]

Brandywine contends that "materiality" is generally a question of fact that cannot or should not be decided as a summary judgment matter. But Brandywine cites no legal authority which requires that a trial be held in every case where materiality is an issue.[28]

Brandywine next argues that Alpha has adduced no evidence to support its conclusion that the easement constituted a material burden. I disagree. Alpha's verified answer and supporting affidavit constitutes *prima facie* evidence of a material burden. That evidence shows that heavy delivery trucks, tractor trailers, and high speed traffic, all used the easement to cross over into Concord Square. Those vehicles posed safety concerns to Talleyville's tenants and their customers, caused damage to Talleyville's parking lot, and resulting in tenant dissatisfaction.[29] It is Brandywine that has adduced no evidence to controvert Alpha's showing.[30] Thus, the record establishes that Alpha had a factual basis to determine that easement constituted a material burden upon the Talleyville Center.

2. Was The Determination Made In Good Faith?

Brandywine also argues that Alpha did not make that determination in good faith. Although the Declaration grants alpha complete discretion to determine whether a material burden exists, Brandywine contends that Alpha must still make that determination in good faith. That did not happen, Brandywine says, because Alpha's only motive for making its "material burden" determination was to prevent a tenant from leaving Talleyville to move to the Concord Square shopping center.[31]

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[26]26 Decl. ¶ 6.

[27]*Id.*

[28]*Branson v. Exide Elecs. Corp.*, 1994 Del. LEXIS 129, at *7-*8 (Del. April 25, 1994) (stating that while issues of materiality may not always be disposed of on summary judgment, the Court can make such a factual determination on the basis of a developed record); *Wells Fargo & Co. v. First Interstate Bancorp.*, 1996 Del. Ch. LEXIS 3, at *29- *30 (Del. Ch. Jan. 18. 1996) (citing *Branson*); *Kelly v. McKesson HBOC, Inc.*, 2002 Del. Super. LEXIS 39, at *49 (Del. Super. Jan. 17, 2002) (citing *Branson*).

[29]V. Answer ¶ 11, 25; Stella Aff. ¶ 8, 9.

[30]Brandywine does not deny the particulars cited in Alpha's Verified Answer or Request for Admissions and Interrogatory to support Alpha's claim that a material burden existed, except for one item, and in any event, Brandywine has proffered no evidence that contradicts Alpha's evidence.

[31]V. Compl. ¶ 35.

All contracts contain an implied covenant of good faith,[32] and from that implied covenant there flows the principle that "if one party is given discretion in determining whether [a] condition in fact occurred[,] that party must use good faith in making that determination."[33] Alpha concedes its duty to make the "material burden" in good faith, but argues that that it fully observed that duty. Again, I agree.

Brandywine's argument that Alpha's sole motivation was to prevent the loss of a "significant tenant," and not to remedy misuse of the easements and customer complaints, is a conclusory statement without support in the record.[34] Alpha, on the other hand, has adduced *prima facie* evidence that it determined, in good faith, that a material burden existed.[35] Because that evidence is uncontroverted, and because Brandywine has adduced no evidence to support its "bad faith" argument, Alpha is entitled to summary judgment on this claim.

C. Whether The Consent Of New Castle County Is Needed For Alpha To Terminate The Easement

The third and final issue raised by Alpha's motion is whether the Declaration requires Alpha to obtain New Castle County's prior consent in order to terminate the easement.[36] Paragraph 8 of the Declaration states that "[e]xcept as provided in paragraph 4 above, this Declaration may not be amended, modified, or rescinded without the prior written consent of New York County Council." Brandywine contends that paragraph 8, on its face, requires Alpha to obtain the County's prior consent. Alpha argues the contrary. It contends that Paragraph 8 contains an obvious typographical

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[32] *Wilgus v. Salt Pond Inv. Co.*, 498 A.2d 151, 159 (Del. Ch. 1985).

[33] *Gilbert v. El Paso Co.*, 490 A.2d 1050, 1055 (Del. Ch. 1984).

[34] Alpha's General Manager, Robert Stella ("Stella"), referred to a possible loss of tenants who might consider relocating due to safety concerns posed by the improper use of the easement. Stella Aff. ¶ 10.

[35] Alpha claims that it sought to work with Brandywine to erect a barrier that would eliminate the offending traffic and preserve the easement. Brandywine does not deny this claim, but takes the position that it does not have sufficient information to admit or deny it. V. Answer ¶ 11; Req. for Admis. and Interrog. #7. That agnostic position does not create a triable fact issue. Moreover, Stella testified that he received complaints from Talleyville tenants with respect to the delivery trucks and high-speed traffic that used the easement, posed serious safety concerns, and caused damage to the Talleyville parking lot. Stella Aff. ¶ 8. That evidence is not controverted either.

[36] V. Compl. ¶¶ 29, 30.

error that, if corrected, would clearly show that the County's prior consent is not required. The typographical error, Alpha claims, prevented the accurate expression of the parties' true intent, which is that the "except" clause of Paragraph 8 was meant to refer to Paragraph 6—and not Paragraph 4 —of the Declaration.[37]

In support of its position, Alpha argues that (i) Paragraph 6 is the only provision of the Declaration that addresses "recission" of the Declaration, and (ii) Paragraph 6 does not make the right to recission subject to County approval. Therefore, Alpha contends, it must be concluded that Paragraph 8 of the Declaration was intended to carve out Paragraph 6 from the County approval requirement—not Paragraph 4, which deals with mechanics' liens.[38]

Alpha's "typographical error" argument may ultimately be shown to have merit, but for the Court to accept that argument on the present record would be tantamount to reforming the Declaration. The remedy of reformation will be granted on a showing of (*inter alia*) mutual mistake with respect to a material term in the contract. The party seeking reformation, however, must show by clear and convincing evidence that the parties' actual intent was not accurately reflected in their written agreement. The "clear and convincing" standard requires evidence that would lead a trier of fact to "an abiding conviction that the truth of [the] factual convictions are highly probable."[39] That showing has not been made here.

Given the exacting standard for granting reformation—which is the remedy that Alpha must earn in order for it to prevail—the "typographical error" issue cannot be resolved at this stage. Testimony will be required, because it is not indisputably self-evident from the Declaration that its reference (in Paragraph 8) to Paragraph 4 is erroneous. Because its resolution must await a trial, summary judgment on the "County approval" issue will be denied.

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[37]Stella Aff. ¶ 11

[38]Paragraph 4, in full text, states that:

> Any rights or obligations of either party to perform repairs or other work on the property of the other shall not be construed to be a consent by the latter to subject its property to a mechanic's lien or similar claim by any person supplying labor or materials for such work.

[39]*Amstel Assocs.* v. *Brinsfield-Cavall Assocs.*, 2002 Del. Ch. LEXIS 54, *15 & n.12 (Del. Ch. May 9, 2002).

IV. CONCLUSION

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

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM v. COULTER

No. 19,191

Court of Chancery of the State of Delaware, New Castle

December 18, 2002

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NOBLE, *Vice Chancellor*