Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

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ACTRADE FINANCIAL TECHNOLOGIES LTD. v. AHARONI

No. 20,168

Court of Chancery of the State of Delaware, New Castle

October 17, 2003

Daniel A. Dreisbach, Esquire, Lisa A. Schmidt, Esquire, and James H. McMackin, III, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Daniel J. Lefell, Esquire, Stacey A. Shortall, Esquire, and Ariel Cannon, Esquire, of Paul, Weiss, Rifkind, Wharton & Garrison LLP, New York, New York, of counsel, for plaintiffs.

Neal J. Levitsky, Esquire, of Fox Rothschild LLP, Wilmington, Delaware; and Sigmund S. Wissner-Gross, Esquire, May Orenstein, Esquire, and Clifford J. Bond, Esquire, of Heller, Horowitz & Feit, P.C., New York, New York, of counsel, for the defendant.

LAMB, *Vice Chancellor*

I.

A Delaware corporation and its wholly owned foreign subsidiary sued their former Chairman and CEO, a non-US resident, for breach of fiduciary duty and misappropriation of monies. On a motion to dismiss, the court concludes that it has properly obtained jurisdiction over the non-resident defendant by means of the director service statute, 10 *Del. C.* § 3114. The court also concludes that the use of that statute to obtain jurisdiction over a foreign resident does not involve the service of process outside the United States and, therefore, does not require compliance with the Hague Convention governing service abroad of judicial writs. The court also concludes that the matters asserted in the complaint are properly within its jurisdiction and that the complaint should neither be dismissed nor stayed in favor of a substantially different action pending in the Cayman Islands.

II.

A. The Parties

The plaintiff, Actrade Financial Technologies Ltd. ("Actrade DE"), is a Delaware corporation. Actrade DE wholly owns several subsidiary companies whose business is selling short-term financing agreements.[1] Actrade Commerce Ltd. ("Actrade Commerce"), an Antiguan corporation, is one of these subsidiaries and is also a plaintiff in this action. Actrade DE and Actrade Commerce are sometimes hereinafter referred to as "Actrade" or "the plaintiff."

The defendant, Amos Aharoni, a resident of the State of Israel, was the Chairman of the Board of Actrade DE and one of the company's founders. He was also the sole director and officer of Actrade Commerce, as well as other directly and indirectly owned subsidiaries of Actrade DE.

B. The Disputed Transfers

The complaint alleges that, on or about June 25, 2002, Aharoni faxed a wire transfer instruction to Banco Comercial Portuguese ("BCP") in the Cayman Islands directing BCP to transfer $10,009,200 from Actrade Commerce's account at BCP to International Clearing Corporation ("ICC"). The complaint further alleges that, on or about July 12, 2002, Aharoni faxed another wire transfer instruction from Israel to BCP in the Cayman Islands ordering it to transfer $21,656,700 from Actrade Commerce's account at BCP to the account of an entity called Fort. The total amount of these transfers ("disputed transfers") is approximately $31.6 million.

On August 2, 2002, Actrade DE's board of directors instructed its Audit Committee to investigate alleged improprieties in the operations of Actrade DE and its subsidiaries. On August 8, 2002, counsel for the Audit Committee wrote to Aharoni seeking to interview him and obtain all Actrade documents under his control. On August 14, Actrade DE's Chief Financial Officer e-mailed Aharoni seeking access to all documents under Aharoni's control. On August 28, 2002, the Audit Committee faxed to Aharoni's U.S. and Israeli counsels copies of a document preservation letter that Actrade DE had received from the SEC and the U.S. Attorney's Office. On September 6, 2002, the Audit Committee again wrote Aharoni's U.S. counsel seeking all Actrade documents in Aharoni's control.

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[1]Actrade DE wholly owns Actrade International, a New York corporation. Actrade International wholly owns Antiguan corporation Actrade S. A. Actrade S .A. wholly owns Bahamian corporation Actrade Resources and Antiguan corporation Actrade Commerce Ltd.

Aharoni eventually gave Actrade five loan agreement documents dated July 10, 2002.[2] These agreements show Actrade Commerce loaning a total of $31.6 million to five foreign entities.[3] Aharoni contends that these loans explain the disputed transfers and that they have already been repaid with $6 million in interest. Actrade alleges that there was no legitimate business purpose for these loans and that neither Actrade DE nor any Actrade subsidiary has received any payment on them. Actrade further alleges that Aharoni controls ICC and Fort and that he fabricated the loan agreements after the disputed transfers to conceal his theft of $31.6 million from Actrade Commerce.

C. The Interpleader Action

On September 26, 2002, BCP commenced an interpleader action in the Cayman Islands regarding the ICC and Fort accounts that had received the disputed transfers. BCP named Actrade DE, Actrade Commerce, Actrade Resources, Actrade S.A., ICC, Fort, Commercial Finance Institution ("CFI"), and BCP as claimants to the money in the accounts. By consent order, Actrade DE and its subsidiaries became plaintiffs in that action on May 2, 2003, leaving the remaining parties as defendants. On May 5, 2003, Actrade filed a complaint seeking an accounting, a declaration that Fort and ICC hold the disputed funds as constructive trustees for Actrade, and payment of the amount the accounting determines to be owed. The Cayman Islands action does not include a claim for breach of fiduciary duty and does not name Aharoni as a party, although Aharoni argues that he expects to eventually be named as a third-party defendant.

D. The Motion To Dismiss

Actrade filed a complaint in this court on February 20, 2003, alleging breach of fiduciary duty, misappropriation and conversion of corporate assets, fraud, and corporate waste. Aharoni has moved to dismiss for lack of personal jurisdiction, lack of subject matter jurisdiction, *forum non conveniens*, failure to join necessary parties, and failure to state a claim

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[2]Through counsel, Aharoni refused to be interviewed or provide substantive information to the Audit Committee. On August 21, 2002, Aharoni resigned all director and officer positions he had held for Actrade DE and its subsidiaries. In late September 2002, Aharoni made available a group of Actrade documents that were under his control. Among these were the five loan agreements.

[3]Onyx Holdings, Ltd., Garibaldi do Brazil Limitida, LLC, Vision Art Group, Manerfold Finance Corp., and LLC Setkomp.

for which relief can be granted. Alternatively, Aharoni moves for a stay of this action pending the outcome of the Cayman Islands action. Finally, Aharoni moves to strike the complaint's references to the document preservation letter from the SEC and the U.S. Attorney's office as immaterial and "scandalous." In considering a motion to dismiss, this court views all facts in a light most favorable to the non-moving party.[4]

III.

Aharoni challenges this court's personal jurisdiction on two grounds. First, Aharoni claims that this court cannot rely upon 10 *Del. C.* § 3114 to obtain personal jurisdiction over him because he did not commit his allegedly wrongful acts in his capacity as a director of a Delaware corporation (Actrade DE), but rather in his capacity as a director of wholly owned foreign subsidiary (Actrade Commerce).[5] Second, Aharoni argues that the attempt to serve process on him pursuant to section 3114 violated the Hague Convention of 1963, a treaty of the United States, and therefore failed to confer jurisdiction.[6] For reasons expressed below, neither of these arguments has merit.

A. The Reach Of 10 *Del. C.* § 3114

Actrade bases its claim of personal jurisdiction on Delaware's Director Consent statute, 10 *Del. C.* § 3114(a), which reads:

> Every nonresident of this State who after September 1, 1977, accepts election or appointment as a director, trustee or member of the governing body of a corporation organized under the laws of this State or who after June 30, 1978, serves in such capacity and every resident of this State who so accepts election or appointment or serves in such capacity and thereafter removes residence from this State shall, by such acceptance or by such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation (or, if there is none, the Secretary of State) as an agent

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[4]*See e.g. Ramunno v. Cowley*, 705 A.2d 1029, 1034 (Del. 1998).

[5]Memorandum of Law in Support of Motion to Dismiss the Complaint of Defendant Amos Aharoni Based, *Inter Alia*, Upon Lack of Personal Jurisdiction, Lack of Subject Matter Jurisdiction, *Forum Non* Conveniens, Prior Pending Proceeding, and Failure to Join Necessary Parties, ("Def. Op. Br.") p. 8.

[6]Def. Op. Br. p. 12.

> upon whom service of process may be made in all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such director, trustee or member is a necessary or proper party, or in any action or proceeding against such director, trustee or member for violation of a duty in such capacity, whether or not the person continues to serve as such director, trustee or member at the time suit is commenced. Such acceptance or service as such director, trustee or member shall be a signification of the consent of such director, trustee or member that any process when so served shall be of the same legal force and validity as if served upon such director, trustee or member within this State and such appointment of the registered agent (or, if there is none, the Secretary of State) shall be irrevocable.

This court has personal jurisdiction over Aharoni because he consented to that jurisdiction by becoming the director of a Delaware corporation. As the Delaware Supreme Court has held, a director "accept[s] [his] directorship [of a Delaware corporation] with explicit statutory notice, via § 3114 that [he] could be haled into a Delaware court to answer for the alleged breaches of the duties imposed on [him] by the very laws which empowered [him] to act in his corporate capacities."[7] Aharoni cannot escape personal jurisdiction under section 3114 by mischaracterizing his alleged wrongful acts as having been done purely in the capacity of directorship of the foreign subsidiary. Actrade DE conducted all of its business through its foreign subsidiaries, "making oversight of subsidiaries a crucial aspect of the [parent] board's function."[8] Under *Grace*, Aharoni's oversight or lack thereof of the actions of Actrade Commerce can constitute a breach of fiduciary duty to Actrade DE.

In *Grace*, the defendants who were directors of both a Delaware parent and foreign subsidiary company allowed the subsidiary to assume control over the parent's primary asset and thus become the owner of the parent, to the detriment of the parent's stockholders but to the benefit of the subsidiary. The *Grace* court rejected the defense that "a director of a parent board . . . has no duty to stop himself from injuring the parent while

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[7]*See Armstrong v. Pomerance*, 423 A.2d 174, 177 (Del. 1980) (finding personal jurisdiction over foreign directors on a claim for breach of fiduciary duty to a Delaware corporation when directors had no contact with Delaware other than being directors of the Delaware corporation).

[8]*See Grace Bros., Ltd. v. Uniholding Corp.*, 2000 WL 982401, at * 12 (Del. Ch. July 12, 2000) (hereinafter *Grace*).

wearing his subsidiary hat."[9] This court found personal jurisdiction over the defendants for the Delaware parent's claim even though the wrongful action occurred through a foreign subsidiary.

Similarly in *Technicorp Int'l II v. Johnston*,[10] this court found personal jurisdiction over persons who were directors of both a Delaware parent and its foreign subsidiary for wrongful acts done in the name of the subsidiary. Under *Technicorp*, wrongful diversions from a foreign subsidiary are a breach of fiduciary duty to both the subsidiary and to its parent.[11]

Aharoni argues that Delaware has little or no interest in hearing this case because the disputed acts took place in either Israel or the Caribbean, directly injured only an Antiguan subsidiary, and any injury to the Delaware company was indirect and incidental. On the contrary, Delaware has a significant interest in protecting Delaware companies from breaches of fiduciary duty by their directors, regardless of where that breach occurs.[12] That interest is magnified in this case because it seems Actrade DE has no other forum in which to litigate its breach of fiduciary duty claim. Aharoni has not submitted to the personal jurisdiction of the Cayman Islands court, nor is he named as a party in that action. Aharoni's implied consent to Delaware's personal jurisdiction through section 3114 ensures that Actrade DE has a forum in which to litigate its injury.

Since this court has personal jurisdiction over Aharoni for Actrade DE's breach of fiduciary duty claim, that jurisdiction extends "to any and all relief that might be necessary to do justice between the parties."[13] This includes jurisdiction over Actrade Commerce's claims. Under very similar facts, the *Technicorp* court found personal jurisdiction over defendant directors for the claims of a foreign subsidiary because those claims "arise out of the same core facts as [the claims of the parent] and because it was therefore reasonably foreseeable that [the subsidiary] as well as [the parent] would seek to recover those diverted funds in the same lawsuit."[14]

Aharoni's attempt to distinguish *Technicorp* is unpersuasive. He argues that Delaware has a greater interest in enforcing the fiduciary duty owed to a Delaware parent company when the subsidiary was a directly-owned buyout vehicle than when the subsidiary is indirectly owned and conducts ordinary business.[15] However, Aharoni offers no reason why this

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[9] *Id.* at *13.

[10] 2000 WL 713750 (Del. Ch. May 31, 2000) (hereinafter *Technicorp*).

[11] *Id.* at *4.

[12] *Id.*

[13] *Gans v. MDR Liquidating Corp.*, 1990 WL 2851, at *10 (Del. Ch. Jan. 10, 1990).

[14] *Technicorp* at *5 n. 12.

[15] Def. Op, Br. p. 9.

difference mandates a disparate result for the same act—breaching a fiduciary duty to a parent company by converting its subsidiary's money for personal use. Since the same core facts are at issue in both of Actrade's claims, the dual-plaintiff suit was entirely foreseeable and *Technicorp* applies. This court has personal jurisdiction over Aharoni for all of Actrade's claims.

B. Service Of Process And The Hague Convention

Aharoni next contends that 10 *Del. C.* § 3114(b), as applied to him, violates the Hague Convention.[16] Under Aharoni's interpretation of section 3114(b), service is a two-step process that, in his case, included both (1) the service on Actrade's registered agent in Delaware, and (2) the mailing by the Register in Chancery of a copy of that process to him in Israel. Because the second part of this "service" was made on him overseas, he contends, the Hague Convention applies to invalidate the attempted service.[17] Actrade responds that for the purpose of the Hague Convention, service on Aharoni pursuant to section 3114(b) was accomplished by serving Actrade's registered agent. According to Actrade, the subsequent mailing by the Register in Chancery was not a necessary part of "service," but merely an additional form of notice. Therefore, Actrade argues, the Hague Convention has no application.

As a matter of textual interpretation, Actrade's reading of the statute is by far more compelling. "Service" under the statute is described in the first sentence of the section and is limited to "serving the registered

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[16]The pertinent part of § 3114(b) is as follows:

> Service of process shall be effected by serving the registered agent (or, if there is none, the Secretary of State) with 1 copy of such process in the manner provided by law for service of writs of summons. In addition, the Prothonotary or the Register in Chancery of the court in which the civil action or proceeding is pending shall, within 7 days of such service, deposit in the United States mails, by registered mail, postage prepaid, true and attested copies of the process, together with a statement that service is being made pursuant to this section, addressed to such director, trustee or member at the corporation's principal place of business and at the residence address as the same appears on the records of the Secretary of State, or, if no such residence address appears, at the address last known to the party desiring to make such service.

[17]Reply Memorandum of Law in Further Support of Motion to Dismiss the Complaint of Defendant Amos Ahoroni Based, *Inter Alia*, Upon Lack of Personal Jurisdiction, Lack of Subject Matter Jurisdiction, *Forum Non* Conveniens, Prior Pending Proceeding, and Failure to Join Necessary Parties, ("Def. Rep. Br. ") p. 5. The Hague Convention, if it applied, would have required that any attempt to serve process on an Israeli resident be mailed to Israel's Directorate of the Courts, rather than directly to the resident. The Register in Chancery mailed Actrade's process directly to Aharoni.

agent." The additional act of mailing is required to be made "within 7 days of such service." This reading is also consistent with the strong public policy of this State to provide a certain and easily accessible forum in which to litigate claims against those who choose to become directors of Delaware corporations.[18] Delaware's interest in defining and enforcing these obligations is substantial and does not depend on or relate to the place of residence of the director.[19] Delaware requires appointment of an in-state registered agent in order to effectuate service of foreign directors entirely in Delaware, hence avoiding the more difficult and time-consuming steps necessary to effect service of process on persons outside the state.[20] The United States Supreme Court has ruled that the Hague Convention applies only to service effectuated outside the United States.[21] For that reason, that treaty is irrelevant to section 3114(b) service in Delaware.

For the foregoing reasons, Aharoni's motion to dismiss for lack of personal jurisdiction and improper service of process will be denied.[22]

IV.

Aharoni challenges this court's subject matter jurisdiction by characterizing the disputed action as a simple conversion of Actrade funds that can be fully remedied by damages.[23] Aharoni argues that Actrade may invoke equity jurisdiction only if damages cannot adequately remedy Actrade's injury. He is simply wrong. This court has subject matter jurisdiction over claims that are equitable in nature even if monetary damages are sought in relief.[24] Breach of fiduciary duty is a well-established equitable claim properly invoking the subject matter jurisdiction of this court.[25] Aharoni's motion to dismiss for lack of subject matter jurisdiction must be denied.

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[18]*See Pestolite, Inc. v. Cordura Corp.*, 449 A.2d 263 (Del. Super. 1982).

[19]*Id.*

[20]*Id.* at 266 (§ 3114 enacted specifically to ensure jurisdiction over directors of Delaware corporations for the claims of those corporations in response to *Shaffer v. Heitner*, 433 U.S. 186 (1977)).

[21]*See Volkswagenwerk Aktiengesellschaft v. Schlunk*, 486 U.S. 694, 701 (1988).

[22]Since the court has personal jurisdiction pursuant to § 3114, I decline to consider whether 10 *Del. C.* § 366(a) (the sequestration statute) could provide an alternate basis for personal jurisdiction.

[23]Def. Rep. Br. pp. 12-13.

[24]*See* 10 *Del. C.* § 3411; *see also International Business Machines v. Comdisco*, 602 A.2d 74, 78 n.6 (Del. Ch. 1991).

[25]*See e.g. Clark v. Teeven Holding Co., Inc.*, 625 A.2d 869, 875 (Del. Ch. 1992) ("This Court thus has jurisdiction to hear such traditional, equitable matters as trusts and fiduciary relations").

Aharoni next contends that even if Actrade has an equitable claim, the court should refuse to exercise jurisdiction over any related legal claims. Instead, he argues, the court should sever these claims to the Superior Court where Aharoni may receive a jury trial. The facts of this case do not warrant severance of Actrade's legal claims from the central claim alleging breach of fiduciary duty. Once this court finds equity jurisdiction over part of a case, it may, at its discretion, exercise jurisdiction over related legal claims.[26] Factors that may cause this court to deny a motion to sever include: "to resolve factual issues; to avoid multiplicity of suits; to promote judicial efficiency; to do full justice; to avoid great expense; to afford complete relief in one action; and to overcome insufficient modes of procedure at law."[27] Actrade bases all of its claims on two allegedly wrongful wire transfers ordered by Aharoni. Since the factual inquiry for Actrade's breach of fiduciary duty claim would be identical to that of the misappropriation, fraud, and waste claims, all the factors of the *Getty Refining* test weigh against the duplicative factual inquiry that severance would cause.[28] The court will therefore exercise jurisdiction over all of Actrade's claims.

V.

Aharoni's motion further asserts a laundry list of reasons why this court should either dismiss or stay the complaint. The arguments made are insubstantial and will be discussed only briefly.

Aharoni's motion to dismiss under the doctrine of *forum non conveniens* fails for two reasons. First, Aharoni offers no persuasive reason why Delaware is an inconvenient forum for a director of a Delaware corporation to litigate a claim for breach of fiduciary duty. Second, Aharoni has failed to suggest a comparable action in a forum so much more convenient that this court should dismiss the present action in its favor.

An action will be dismissed for *forum non conveniens* only in "the rare case where a dismissal of a complaint is appropriate because this forum is overwhelmingly and unduly inconvenient . . . ."[29] A mere preference for another forum is insufficient: "While there is no doubt that [Aharoni] would prefer to litigate this case in his home [country], he cannot plausibly claim any undue inconvenience from having to defend himself

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[26]*See Getty Refining & Marketing Co. v. Park Oil, Inc.*, 385 A.2d 147, 149 (Del. Ch. 1978).

[27]*Id.* at 150

[28]*Id.*

[29]*See Caithness Resources, Inc. v. Ozdemir*, 2000 WL 1741941 at 1 (Del. Ch. Nov. 22, 2000).

against claims for breach of fiduciary duty in this court. [The defendant] voluntarily chose to serve as the director and principal operating officer of a Delaware corporation. He is an intelligent man who cannot have been ignorant of the possibility that he would face a suit in Delaware in the event of a dispute between himself and [the Delaware corporation he served]."[30]

Additionally, Aharoni does not offer a comparable, more convenient action to which this court should defer. The only other related action currently pending is the Cayman Islands action, which is both incomparable and less convenient than this action. The Cayman Islands action neither names Aharoni as a party nor involves a claim for breach of fiduciary duty. It is difficult to see how an action prosecuting a different claim against a different party would warrant dismissal for *forum non conveniens*.

Even if the Cayman Islands action were comparable, it would certainly be no more convenient than this action. Factors measuring convenience include "(1) the relative ease of access to proof; (2) the availability of compulsory process for witnesses; (3) the possibility of the view of the premises; (4) whether the controversy is dependent upon the application of Delaware law which the courts of this state more properly should decide than those of another jurisdiction; . . . and [5] all other practical problems that would make the trial of the case easy, expeditious and inexpensive."[31] None of these factors weigh in favor of dismissal. The fact that this action may involve the laws of multiple jurisdictions or the compulsion of witnesses therefrom is not compelling because those problems would arise wherever this dispute is litigated. The central claim of this case is breach of fiduciary duty to a Delaware company. This claim requires application of Delaware law within the special expertise of this court. Finally, Aharoni has little cause to complain of inconvenience in defending an action properly before this court when he consented to its jurisdiction.

The court also declines to stay this action for the same reasons it declines to dismiss for *forum non conveniens*. Aharoni correctly argues that "discretion should be freely exercised in favor of [a] stay when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same issues and the same parties."[32] However, a stay in favor of the Cayman Islands action is inappropriate because that case does not involve the same parties or cause of action and

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[30]*Id.* at *5.

[31]*Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1198-99 (Del. 1997).

[32]*McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g. Co.*, 263 A.2d 281, 283 (Del. 1970).

that court may not be able to do complete justice for lack of personal jurisdiction over Aharoni.

Aharoni is not a party to the Cayman Islands action as required by *McWane*.[33] He argues that since his alleged proxy companies are defendants there, his interests are adequately represented as well. Even if so, this argument entirely misses the point of director liability for breach of fiduciary duty. If Actrade's factual allegations are true, Aharoni is personally liable for breach of fiduciary duty, regardless of whether the proxy companies are liable.[34] Personal liability is especially important here because the Cayman Islands courts apparently do not have personal jurisdiction over Aharoni. Thus, if Aharoni removed the funds from the accounts of the proxy companies, Actrade would be left without an equitable remedy. Such a result is not the "prompt and complete justice" contemplated by *McWane*.[35]

The court also rejects Aharoni's contention that ICC, Fort, CFI; and various Actrade subsidiaries are indispensable parties without whom this court cannot do full and complete justice. Court of Chancery Rule 19(a) lists the factors making a party necessary:

> (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest.

Aharoni argues that Fort, ICC and CFI are indispensable parties because they have a claim to the disputed $31.6 million. This does not affect this court's ability to grant complete relief to the parties before it. The central claim here is that Aharoni breached his fiduciary duty to Actrade by stealing from Actrade Commerce. If Actrade is able to prove this claim, Aharoni will be personally liable for the $31.6 million he allegedly stole, whether or not some other person or entity might also be liable to Actrade.

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[33] *Id.*

[34] *See e.g. Technicorp.*

[35] 263 A.2d at 283 (granting a stay because another action could afford the parties "all the discovery, pretrial, and trial advantages" they would have in Delaware and could grant a "speedy, just and complete disposition to the claims" of all parties before the court).

There is also little risk that these companies will be unable to protect their interests or that Aharoni will be subject to duplicative obligations. If, as alleged, Aharoni controls ICC, Fort and CFI, then Aharoni can adequately defend their interests. If not, this case will only decide whether the disputed transfers were within the scope of Aharoni's authority as a director of Actrade. The alleged proxy companies' liability will not be at issue. The "one satisfaction" rule ensures that Actrade can actually recover the $31.6 million only once, regardless of the number of actions or defendants.[36] Since ICC, Fort, and CFI are not necessary parties under Rule 19(a), it is unnecessary for the court to consider Aharoni's Rule 19(b) analysis.

Similarly, the other Actrade subsidiaries are not necessary parties to this action because the "one satisfaction" rule prevents duplicative recovery and because those subsidiaries are not otherwise interested.[37] Aharoni offers no legitimate reason why this case cannot go forward without these unrelated parties.[38]

Finally, the court will deny Aharoni's motion to the extent it seeks dismissal of the claims for misappropriation,[39] fraud[40] and waste[41] asserted

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[36]See 47 Am. Jur.2d, *Judgments* §1009.

[37]*Id.*

[38]Aharoni offers no basis for his contention that any court would force him to pay the same $31.6 million multiple times to each Actrade subsidiary. Nor does Aharoni show why this case requires joining Actrade International or Actrade S.A. when those companies had nothing to do with the disputed transfers. While Aharoni may have transferred money from Actrade Resources to Actrade Commerce prior to the disputed transfers, that act appears to have been within Aharoni's director authority and is unchallenged by Actrade. Aharoni suggests his discovery will be hampered without the subsidiary companies, but it is unclear why any information about the disputed transfers, especially payment on the loan agreements, would be outside the control of Actrade DE, owner of all the companies at issue.

Finally, Aharoni worries that he will win here, be able to dismiss Actrade DE and Actrade Commerce from the Cayman Islands action, then be found liable to the other Actrade subsidiaries. This argument is wholly without merit since Aharoni is not a party to the Cayman Islands action and denies he controls the companies that are parties to that action.

[39]The motion to dismiss Actrade's conversion claim is premature. Neither party briefed the issue of whether Antiguan law recognizes a claim for conversion of a specific sum. Since the parties agree that Antiguan law controls, dismissal is inappropriate.

[40]According to Aharoni, "[n]owhere in their entire complaint do Plaintiffs allege that they were damaged from purported incorrect information contained in the financials." Def. Rep. Br. at 30. However, ¶ 97 of the complaint reads, "Aharoni's representations of fact contained in the purported loan agreements were false when made, were known to be false when made, and were made for purpose of inducing Actrade Commerce to rely on them to their detriment, which Actrade Commerce did." Further, ¶ 98 reads, "[a]s a direct result, Actrade Commerce suffered damages in an amount to be proved at trial." This is an adequate allegation of damage.

[41]In support of his motion to dismiss the waste claim, Aharoni argues that the loan agreements on their face are evidence that Actrade received reasonable consideration. Of course,

in the complaint. Similarly, the court will deny the motion to strike references to the letter from the SEC and the subpoena from the U.S. Attorney's office. These allegations tend to prove a core element of Actrade's case: that Aharoni created the loan documents after the fact to hide his wrongdoing. Actrade alleges that Aharoni knew that Actrade was under government investigation and still refused to produce the allegedly exonerating loan agreements for several weeks. If true, this fact would tend to prove bad faith and is relevant.[42] The probative value of such evidence far outweighs any danger of unfair prejudice to Aharoni.[43]

VI.

For all of the foregoing reasons, Aharoni's motion to dismiss for lack of personal jurisdiction, lack of subject matter jurisdiction, and *forum non conveniens* is denied. Aharoni's motion to stay or dismiss this action in favor of the Cayman Islands action is denied. Aharoni's motion to dismiss for failure to state a claim and for failure to join necessary parties is denied. Aharoni's motion to strike is denied. IT IS SO ORDERED.

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the complaint alleges facts that cast doubt on the regularity of those documents. Aharoni's argument that this court is helpless to look beyond the four comers of an allegedly fraudulent document to address allegations of self-dealing waste (Def. Rep. Br. p. 31) is simply wrong.

[42]Delaware Uniform Rule of Evidence 401 (defining relevant evidence as "having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable").

[43]In passing, the court notes that the parties vigorously argue over remedies that might be available, including accounting, sequestration of stock, and constructive trusts. This discussion is premature and unnecessary to the present motion and I decline to make any ruling on it.

INTERIM HEALTHCARE, INC. v. SPHERION CORP.

No. 18,977 NC

Court of Chancery of the State of Delaware, New Castle

November 29, 2003
Revised December 1, 2003

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SLIGHTS, Judge[1]

I. Introduction

On this motion for partial summary judgment, the Court must determine whether the equitable remedy of reformation is available when the party seeking relief has asserted a legally and factually viable claim for breach of the contract it seeks to have reformed. The Court also must determine whether a party to a contract may seek to reform the instrument based on an alleged mutual mistake of fact regarding a future event, the outcome of which neither party to the contract can control. In this case, the issue arises more than six years after the parties entered into a Restated Stock Purchase Agreement (the "Agreement") for the sale of Interim Healthcare, Inc. ("Interim") by defendant, Spherion Corporation ("Spherion") to plaintiffs, Catamaran Acquisition Corp. ("Catamaran") and Cornerstone Equity Investors, IV L.P. ("Cornerstone") (collectively "plaintiffs").

A post-sale administrative audit of Interim's reimbursements from the Medicare program found that Interim had been substantially overpaid by Medicare prior to the sale. Plaintiffs were required to repay a significant portion of the overage back to Medicare as part of a negotiated settlement. Because neither party believed at the time of the sale that Interim had been

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[1]Appointed to sit temporarily as Vice Chancellor by Order of the Supreme Court of Delaware dated December 20, 2001. *See* Del. Const. Of 1897, art. IV, § 13 (2).

overpaid by Medicare to the extent revealed in the audit, plaintiffs contend that the parties were mutually mistaken as to a material fact underlying the Agreement, i.e, the value of Interim, and that the resulting purchase price for Interim was grossly inflated. Plaintiffs seek reformation of the purchase price provision of the Agreement to reflect the true value of Interim as revealed by the post-sale audit.

The Agreement as written provides a platform from which plaintiffs may argue breach and seek compensatory damages, including the amount they contend they overpaid for Interim. There is no need to reform the contract because it already clearly reflects the intent of both parties.

Moreover, the undisputed record reveals that both parties were aware that an administrative audit of Interim's Medicare reimbursements might be performed after the sale and that both parties knew that the outcome of the audit could not be directed or controlled by either party. Under these circumstances, plaintiffs cannot sustain their burden of proving that a mutual mistake of fact existed at the time the parties executed the Agreement. Consequently, in the absence of a mutual mistake, or unilateral mistake coupled with knowing silence or fraud, plaintiffs cannot prevail on their claim for reformation.[2] Spherion's motion for summary judgment is **GRANTED.**

II. Facts

A. The Parties

Cornerstone manages investment funds on behalf of sophisticated investors. Prior to the events giving rise to this controversy, Cornerstone's investment activities led it into the healthcare industry on several occasions, both as an investor in and acquirer of healthcare businesses.[3] When Cornerstone became aware that Spherion would sell Interim at auction, it formed Catamaran so that it could participate in the bidding and, if successful, acquire Interim.[4]

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[2]As discussed below, plaintiffs' eleventh-hour assertion of fraud, particularly given the procedural history of this case, is not sufficient to create a genuine issue of material fact with respect to unilateral mistake.

[3]For instance, Cornerstone has either acquired or invested in such companies as Health Management Associates, Total Pharmaceutical Care, Guardian Care, Coventry Health, Primary Health, Regent Assisted Living and Specialty Hospitals of America. D.I. 84, Ex. 15, at AB000331.

[4]Interim is a named plaintiff in this suit. Unless otherwise specified, the Court's references to Interim will be in its capacity as the entity which was sold, as opposed to any separate interest it may have as a plaintiff in this action.

Spherion, a Delaware holding company, owned several temporary staffing businesses, including Interim. At the time of the sale, Interim was the second-largest independent home health care company in the United States.[5]

B. Interim's Relationship With Medicare

A portion of Interim's pre-sale patient population participated in the Medicare program. This program, administered by the Health Care Financing Administration of the Department of Health and Human Services ("HCFA"), reimburses healthcare providers for certain covered services provided to Medicare beneficiaries. The reimbursement scheme is highly regulated and strictly enforced. Interim, as a provider of services to Medicare beneficiaries, was entitled to be reimbursed for healthcare services it rendered to these beneficiaries and for a portion of the costs associated with providing these services.

HCFA engages "fiscal intermediaries," usually private insurance service companies, to determine initially what provider costs will be reimbursed. The fiscal intermediaries use well-publicized formulas when determining reimbursable costs and rely upon the providers to submit claims for reimbursement that are consistent with these formulas. In its most basic form, a reimbursement transaction involves a provider, such as Interim, estimating its costs and billing the fiscal intermediary at periodic intervals during the fiscal year. At the end of the fiscal year, the fiscal intermediary adjusts the provider's estimated costs so that they match the actual reasonable costs. HCFA then reaches a "settlement" with the provider whereby the provider either owes money to Medicare, Medicare owes money to the provider or it is agreed that the periodic reimbursements paid to the provider reflected the provider's actual reimbursable costs.

Although Medicare reimbursements represented only a portion of Interim's pre-sale income, they were significant enough to affect the company's bottom line financial performance.[6] It is not surprising, then, that the Medicare aspects of Interim's business would be particularly significant to any suitors who might be interested in acquiring Interim when it became available on the market.

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[5]D.I. 84, Ex. 12, at SPH012139.

[6]According to Spherion, Medicare-reimbursed services represented approximately 20-22% of Interim's total services in 1996.

C. The Auction

In 1996, Spherion decided to sell Interim so that it could focus its business on more traditional commercial staffing markets. The sale was to follow an open auction. Prior to the sale, Interim had been operated much like a division of Spherion's diversified whole. Accordingly, in anticipation of the sale, Spherion undertook the process of preparing pro forma income statements for Interim which would reflect its value as an independent operating entity. Interim's financial statements essentially had to be prepared from scratch because Spherion had never maintained separate financial records for the healthcare aspect of its business.

Once prepared, Interim's income statements were audited by Deloitte & Touche LLP ("Deloitte & Touche"). As part of the audit process, Spherion directed Deloitte & Touche to "evaluate the fairness of presentation of the financial statements in conformity with generally accepted accounting principles in all respects."[7] Because separate financial records had never been prepared for Interim, and because the pro forma income statements were prepared to paint a picture of Interim as a separate operating entity, which in reality it was not, Deloitte & Touche felt compelled to test all of the data underlying the Interim pro forma statements, including the balance sheets, profit and loss statements, account statements and, significantly, the Medicare cost reports.

Deloitte & Touche engaged a Medicare specialist to assist with its review of the Medicare reimbursements, and particularly to review the propriety of Interim's cost reports and the adequacy of Interim's Medicare reserves in the event of an overpayment. At the conclusion of its audit, Deloitte & Touche issued a report in which it concluded that the financial statements were "clean" and, as adjusted, reflected Interim's financial condition as a separate entity. Thereafter, the Deloitte & Touche audit was incorporated into a Confidential Descriptive Memorandum prepared by the investment banking firm Alex.Brown for distribution to the participants in the auction. Although Spherion engaged Alex.Brown to assist in the conduct of the auction, it alleges that it never sought a valuation of Interim from Alex.Brown or any other investment banking firm. Instead, Spherion was content to allow the auction process to set the price for Interim.

The auction took place in 1997. Originally, thirty four suitors were solicited. Eventually the bidders dwindled down to two, one of which was Catamaran. Catamaran's preliminary expression of interest to Alex.Brown suggested a willingness to explore a bid range of $120 million to $150

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[7]D.I. 84, Ex. 4, at DT000002.

million. Its first bid was $128 million. After discussions with Alex.Brown, the bid was raised to $134 million and the auction gavel fell at that price.[8]

D. The Agreement

Spherion's acceptance of Catamaran's bid was followed by an extended period of negotiations and due diligence.[9] Plaintiffs engaged several experts to assist them during this process, including consultants with Medicare reimbursement expertise. Plaintiffs' healthcare experts found no significant problems with Interim's cost reports or its reporting methodology. The consultants also opined that Interim's Medicare reserves were conservative.

The Agreement, executed on September 26, 1997, contained numerous representations and warranties regarding Medicare reimbursements. For instance, Spherion represented in Section 3.16 that, to the best of its knowledge, Medicare had not initiated or threatened to initiate any investigations of Interim, other than routine audits. Section 3.17 specified that:

> Any and all cost reports, budgets, and other filings required to be filed pursuant to any Law issued by or relating to the Medicare program and any other governmental healthcare program due as of or before the Closing Date and which may be due as a result of the Closing has or will be timely filed by the Seller Group except where a failure to file would not have a Material Adverse Effect. Except as stated in Schedule 3.17, such cost reports and other filings are complete and in compliance in all material respects with applicable Laws. Except as set forth in Schedule 3.17, to the knowledge of the Seller Executives, after consultation with the Healthcare Executives, there are no existing overpayments due and owing to HCFA or any existing material

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[8]The parties dispute how Catamaran calculated its bid. Plaintiffs contend that Spherion was aware that Catamaran used an earnings before interest, taxes, depreciation and amortization ("EBITDA") based multiplier when it valued Interim. Spherion, on the other hand, alleges that Catamaran never disclosed how it calculated its bid and that, to this day, Spherion does not know how Catamaran arrived at its final offer. Although the Court recognizes that a factual dispute exists with respect to this issue, it is not a "material" issue of fact in the context of the issues raised in this motion.

[9]The record reveals that plaintiffs undertook some due diligence prior to the submission of Catamaran's final bid.

> overpayments due and owing to any other third party payor from any member of the Seller Group.

The Agreement also contained representations and warranties not specifically addressing Medicare reimbursements but arguably broad enough to cover claims arising from them. Spherion warranted in Section 3.20 that, with the exception of specifically identified claims, it was not aware of any actual or threatened litigation against Interim. In Section 3.29, Spherion warranted that there were no undisclosed liabilities that would have a "Material Adverse Effect" on Interim.[10]

Significantly, Spherion stopped short of specifically warranting that a future audit of Interim's cost reports would not reveal an overpayment by Medicare. Indeed, the absence of this warranty—perhaps better characterized as an indemnity provision—is quite conspicuous given the attention paid by the parties to Medicare reimbursement issues in the Agreement. Both parties clearly were experienced in the healthcare field, and it is evident from the record that both parties knew prior to the sale that Medicare audits were common and that the outcome of the audits were not certain.[11] The parties knew full well that the audits were conducted by fiscal intermediaries over whom they had no control. Indeed, it was fully understood that the fiscal intermediaries were retained by HCFA to insure that Medicare was paying to providers no more than it owed. Since the audit was being conducted at the request and on behalf of the party paying the bills, the auditor's motivation to conduct a careful and thorough audit was understood by all who participated in the Medicare program. The absence of a warranty or indemnity provision specifically addressing audits of Medicare cost reports is significant and likely reveals the indisputable reality that no one can say for sure how a Medicare audit will turn out until the auditor delivers the good or bad news.

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[10]"Material Adverse Effect" is defined in the Agreement as "any change of effect that, individually or in aggregate, is materially adverse to the financial condition, business or results of operations of the Healthcare Business taken as a whole."

[11]Plaintiffs were familiar with the audit process long before they considered an acquisition of Interim. During the due diligence review of Interim, plaintiffs own healthcare consultants reported that Interim had been the subject of past audits and that adjustments had been made as a result of those audits. They also predicted that an audit of 1996 cost reports would occur but predicted that man power constraints would likely limit the scope of the audit. Moreover, both parties were aware that the government had launched "Operation Restore Trust," an investigatory initiative targeting home healthcare companies. In this environment of heightened scrutiny, an audit of Interim's cost reports was all the more likely.

E. The Audit

In 1998, less than a year after the sale, Interim's fiscal intermediary, Palmetto Government Benefits Administrators ("PGBA"), announced that it would conduct an audit of Interim's 1996 cost reports.[12] An audit of the 1997, 1998 and 1999 cost reports followed. In a letter dated October 16, 1998, PGBA proposed several adjustments to Interim's accounting methodology. Since the adjustments would have resulted in Interim refunding millions of dollars to the government, Interim retained counsel and Medicare specialists to assist in its negotiations with PGBA and HCFA.[13] Spherion also participated in these negotiations. Over the course of two years, Interim convinced HCFA to reverse many of the adjustments proposed by PGBA. Other adjustments were endorsed by HCFA.[14] After HCFA asserted its final position, PGBA issued Notices of Program Reimbursement ("NPR's") to Interim's network of providers pursuant to which Medicare payments to Interim were withheld to pay down the liability to HCFA.

In September of 2001, Interim reached an agreement with its creditors to restructure the company and settled with HCFA. As a result of the settlement agreement, and with Spherion's approval, Interim paid the government approximately $5.2 million as a global settlement for overpayments received in fiscal years 1994 and 1996 through 1999.

During the course of negotiations with PGBA, plaintiffs discovered documents indicating that Aetna had expressed concerns to Interim in 1995 regarding Interim's cost allocation methodology. Spherion did not provide these documents to plaintiffs during due diligence nor did it disclose their content. According to plaintiffs, these documents reveal that Spherion was on notice that Interim's fiscal intermediary was not satisfied with its cost reports and that an audit likely would result in a substantial overpayment

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[12]Prior to the sale, Interim's fiscal intermediary had been Aetna Life Insurance Company ("Aetna"). For reasons not entirely clear in the record, HCFA assigned Interim to PGBA shortly before the closing. Spherion has argued that PGBA took a much more aggressive view toward cost reporting methodology than Aetna had taken over the years, and that it reneged on several agreements Interim had reached with Aetna in connection with past audits of Interim's cost reports. Spherion maintains that PGBA's audit process was flawed and its audit results contrary to Medicare policy and regulations.

[13]Plaintiffs initially calculated that PGBA's proposed adjustments would result in a $40 million liability to HCFA.

[14]The final overpayment calculated by HCFA was approximately $12 million. Of this amount, plaintiffs attribute roughly $7.6 million to 1996 overpayments. The cost reports for fiscal year 1996 were the only reports subject to audit that predated the sale. Spherion contends, therefore, that they were the only cost reports audited by PGBA that were subject to the representations and warranties in the Agreement.

liability for Interim. Plaintiffs contend that Spherion purposefully withheld this information during due diligence.

III. The Procedural History

Plaintiffs filed their complaint in the Superior Court on September 25, 2000. In their initial pleading, plaintiffs alleged that Spherion breached the Agreement and committed fraud by failing to disclose during due diligence that Interim was the defendant in a medical negligence suit involving severe neurological injuries to a young child. In April of 2001, plaintiffs sought to amend the complaint to remove the fraud claim and to include allegations regarding the Medicare overpayment and prayers for equitable relief (rescission and reformation). Plaintiffs argued that because they were unable to allege that Spherion had knowingly misled them with respect to the Medicare overpayments, they could not seek legal reformation and were limited, therefore, to equitable reformation in the Court of Chancery. The Court agreed. The motion to amend was granted and the equitable claims and associated legal claims were transferred to the Court of Chancery.[15] The Superior Court retained jurisdiction over the remaining legal claims.[16] Several months later, the parties stipulated to consolidate the actions for discovery purposes and to resolve the claims at a consolidated bench trial.

IV. The Parties' Contentions

Plaintiffs have alleged that the net effect of PGBA's audit was an overstatement of income in Interim's pro forma income statements for 1996 of $3.8 million. Based on the EBITDA multiplier plaintiffs allege was utilized to value Interim, the purchase price was inflated by $24,000,000. Plaintiffs seek reformation of the Agreement to reflect the true value of Interim at the time of the sale. They allege that the parties labored under a mutual mistake of fact with respect to the extent of Interim's exposure to HCFA for overpayments received in 1996. Because the pro forma income statements assumed no exposure to HCFA beyond Interim's Medicare reserves, and because both parties knew that plaintiffs were relying upon the income statements to value the company, the mistake was mutual and related to a fact material the Agreement—the purchase price. According

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[15] *Catamaran Acquis. Corp. v. Spherion Corp.*, 2001 Del. Super. LEXIS 227, at *27-28 (concluding that only the Court of Chancery could reform a contract when the basis for reformation was mutual mistake based on an innocent misrepresentation).

[16] *Id.*

to plaintiffs, the Agreement should be reformed to reduce the purchase price from $134 million to $110,766,551.

Alternatively, plaintiffs allege that Spherion knew that its cost reports were not accurate but failed to disclose this to the plaintiffs during pre-sale negotiations. Because Spherion knew that plaintiffs were relying upon inaccurate pro forma income statements to value Interim, but remained silent with respect to the Medicare overpayment issue, plaintiffs contend that reformation is the appropriate remedy to correct their unilateral mistake.

On August 29, 2003, Spherion filed a Motion for Partial Summary Judgment on Plaintiffs' reformation claim. Spherion contends that plaintiffs have not set forth clear and convincing evidence of a mutual mistake that would warrant reformation. In this regard, Spherion urges the Court to take note of Cornerstone's sophistication in the healthcare market and the breadth of their due diligence. Moreover, Spherion asserts that the Agreement reflects the true intent of the parties after months of arms-length negotiations. If Spherion breached the Agreement, damages will provide the plaintiffs with full, fair and complete relief.

V. Discussion

A. Standard of Review

Summary judgment is appropriate when no genuine issues of material fact exist and the moving party is entitled to judgment as a matter of law.[17] The Court will view the evidence in the light most favorable to the non-moving party.[18] The initial burden of showing that no material issues of fact exist and, in the case of a defense motion, that the plaintiff's claims are not viable as a matter of law, rests with the moving party.[19] When the defendant meets this burden, the burden shifts to the plaintiff to demonstrate that material issues of fact exist and that the claims are valid as a matter of law.[20]

B. Reformation

Plaintiffs seek the equitable remedy of reformation. Implicit in their prayer for relief, therefore, is an allegation that they have no adequate

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[17] *Wilson v. Joma, Inc.*, 537 A.2d 187, 188 (Del. 1988).

[18] *Alabi v. DHL Airways, Inc.*, 583 A.2d 1358, 1361 (Del. Super. 1990).

[19] *Moore v. Sizemore*, 405 A.2d 679, 680 (Del. 1979).

[20] *State v. Regency Group, Inc.*, 598 A.2d 1123, 1129 (Del. Super. 1991).

remedy at law.[21] In tandem with their reformation claim, plaintiffs also have alleged that Spherion breached various warranty provisions in the Agreement for which they seek compensatory damages, including the amount they allege they overpaid for Interim as a result of the non disclosure of the 1996 Medicare overpayment. At oral argument, counsel for plaintiffs acknowledged that the Court need not address the reformation claim at trial if the plaintiffs prevail on their breach of warranty claim. Before the Court addresses the merits of the reformation claim, it must first consider whether equity has a proper place in this controversy given what, at first glance, appears to be an available and adequate remedy at law.

"Reformation is an equitable remedy which emanates from the maxim that equity treats that as done which ought to have been done."[22] The purpose of reformation is to correct a contract in order to express the true agreement of the parties.[23] The Court will reform a contract only when the plaintiff has demonstrated with clear and convincing evidence that a valid oral agreement exists and that the terms of that agreement are not properly reflected in the written instrument.[24] Plaintiffs must also demonstrate, with clear and convincing evidence, that the reason the written instrument does not reflect the parties' true agreement is either that both parties were under the mistaken impression that the scrivener had properly memorialized the agreement in the instrument, or that one party was mistaken in this regard and the other, knowing of the mistake, remained silent.[25] Typically, the claim for reformation will be coupled with a claim for damages for breach of the reformed contract or specific performance.[26]

Here, plaintiffs have identified several warranties and representations in the Agreement which they contend were violated when Spherion failed to submit proper cost reports to Medicare and failed to disclose this fact during due diligence. The warranties upon which plaintiffs rely clearly express the intentions of the parties; plaintiffs do not seek to reform them. Instead, plaintiffs contend that, based on develop-

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[21]*See El Paso Natural Gas Co. v. Transmission Gas Co.*, 669 A.2d 36, 39 (Del. 1995)(equity will not intervene when the plaintiff can obtain full, fair and complete relief at law); *Gordon v. Nat'l Railroad Passenger Corp.*, 1997 Del. Ch. LEXIS 52, at *16 (same).

[22]27 WILLISTON ON CONTRACTS §70:19 (4th Ed. 2003).

[23]*Cerebrus Intern, Ltd. v. Apollo Management, L.P.*, 794 A.2d 1141, 1151 (Del. 2002), citing *Colvocoresses v. W.S Wasserman Co.*, 28 A.2d 588, 589 (Del. Ch. 1942).

[24]*See Gracelawn Memorial Park, Inc. v. Eastern Memorial Consult., Inc.*, 280 A.2d 745, 748 (Del. Ch. 1971).

[25]*See Amstel Assoc., L.L.C. v. Brinsfield-Cavall Assoc.*, 2002 Del. Ch. LEXIS 54, at *15-16, citing *Collins v. Burke*, 418 A.2d 999, 1002 (Del. 1980).

[26]*See* DOBBS, REMEDIES §4.3, at 256 (West 1973)("Reformation is almost always sought so that some other remedy may then be pursued.").

ments which occurred after the sale (the PGBA audit), they now believe the purchase price provision of the Agreement does not reflect the true agreement of the parties. Yet, they acknowledge that if they prevail on their breach of warranty claim, the Court need not rewrite the purchase price provision because breach damages will include the difference between the purchase price and the actual value of Interim at the time of the sale.

Plaintiffs' claim for reformation is misplaced for two reasons. First, it is clear that plaintiffs have an adequate remedy at law. Their breach of warranty claim is legally viable, procedurally postured for prompt disposition and, if successful, a proper vehicle for full, fair and complete relief.[27] The fact that plaintiffs may not sustain their burden of proof at trial with respect to the breach of warranty claim does not mean that an adequate remedy at law is not available to them.[28] If they sustain their burden of proof at trial, breach damages will adequately compensate them if they paid too much for Interim.[29]

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[27]*See Theis v. Board of Educ.*, 2000 Del. Ch. LEXIS 48, at *5 ("This Court cannot exercise its equity jurisdiction on any claim where an adequate remedy at law is available. An adequate remedy at law must be as complete, practical, and efficient to the ends of justice and to its prompt administration as the equitable remedy. In order to divest this Court of equity jurisdiction, the legal remedy must afford plaintiff 'full, fair and complete relief. "')(citations omitted); 1 POMEROY, EQUITY JURISPRUDENCE, § 178, at 247 (5th Ed. 1941)("Even when the cause of action . . . does involve some particular feature . . . over which the concurrent jurisdiction normally extends [such as fraud, mistake accident, trust, accounting, etc.] . . . , if the legal remedy by action and pecuniary judgment for debt or damages would be complete, sufficient and certain—that is, would do full justice to the litigant parties—in the particular case, the concurrent jurisdiction of equity does not extend to such case.").

[28]*See Willing v. Mazzocone*, 393 A.2d 1155,1158 (Pa. 1978)("In deciding whether a remedy is adequate, it is the remedy itself, and not its possible lack of success that is the determining factor."); *Chartiers Valley School Dist. v. Virginia Mansions Apts., Inc.*, 489 A.2d 1381, 1386 (Pa. Super. 1985)("the adequacy of a legal remedy is not measured by the success or failure of a legal claim.").

[29]The Court is mindful that plaintiffs pled reformation as an alternative basis for relief in the event Spherion successfully defends the breach of warranty claim on the ground it was mistaken regarding the extent of the Medicare overpayment liability. The Court also recognizes that pleading alternative grounds for relief is appropriate under the Court's rules. *See* Del. Ch. Ct. R. 8(d)(2). *See also The Travelers Indem. Co. v. North American Phillips Corp.*, 1992 Del. Ch. LEXIS 187, at *5-6 (noting that reformation may be pled as an alternative basis for relief to legal claims). But, in this case, where plaintiffs have acknowledged that the warranties they contend were breached are clearly and unambiguously stated in the Agreement, and that breach damages will fully and completely compensate them for their alleged losses, the Court is hard-pressed to find a justification for allowing a reformation claim to proceed to trial. The "best knowledge" warranties that would allow a mistake defense to be presented were thoroughly negotiated and drafted in the Agreement as intended by both parties. The case is now well beyond the pleadings stage—plaintiffs have been given a full and fair opportunity to develop a factual record in support of their reformation claim. What this record reveals, however, is that damages will provide an available, full, fair, prompt, and practical remedy. Under these circumstances, plaintiffs' prayer

Reformation is not available here for another reason. As stated, reformation is appropriate when the parties mistakenly believed that the written instrument properly memorialized their agreement when, in fact, it did not.[30] Under such circumstances, the court will reform the contract to reflect the definitive agreement reached by the parties. To do so, the court must be presented with clear evidence of the agreement; without this evidence, "there would be no standard by which the writing could be reformed."[31] As Professor Williston explains:

> It is not enough that the parties would have come to a certain agreement had they been aware of the actual facts. Reformation requires an antecedent agreement, which the written instrument attempts to express. However, any mistake must have been in the drafting of the instrument, not in the making of the contract. An instrument will not be reformed due to a mere misunderstanding of the facts, or a mistake as to an extrinsic fact which, if known, would probably have induced the making of a different contract or no contract at all. If there has been any misunderstanding between the parties, or a misapprehension by one or both, so that there is no mutuality of assent, then the parties have not made a contract, and neither will the court do so for them.[32]

Plaintiffs' prayer for reformation in this case is tantamount to a request that the Court write a new contract for the parties. As of the date of the Agreement, it is undisputed that neither party knew for a fact that PGBA would conduct an audit, much less what the results of any such audit might be. Indeed, as a practical matter, it would be impossible for either party to predict the outcome of an audit over which they have no control. At most, then, plaintiffs have identified a mutual "mistake" of the parties with respect to their predictions regarding the outcome of a future event. For purposes of reformation, this is no "mistake" at all.[33]

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for equitable relief must give way to the relief available at law.

[30]27 WILLISTON ON CONTRACTS §70:19, at 255 (4th Ed. 2003)("The purpose of reforming a contract on the basis of mutual mistake is to make a defective writing conform to the agreement of the parties upon which there was mutual assent.").

[31]*Id.*

[32]*Id.* at 255-56.

[33]*Dairyland Power Coop. v. United States*, 16 F.3d 1197, 1202-1203 (Fed. Cir.1994), citing RESTATEMENT (SECOND) OF CONTRACTS § 151 cmt. a (1981)("A party's prediction or judgment as to events to occur in the future, even if erroneous, is not a 'mistake' as that word is

Moreover, it is clear that the Agreement as drafted accurately reflects the parties' agreement with respect to price as it existed when the Agreement was made. The Agreement, including its purchase price provision, was the product of an active auction, lengthy negotiations and extensive due diligence. There was no mistake in the drafting of the instrument itself; no "scivener's error" occurred here. Indeed, it would appear that plaintiffs now take the position that if they had known of Interim's liability for Medicare overpayments, they would have reached a different agreement altogether with respect to price, or might not have made an offer for Interim at all. Plaintiffs' misunderstanding does not make a case for reformation.[34] If warranties with respect to Medicare claims or future liabilities have been breached, plaintiffs may seek appropriate compensatory damages.

For the first time in their answering brief (in a footnote), plaintiffs have offered an alternative basis for reformation: the court must rewrite the contract because Spherion knew that its cost reports were problematic but failed to disclose this fact during due diligence.[35] This new argument is troubling given the procedural history of this case. At the time plaintiffs sought to amend their complaint to add new claims,[36] including equitable claims, they also sought to transfer the case from the Superior Court to the Court of Chancery. They argued they had no basis to plead fraud and, indeed, the fraud count was dropped from the amended complaint.[37] Under these circumstances, they correctly observed that the Superior Court could not grant a remedy for an innocent misrepresentation; only the Court of

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defined.").

[34]The following example from the RESTATEMENT (SECOND) OF CONTRACTS §51, cmt. a, (1981), illustrates this point:

> Illustration 2: A contracts to sell and B to buy stock amounting to a controlling interest in C Corporation. At the time of making the contract, both A and B believe that C Corporation will have earnings of $1,000,000 during the following fiscal year. Because of a subsequent economic recession, C Corporation earns less than $500,000 during that year. Although B may have shown poor judgment in making the contract, there was no mistake of either A or B.

[35]D.I. 89, at 23.

[36]The proposed amended complaint was essentially a rewrite of the complaint. The pleading went from 56 to 134 paragraphs and from two to six counts. (D.I. 1; D.I. 7, at Exh. A).

[37]D.I. 7, at 5 ("[I]t appears that the Interim plaintiffs' claim for fraud is not viable, and therefore, should be withdrawn.").

Chancery could intervene under such circumstances.[38] The Court agreed and transferred the reformation claim to the Court of Chancery.[39]

At no time during the more than two years this case has been pending in this Court have plaintiffs sought to amend their complaint to plead unilateral mistake or fraud at all, much less with requisite particularity.[40] And, at this late date, such an application would be spurious at best. Plaintiffs allege they first uncovered the information which forms the basis of their unilateral mistake argument—Aetna's correspondence to Interim raising concerns regarding its cost allocation methodology—during the course of the PGBA audit. Aetna's expressions of concern, therefore, were well known to plaintiffs at the time they filed their first complaint (which made no mention of the Medicare overpayment issue) and their amended complaint (which described the Medicare overpayment in detail but made no mention of concealed information). An amendment on the eve of trial, under these circumstances, would not be appropriate.

Plaintiffs' unilateral mistake argument also suffers from the same fatal infirmity as their mutual mistake argument. Plaintiffs cannot point to a definitive agreement of the parties to which the Court can refer when reforming the Agreement. There is no evidence that the parties would have agreed to a lesser price for Interim had Spherion placed Aetna's alleged problems with Interim's cost reports front and center on the negotiating table. Indeed, the undisputed record suggests the contrary. Spherion disagreed with Aetna's criticisms of its cost reports and intended to challenge Aetna's position in the event of an audit. There is absolutely no basis to argue from the record that Spherion would have accepted less for Interim at the time it negotiated the Agreement even if Aetna's concerns were a feature of the parties' negotiations. The Court will not rewrite the Agreement in the absence of clear and convincing evidence that another agreement was, in fact, reached by the parties.[41] That predicate cannot be proven in this case. Consequently, reformation is not the solution to plaintiffs' problems here.

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[38]*Catamaran*, 2001 Del. Super. LEXIS 227, at *11-12, citing *E.I. DuPont De Nemours & Co. v. HEM Research, Inc.*, 1989 Del. Ch.. LEXIS 132, at *14, n.12; *In re Brandywine Volkswagon*, 306 A.2d 24, 28 (Del. Super. 1973).

[39]*Catamaran*, 2001 Del. LEXIS 227, at *26-28.

[40]*See* Del. Ct. Ch. R. 9(b)("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity."). *See also* D.I. 4 at ¶¶ 37-47.

[41]*Cerebrus*, 794 A.2d at 1151.

C. Rescission

Spherion has moved for summary judgment only with respect to plaintiffs' claim for reformation. In its brief, Spherion indicates that it is not seeking summary judgment on plaintiffs' rescission claim because the Superior Court, in its decision on plaintiffs' motions to amend and transfer, already has determined that rescission is not practical in this case. This characterization of the Superior Court's decision is accurate. When determining whether to allow plaintiffs to amend their complaint to add equitable claims, and whether to transfer these claims to the Court of Chancery, the Superior Court observed that it would be all but impossible to unwind a transaction involving the sale of a company which occurred more than six years ago.[42] The Court concluded, therefore, that the rescission claim was "futile" for purposes of the required analysis under Court of Chancery Rule 15.[43] The Court did, however, specifically leave the door open for a rescissory damages claim.[44]

Spherion has not moved for summary judgment on plaintiffs' claim for rescissory damages and the Court is not inclined to address it *sua sponte*. By declining to address the rescissory damages claim, however, the Court does not intend to suggest that the claim is legally viable. Spherion may argue at trial that rescissory damages are not appropriate either because they are not supported by the factual record, not supported as a matter of law, or both. Indeed, given the Court's decision with respect to the reformation claim, it is only fair to warn the plaintiffs that they willlikely face a tough road ahead with respect to the rescissory damages claim.[45] The ultimate decision in this regard, however, will await trial.

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[42]*Catamaran*, 2001 Del. Super. LEXIS 227, at *15-16 ("The Court is satisfied . . . that the Court of Chancery would find it 'impossible to unscramble the eggs' by rescinding the Agreement [a]nd, therefore, . . . [the] equitable rescission claim—at least in its current form—is futile for purposes of Rule 15."), citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983); *Lynch v. Vickers Energy Corp.*, 429 A.2d 497, 501 (Del. 1981); *Stegemeier v. Magness*, 728 A.2d 557, 565 (Del. Ch. 1999); *Harman v. Masoneilan Intern'l, Inc.*, 418 A.2d 1004, 1006-07 (Del. Ch. 1980); *Gimbel v. Signal Cos., Inc.*, 316 A.2d 599, 603 (Del. Ch. 1974)).

[43]At the time this judge addressed this question he was attempting to predict how the Court of Chancery would respond to the prayer for equitable rescission in order to decide the jurisdictional issue. *Catamaran*, 2001 Del. LEXIS 227, at *14. I stopped short of finally adjudicating the claim, however, so that the Court of Chancery could determine on its own whether the rescission claim was appropriate. Now that I have been designated to sit as the Vice Chancellor in this case, and having had the opportunity to consider the issue again, I am satisfied that I properly determined that the rescission claim was futile and that it should not be presented at trial.

[44]*Catamaran*, 2001 Del. Super. LEXIS 227, at *19 ("plaintiffs will have their opportunity to seek . . . rescissory damages in the Court of Chancery.").

[45]*See Liberto v. Bensinger*, 1999 Del. Ch. LEXIS 241, at *29 (rescission not

VI. Conclusion

Based on the foregoing, the Motion for Summary Judgment is **GRANTED** with respect to plaintiffs' claim for reformation. Plaintiffs' prayer for rescission is not practical in this case and, therefore, the Court will not consider the claim at trial. Plaintiffs' claim for rescissory damages, however, will be adjudicated at trial along with the breach of warranty claims. Because the matter will be tried as a consolidated bench trial, and because the breach of warranty claims are all the subject of a separate motion for summary judgment, the Court has determined that the most efficient alignment of the claims for trial is as follows: the rescissory damages claim will be litigated in the Court of Chancery action; the breach of warranty claims, including the claims relating to the Medicare overpayment, will be litigated in the Superior Court action.[46]

IT IS SO ORDERED.

LEWIS v. WARD

No. 15,255

Court of Chancery of the State of Delaware, New Castle

October 29, 2003

Joseph A. Rosenthal, Esquire, and Norman M. Monhait, Esquire, of Rosenthal Monhait Gross & Goddess, P.A., Wilmington, Delaware; A. Arnold Gershwin, Esquire, of A. Arnold Gershwin, P.C., New York, New York, of counsel; and Irving Bazar, Esquire, of Balloon Stoll Bader & Nadler, P.C., New York, New York, of counsel, for plaintiff.

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appropriate when alleged mistake or misrepresentation relates to an opinion about a probable future event). *See also Elysian Federal Savings Bank v. Sullivan*, 1990 Del. Ch. LEXIS 30 (claims for breach of warranty and rescission are inconsistent and, in appropriate cases, plaintiffs must elect one remedy to the exclusion of the other).

[46]*See* DEL. CODE ANN., tit. 10, § 1902 (1999)(court may remove or transfer claims to another State court of competent jurisdiction).

David C. McBride, Esquire, and James P. Hughes, Jr., Esquire, of Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware, for defendants Milton H. Ward, Allen Born, and Gerald L. Malys.

William M. Lafferty, Esquire, of Morris Nichols Arsht & Tunnell, Wilmington, Delaware, for defendants Vernon F. Taylor, Jr. and Russell L. Wood.

Joel E. Friedlander, Esquire, of Bouchard Margules & Friedlander, P.A., Wilmington, Delaware, for defendant Cyprus Amax Minerals Company.

Thomas P. Preston, Esquire, of Blank Rome, LLP, Wilmington, Delaware, for defendant Amax Gold, Inc.

STRINE, *Vice Chancellor*

The plaintiff in this derivative action lost her stockholder status in an arm's-length merger. Because she has failed to plead facts that support a reasonable inference that the merger that caused her to lose her status as a stockholder was a fraud perpetrated merely to deprive her of her ability to press her derivative claims, she lacks standing under the teaching of *Lewis v. Anderson*. Therefore, the court will grant the defendants' motion to dismiss her complaint.

I. Background

In this derivative action, the plaintiff alleges that in 1996 the then-majority stockholder of Amax Gold, Inc. provided Amax Gold with financing on terms that were unfair. The plaintiff was a stockholder of Amax Gold on October 8, 1996, when this suit was filed.

On June 1, 1998, Amax Gold merged with a subsidiary of Kinross Gold Corporation ("Kinross") in a reverse triangular merger. The plaintiff in this action never directly challenged the fairness of that arm's-length, third-party merger.[1] As a result of the merger, Amax Gold[2] became a wholly owned subsidiary of Kinross, and all of the shares of Amax Gold

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[1]There was litigation filed by other stockholders of Amax Gold seeking, among other things, to enjoin consummation of the merger. *Ratzersdorfer v. Ward*, C.A. No. 16189 (Del. Ch. filed Feb. 13, 1998). That case was not actively litigated and was dismissed pursuant to a stipulation of dismissal.

[2]Amax Gold was later renamed. I use its original name for the sake of clarity.

were converted into the right to receive shares of Kinross. Thus, the plaintiff lost her shares in Amax Gold and became a Kinross stockholder. Kinross was and remains an Ontario corporation.

After the merger, the defendants in this derivative action—who include Amax Gold's directors at the time of the financing and its then-majority stockholder Cyprus Amax Minerals Company—moved to dismiss the complaint on the grounds that the plaintiff's loss of her Amax Gold stockholder status deprived her of the right to press the derivative action, under the teaching of *Lewis v. Anderson*[3] and its progeny.[4]

This court, through then-Vice Chancellor Jacobs, granted the defendants' motion to dismiss, finding that the merger divested the plaintiff of standing to pursue her claims and that she had not pled facts demonstrating the applicability of what I will refer to as the "fraud exception" to *Lewis v. Anderson*.[5] To wit, he rejected the plaintiff's argument that she had "pled facts that bring this case within the exception where the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive the plaintiff of derivative standing."[6]

Thus Vice Chancellor Jacobs held:

> The difficulty with the plaintiff's position is that the complaint does not plead facts from which it could be reasonably inferred that the defendants perpetrated the merger *merely* to deprive the plaintiff of derivative standing. Because the plaintiff's brief suggests that the plaintiff may be able to plead such a claim, however, the defendants' motion to dismiss will be granted with leave to amend.[7]

Vice Chancellor Jacobs's ruling is, of course, law of the case.[8]

On October 13, 2000, the plaintiff filed her amended complaint in response to Vice Chancellor Jacobs's ruling and attempted to plead facts invoking the fraud exception to *Lewis v. Anderson*. The defendants then

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[3]477 A.2d 1040 (Del. 1984).

[4]*E.g., Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 354-55 (Del. 1988); *In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851, 867-68 (Del. Ch. 1998), *aff'd sub nom. Bradley v. First Interstate Bancorp*, 748 A.2d 913 (Del. 2000) (ORDER); *Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1244-45 (Del. 1999); 8 Del. C. § 327.

[5]*Lewis v. Ward*, 2000 WL 1336721, at * 1 (Del. Ch. Aug. 28, 2000).

[6]*Id.* (internal quotation marks and citations omitted). *See also Kramer*, 546 A.2d at 354-55; *Lewis v. Anderson*, 477 A.2d at 1046 n.10.

[7]*Lewis v. Ward*, 2000 WL 1336721, at *1 (emphasis added).

[8]*E.g., Frank G.W. v. Carol M.W.*, 457 A.2d 715, 718 (Del. 1983).

moved to dismiss arguing that the plaintiff had again failed to plead facts supporting application of that exception. But the defendants did not file their opening brief until March 30, 2001. The plaintiff took an equally luxurious period to answer, filing its brief on March 26, 2002. The defendants then replied in late January of 2003.

By that time, Amax Gold had moved its corporate home from Delaware to Nevada. When Vice Chancellor Jacobs joined the Supreme Court, this case was assigned to me and the defendants' motion to dismiss was scheduled for argument.

II. Legal Analysis

The defendants' renewed motion to dismiss is based on a simple and direct argument: The plaintiff has failed to plead facts supporting a reasonable inference that the merger was a fraud designed merely to deprive her of derivative standing. As such, the complaint must be dismissed in accordance with Vice Chancellor Jacobs's prior ruling and *Lewis v. Anderson.*

In response, the plaintiff makes two arguments. First, she contends that her amended complaint does plead sufficient facts to invoke the fraud exception to *Lewis v. Anderson.* Second, she contends that regardless of whether that is the case, Nevada law and not Delaware law now governs her standing to pursue her suit because Nevada is now the home of Amax Gold. She asks me to conclude that Nevada would not follow *Lewis v. Anderson* but instead apply a more lenient approach that would permit a former stockholder in her position to continue a derivative suit.

I deal with these arguments in reverse order, starting with the choice-of-law question.

A.

The choice-of-law question the plaintiff poses could be an interesting one in the right case. The issue of whether a derivative plaintiff should be permitted to press a cause of action on behalf of a corporation is, in key respects, a policy matter about the allocation of authority between the corporation's board and its stockholders and other constituencies. In this case, the plaintiff argues that the merger that divested her of her Amax Gold shares did not end her interest in the affairs of Amax Gold. As a Kinross stockholder, she retains an important ongoing interest in the financial health of Amax Gold, because Amax Gold has become a wholly owned subsidiary of Kinross. Because Amax Gold has chosen to become a Nevada corporation, the plaintiff argues that Nevada law—and not that

of Delaware—should determine whether she can advance a claim derivatively on behalf of that Nevada corporation. She argues that this prudential matter of public policy is one in which Delaware no longer has an interest.[9]

In answer, the defendants argue that once the plaintiff lost "standing"under *Lewis v. Anderson*, she lost it forever and that it cannot be revived by Amax Gold's later reincorporation into Nevada. In support of this argument, the defendants argue that there is a need for certainty as to the law that applies to derivative actions or otherwise directors will not be able to assess their own exposure to liability and stockholders will not know to what standards of accountability they may hold their directors.

This is a nice debate that I need not and therefore do not enter.[10] Although the plaintiff argues that "there is no reason to believe that Nevada would adopt the reasoning of *Lewis v. Anderson*," she concedes that she was unable to find a judicial decision in Nevada taking a different approach than that Delaware decision.[11] Where there is no Nevada law on point,

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[9]The debate is an even deeper one than the parties' papers explore. Arguably, the key issue is whether the plaintiff can cause a double derivative suit to be brought in the interest of Kinross, an Ontario corporation. That is, it is arguably Ontario that has the greatest interest in determining whether the plaintiff can proceed with a case brought in the interest of a wholly owned subsidiary of an Ontario corporation. In this regard, the plaintiff's pleas about equity are far less convincing because in the *five* years since the merger she never attempted to assert a double derivative action on behalf of Kinross or to demand that Kinross cause Amax Gold to press her claims. Nor, I note, has she argued that Ontario law is relevant to the resolution of this motion.

[10]The question is a subtle one. For example, it seems to me obvious that Delaware law would apply to determine whether the defendants had committed any breach of duty against Amax Gold in connection with the financing that is challenged in the amended complaint. To find that the change in domicile of Amax Gold changed the law that applied to the merits would be a highly troubling conclusion, disruptive of the defendants' settled expectations. The proposition that the law of Kinross's or Amax Gold's home jurisdiction might govern whether a former Amax Gold stockholder could continue to press claims that belonged to Amax Gold before the merger when that stockholder continues to own Kinross stock is a less extreme one.

[11]Pl.'s Opp'n Br. at 3. Through independent research, I discovered some authority suggesting that Nevada would in fact follow *Lewis v. Anderson*. Nevada law, like that of many states, generally requires derivative plaintiffs to maintain stockholder status throughout the litigation. *See* NEV. R. CIV. P. 23.1; *Keever v. Jewelry Mountain Mines, Inc.*, 688 P. 2d 317, 317 (Nev. 1984) ("Under the contemporaneous ownership requirements of NRCP 23.1, a representative plaintiff must have owned stock in the corporation at the time of the transaction of which he complains *and throughout the pendency of the suit*." (emphasis added) (internal quotation marks and citations omitted)). Although there do not appear to be any Nevada cases directly addressing the precise issue before the court now, the Nevada Supreme Court has stated that former stockholders lack standing to pursue derivative claims. *See Cohen v. Mirage Resorts, Inc.*, 62 P.3d 720, 732 (Nev. 2003). As support for this proposition, *Cohen* cited two Delaware Supreme Court decisions following the holding of *Lewis v. Anderson* that a derivative plaintiff who loses stockholder status as a result of a merger loses standing to maintain the action. *See id.* at 732 & nn.70, 72 & 76 (Nev. 2003) (citing *Parnes v. Bally Entm 't Corp.*, 722 A.2d 1243, 1244-

courts applying Nevada corporate law have traditionally looked to Delaware law for guidance.[12] Moreover, scholars have noted the extent to which Nevada has attempted to conform its corporate law to that of Delaware.[13] Therefore, I have every reason to anticipate that the Nevada Supreme Court would adopt the rule of *Lewis v. Anderson* as Nevada law, and no reliable basis to infer that it would take another approach. Thus, the governing principles that apply are identical whether Delaware law or Nevada law applies to the question of whether the plaintiff may proceed to press claims belonging to Amax Gold.

B.

Having decided that *Lewis v. Anderson* governs, I now turn to the question of whether the plaintiff has pled facts invoking the fraud exception to the general rule that the loss of stockholder status in a merger divests a

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45 (Del. 1999) and *Kramer*, 546 A.2d at 351).

Indeed, one of the authorities cited by the plaintiff actually undermines her argument that Nevada might choose not to follow *Lewis v. Anderson*. The plaintiff notes that the American Law Institute has proposed a rule in which a derivative plaintiff could maintain suit following the loss of stockholder status if that loss

> is the result of corporate action in which the holder did not acquiesce, and either (A) the derivative action was commenced prior to the corporate action terminating the holder's status, or (B) the court finds that the holder is better able to represent the interests of the shareholders than any other holder who has brought suit.

Principles of Corp. Governance § 7.02(a)(2) (2003). But, it is unlikely that Nevada would choose the ALI rule over *Lewis v. Anderson*, because the comment to § 7.02 explicitly states that it departs from the majority approach to the continuous-ownership rule. *See id.* § 702 cmt. a.

[12]*See Cohen*, 62 P.3d at 726 n. 10 ("Because the Legislature relied upon the Model Act [in the particular respect before the court] and the Model Act relies heavily on New York and Delaware case law, we look to the Model Act and the law of those states in interpreting the Nevada statutes."); *Hilton Hotels Corp. v. ITT Corp.*, 978 F. Supp. 1342, 1346 (D. Nev. 1997) ("Where, as here, there is no Nevada statutory or case law on point for an issue of corporate law, this Court finds persuasive authority in Delaware case law."); *Shoen v. AMERCO*, 885 F. Supp. 1332, 1341 n.20 (D. Nev. 1994) ("Where there is no Nevada precedent on point . . . this court must predict how Nevada's supreme court would decide the question. . . . On questions of corporation law, the Delaware Supreme Court and the Delaware Courts of Chancery are persuasive authorities.").

[13]*See* Jill E. Fisch, *The Peculiar Role Of The Delaware Courts in the Competition For Corporate Charters*, 68 U. Cin. L. Rev. 1061, 1067 (2000) ("In addition to adopting the Delaware statute, the Nevada legislature adopted Delaware case law. Moreover, courts construing Nevada law appear to follow Delaware precedent." (footnotes omitted)); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 Colum. L. Rev. 1908, 1911 (1998) ("[I]n fact, Nevada adopted Delaware law wholesale . . . ."); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex. L. Rev. 469, 488 (1987) ("In fact, Nevada [has] adopt[ed] both the Delaware statutory and common law as it applies to corporations.").

derivative plaintiff of standing. To be fair to the plaintiff, it is useful to set forth in full the relevant portions of her complaint:

> The Subsequent Merger
>
> 26. On or about February 9, 1998, a merger was announced between the Company [Amax Gold] and Kinross. The form of the merger contemplated that the Company would become a subsidiary of Kinross, and the common stockholders of the Company would receive shares of Kinross stock in exchange for their shares of Company stock.
>
> 27. The merger proxy statement, at p. 26, describes the discussions as leading potentially to a merger of equals. At p. 33, the merger proxy statement discloses that Kinross's contribution to the combined entity ranged from 31.0% to 57.7% on the equity value measures. However, Kinross stockholders would own approximately 50% of the combined entity on an equity value basis.
>
> 28. At p. 38, it discloses that Kinross's total present value contribution would equal 45.5%. At p. 41, it discloses that the Company's contribution to the combined company ranged from 17% to 72% on equity measures and 57% to 134% on Enterprise measures. Under another analysis the Company's contribution was 45% to 53% to equity and 73% to 78% to Enterprise Value. The Company's stockholders would own approximately 50% of the equity and 67% of the Enterprise Value of the combined company.
>
> 29. The merger became effective on June 1, 1998.
>
> 30. The merger of the Company and Kinross was specifically structured and perpetrated in the form described in paragraph 26 merely to deprive the plaintiff and other common stockholders of standing to prosecute this action.
>
> 31. Moreover, there is no principled economic or equitable argument that plaintiff should lose standing here as a result of the merger between the Company and Kinross. Such loss of standing is inconsistent with basic

> economic principles as well as fundamental principles of equity and fairness.[14]

Distilled to their essence, these allegations assert that because 1) on some measures Kinross can be said to have gotten the better of the economic bargain between itself and Amax Gold in the merger; and 2) the merger could have been structured as a "straight" merger with Amax Gold as the surviving corporation (or as a triangular merger with Amax Gold surviving as the public parent entity), then a reasonable inference exists that the merger was solely designed so as to deprive the plaintiff of her standing to press her derivative claims.[15]

As an initial matter, the parties clash over whether the sufficiency of the plaintiffs' pleading is governed by the notice pleading standard of Rule 12(b)(6) or the particularity standard of Rule 9(b). The defendants contend that the heightened standard of Rule 9(b) applies because the relevant *Lewis v. Anderson* exception involves an accusation of "fraud." By contrast, the plaintiff asserts that the Supreme Court did not intend by use of the term "fraud" to place such a heightened burden on derivative plaintiffs.

In my view, the defendants have the better of this argument. The fraud exception to *Lewis v. Anderson* is just that—an exception that allows a plaintiff to show that a merger that was presented as having a legitimate business purpose was in fact entered into by one side of the deal solely for the purpose of immunizing corporate fiduciaries from liability in a pending

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[14]Am. Compl. ¶¶ 26-31.

[15]The plaintiff also argues that there is "no equitable or economic reason to dismiss a valid derivative suit brought pre-merger in order to compel a post-merger double derivative suit." Pl.'s Opp'n Br. at 6. In a double derivative suit, a stockholder of a parent corporation seeks recovery on behalf of a cause of action belonging to a subsidiary corporation. *See Sternberg v. O'Neil*, 550 A.2d 1105 (Del. 1988). Because the plaintiff might have been able to bring a post-merger double derivative suit (but did not attempt to do so), she contends, she should maintain standing to pursue the present suit.

But, the Delaware Supreme Court has already rejected this argument as inconsistent with Delaware law, and I am bound to its decisions. Nor am I free to ignore the law of the case as established by Vice Chancellor Jacobs's prior ruling. Although the Third Circuit accepted an argument similar to the plaintiff's in *Blasband v. Rales*, 971 F.2d 1034, 1040-46 (3d Cir. 1992) ("[T]he Delaware Supreme Court *sub silentio* recognized an indirect financial interest as a basis for standing in . . . Steinberg . . . [by] permit[ting] a plaintiff to pursue a double derivative suit."), both this court and the Supreme Court have rejected *Blasband*. *See In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851, 868 & n.18 (Del. Ch. 1998) ("*Blasband* is . . . inconsistent with the clear holding of *Lewis v. Anderson* . . . ."), *aff'd sub nom. Bradley v. First Interstate Bancorp*, 748 A.2d 913 (Del. 2000) (ORDER); *Ash v. McCall*, 2000 WL 1370341, at *13 & n.47 (Del. Ch. Sept. 15, 2000) ("First Interstate clearly expressed the Delaware Courts' rejection of the Third Circuit's holding in *Blasband v. Rales* . . . . [Blasband] is not consistent with the Delaware Supreme Court's holding in *Lewis v. Anderson* and, for that reason, I am not free to follow it.").

derivative suit. In analogous contexts when a breach-of-fiduciary-duty claim is premised on an accusation of fraud, this court has examined the complaint against the particularized pleading standard of Rule 9(b).[16] Here, the plaintiff argues that an arm's-length merger of two public companies was not in fact consummated for the reasons contained in the merger proxy materials, but instead merely as a device to get rid of the plaintiff's derivative claims. That is, the plaintiff argues that the merger was a classic fraud perpetrated by the Amax Gold directors and Cyprus Amax.

As important, the plaintiff here seeks to defeat what is in essence a motion under Rule 23.1. It is traditional for a plaintiff seeking to have demand excused to have to plead particularized facts.[17] There is no evident reason why a plaintiff should be able to proceed with mere notice pleading in attempting to invoke an exception to the general rule of *Lewis v. Anderson* that stockholders who lose stockholder status in a merger also lose derivative standing. This is especially the case when a plaintiff attempts to overcome *Lewis v. Anderson*'s general rule by accusing the defendants of having committed fraud, by ginning up a pretextual merger solely to deprive the plaintiff of standing. For these reasons, I therefore find that the plaintiff has to have pled particularized facts invoking the fraud exception to *Lewis v. Anderson* in order to avoid dismissal.

For reasons I now articulate, I further conclude that the plaintiff has not met that burden (or even the lesser burden that would apply under Rule 12). I begin my explanation with an obvious point. The mere fact that a merger was structured as a "triangular merger" provides no rational basis to infer that the merger was a fraud designed merely to deprive stockholders of the corporation that has lost its status as a public company of derivative standing. As the defendants point out, triangular mergers are common and have a myriad of legitimate justifications.[18] Similarly, there are numerous reasons for choosing one company rather than the other as the

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[16]*See York Linings v. Roach*, 1999 WL 608850, at *2-3 (Del. Ch. July 28,1999). *See also Dann v. Chrysler Corp.*, 174 A.2d 696,700 (Del. Ch. 1961) (holding that particularity requirement of Rule 9(b) applies to claims of "constructive" as well as "actual" fraud).

[17]*Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984).

[18]In a triangular merger, the acquirer's stockholders generally do not have the right to vote on the merger, nor are they entitled to appraisal. *See, e.g.*, 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations § 9.7, at 9-10 (3d ed. Supp. 2003). If a reverse triangular structure is used, the rights and obligations of the target are not transferred, assumed or affected. *See id.* § 9.8, at 9-1 1; James C. Freund, Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions 79 (1975). Because of these and other advantages to using a triangular structure, it is the preferred method of acquisition for a wide range of transactions. *See* 1 Lou R. Kling & Eileen T. Nugent, Negotiated Acquisitions of Companies, Subsidiaries, and Divisions § 1.02[11], at 1-19 (2001); Freund, *supra*, at 107.

surviving public company, whether the transaction is structured as a straight or triangular merger.[19]

Nothing in the plaintiff's complaint reasonably supports the inference that Amax Gold structured the merger with Kinross the way it did solely to deprive the plaintiff of standing or that it was Amax Gold that sought this structure.[20] That is, no fact in the complaint buttresses the conclusory proposition that Amax Gold rather than Kinross would have been the surviving public company in the merger but was not solely because Amax Gold's controlling stockholder and directors wished to insulate themselves from liability in this derivative action. In focusing on Amax Gold, I take a pro-plaintiff point of view, which is to read *Lewis v. Anderson* as focusing the "fraud" inquiry on the board facing a derivative suit and whether it caused the company to merge with another party simply to avoid defending the derivative suit rather than for other valid business reasons.

But even taking that friendly point of view, the plaintiff's complaint falls far short of the mark. Its pleading of excerpted economic facts from the merger proxy statement suggests, at most, that Kinross's negotiators might have done a better job than Amax Gold's. Candidly, the complaint's recitation of the economic facts is so sketchy as to be unreliable even in that respect. The merger proxy statement that the complaint refers to and relies upon, and therefore incorporates, contains other facts that suggest that the merger exchange ratio was fair to Amax Gold. Indeed, it is noteworthy that a well-known investment bank gave a fairness opinion to that effect to a special committee of the Amax Gold board charged with protecting the minority stockholders. These facts accord with the reality that Kinross was an NYSE-traded company that had revenues of approximately $200 million annually in the two years preceding the merger

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[19]The parties to a merger might allocate the roles of "purchaser" and "target" for a variety of reasons, such as avoiding a high stockholder vote requirement or appraisal rights for stockholders in one merging entity's jurisdiction of incorporation, dealing with hold-out stockholders or not violating a provision in a contract of one of the merging entities that prohibits it from being a party to a merger or asset transfer, or for tax considerations. *See* 1 Kling & Nugent, *supra* note 18, § 1.02[7], at 1-12. Even in a "merger of equals," a variety of factors influence the decision of which company remains as the publicly owned entity, such as the relative size of the companies, which entity's shareholders will hold a greater percentage of the combined companies, which company's management will have the more senior positions in the combined company, or which company's directors will represent a majority of the board of the combined company. 1 *id.* § 1.02[8][a], at 1-14.

[20]*See Dell v. Grimm*, 1979 WL 175247, at *2 (Del. Ch. July 17, 1979) ("There is no hint in the record that the merger here was sought to be used to cover up the wrongful acts of management or to in any way circumvent what otherwise would appear to be a valid cause of action on behalf of the corporation and its shareholders.").

and that had a stock trading price exceeding that of Amax Gold immediately before the merger.

More important, even if one assumes that Kinross made out somewhat better in the merger negotiations than Amax Gold, that assumption does not get the plaintiff very far in proving that the fraud exception to *Lewis v. Anderson* applies. Remember that Cyprus Amax owned over 58% of Amax Gold. For it to be rational for Cyprus Amax to have entered into the merger solely for the purpose of getting rid of this derivative action, Cyprus Amax would have had to conclude that the potential liability it faced in this action exceeded the loss it would suffer from the inadequate price it was receiving for its majority ownership of Amax Gold. At oral argument, the plaintiff's counsel was unable to identify with any precision the magnitude of his client's claims regarding the unfair financing that Cyprus Amax allegedly provided to Amax Gold. Most critically, nothing in the complaint supports a rational inference that Cyprus Amax would have entered into a merger divesting itself of 58% of Amax Gold solely to insulate itself and its affiliated directors from liability in this derivative action. Given the magnitude of the merger transaction, the involvement of an Amax Gold special committee, and a third-party merger partner like Kinross, the absence of well-pled facts suggesting that the liability Cyprus Amax and its affiliated directors faced was so substantial as to have motivated them to cause Amax Gold to enter into a pretextual merger with another publicly traded company at a sub-optimal price is fatal.

By its plain terms, the fraud exception to *Lewis v. Anderson* requires a showing that the sole basis for Amax Gold's decision to enter the merger was to divest the plaintiff of derivative standing. This is the reading of *Lewis v. Anderson* that was adopted by Vice Chancellor Jacobs and is law of the case. I am bound to that interpretation. The plaintiff was given a second chance to make the required showing. Her cursory effort to do so rests on a conclusory allegation that is not supported by well-pled facts and that seems implausible in light of the nature of the merger and Cyprus Amax's strong interest in obtaining the right price for its equity interest in Amax Gold.

III. Conclusion

Because the plaintiff has failed to plead facts supporting the applicability of the fraud exception to *Lewis v. Anderson*, the defendants' motion to dismiss with prejudice is granted. IT IS SO ORDERED.

RATTNER v. BIDZOS

No. 19,700

Court of Chancery of the State of Delaware, New Castle

September 30, 2003
Revised October 7, 2003

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David C. McBride, Esquire, of Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware; and David M. Furbush, Esquire, and Noah D. Boyens, Esquire, of O'Melveny & Myers LLP, Menlo Park, California, of counsel, for defendants.

NOBLE, *Vice Chancellor*

Plaintiff Barbie Rattner ("Rattner") brings this derivative action on behalf of Nominal Defendant VeriSign, Inc. ("VeriSign" or the "Company") alleging that Defendants James D. Bidzos ("Bidzos"), Stratton D. Sclavos ("Sclavos"), Timothy Tomlinson ("Tomlinson"), Roger H. Moore ("Moore"), David J. Cowan ("Cowan"), Anil H. P. Pereira ("Pereira"), Douglas L. Wolford ("Wolford"), Robert J. Korzeniewski ("Korzeniewski"), James M. Ulam ("Ulam"), Quentin P. Gallivan ("Gallivan"), Dana L. Evan ("Evan"), Kevin R. Compton ("Compton"), William L. Chenevich ("Chenevich"), Gregory L. Reyes ("Reyes") and Scott G. Kriens ("Kriens") (collectively, the "Individual Defendants") breached their fiduciary duties owed to the Company and its shareholders. Specifically, Rattner asserts that the Individual Defendants breached their fiduciary duty of care by inadequately maintaining accounting controls and utilizing improper accounting and audit practices. Rattner also contends that certain Individual Defendants sold securities while in possession of material inside information, thereby breaching their fiduciary duties, and