actions for which an indemnified party might seek remedy, clearly implies that indemnification is to be treated on a case-by-case basis: a party may be indemnified for a civil action, and may also seek indemnification for a later criminal action, if it arises.[38] To read this language to mean that in any case where multiple causes of action could be raised the indemnified party must wait for all relevant statutes of limitations to run, or for all other possible causes of action to be disposed of, is to eviscerate the important right of indemnification on which Delaware corporations rely to secure qualified people to serve on their boards.

The defendants primarily rely on *Scharf v. Edgcomb*,[39] where a corporation resisting a director's indemnification claim raised the statute of limitations as a defense. The defendant in that case argued that the three-year statute of limitations for bringing an indemnification claim had begun to run when the SEC informed the plaintiff that he was unlikely to be prosecuted. More than three years later, in the corporation's view, the plaintiff was estopped from pursuing his claim. The Delaware Supreme Court rejected the defendant's argument. Holding that the statute of limitations for indemnification claims only begins to run when the indemnitee can be "confident that any claim against him . . . has been resolved with certainty,"[40] the Supreme Court ruled that the qualified nature of the SEC's assurances failed to establish that the claim against the director had been resolved, and thus the plaintiff could still timely bring his indemnification claims. Therefore, Old Hayes argues, the plaintiffs' rights to indemnification for their class action claims have also not yet accrued, because they potentially still face related SEC action on the same underlying facts.

The question presented in this case, however, is quite different than that faced by the court in *Scharf*. Here, the issue is not whether the plaintiffs' indemnification claim for any SEC investigation has begun to accrue, but whether the plaintiffs are due indemnification for the class action settlement, which the complaint alleges they have already paid. This court treated that separate subject in the case *Certainteed Corp. v. Celotex Corp.*,[41] where the parties disputed a contractual indemnification provision in a merger agreement, under which the seller had promised the buyer indemnification if certain losses eventuated after the merger's closing. In

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[38]*See, e.g.*, *Witco Corp. v. Beekhuis*, 1993 U.S. Dist. LEXIS 17289, *10 (Del. Ch. Oct. 22, 1993) (in deciding not to stay an indemnification action under 8 *Del. C.*§ 145 while awaiting appeal of the underlying case, the court considered the plaintiff's entitlement to indemnification separately on three different "matters").

[39]864 A.2d 909 (Del. 2004).

[40]*Id.* at 919.

[41]2005 Del. Ch. LEXIS 11 (Del. Ch. Jan. 24, 2005).

resisting the buyer's contractual claims, the seller argued that those claims had become barred by laches on the third anniversary of the closing date, rather than the third anniversary of when all the losses at issue had been incurred. The buyer answered by arguing that the general rule, as cited in *Scharf*, was that indemnification claims only accrue when they have been resolved with certainty. Because that could not be until all losses had actually been paid, and because that had not yet occurred, the buyer believed that his action was still timely.

The court ruled in favor of the seller, holding that the indemnification claim accrued on the date of closing. Crucially, the court reached that conclusion by differentiating the contractual indemnification claim at issue from what it termed "common law indemnification," which it defined as "a general right of reimbursement for debts owed to third parties by the [indemnifier] as a secondarily-liable party."[42] The "indemnification" at issue in *Certainteed*, the court held, was a term of art designed to describe a particular contractual remedy between two parties. Common law indemnification, in contrast, involves the responsibility of a third party to pay for another's liability. In those cases, "a cause of action [for indemnification] accrues after the party seeking indemnification has made payment to the third party and the dispute with that party is finally concluded."[43] In other words, a claim for indemnification in the common law sense is defined by reference to a particular action, and becomes legally cognizable when payment is made to a third party on that action specifically.[44]

The indemnification provision in this case, of course, is a paradigmatic example of third-party indemnification. Indeed, it is precisely the kind of indemnification that was at issue in *Scharf*, on which the *Certainteed* decision relies.[45] The plaintiffs here wish to be indemnified by Old Hayes for liability to a third party. Further, the complaint alleges that the plaintiffs have paid $7.2 million to certain claimants as part of a $27.5 million class action settlement. The outside directors therefore settled a particular claim for which a sum certain was due and allegedly paid on June 1, 2005. In other words, the plaintiffs have suffered an indemnifiable injury, separate from any injury they may suffer as a result of the pending SEC investigation.[46] That the SEC action concerns, in part, the same facts

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[42]*Id.* at *10.

[43]*Id.* at *8.

[44]Numerous other state and federal courts have recognized that this understanding of indemnification is a blackletter rule of common law. *See, e.g.*, *McDermott v. New York*, 50 N.E.2d 460, 461-62 (N.Y. 1980).

[45]*Certainteed*, 2005 Del. Ch. LEXIS, at *8.

[46]In *Simon v. Navellier Series Fund*, 2000 Del. Ch. LEXIS 150 (Del. Ch. Oct. 19,

does not preclude a current indemnification demand. Under the language of the indemnification agreements, the plaintiffs may pursue indemnification for the class action claims now, and may also seek indemnification for the SEC action if and when it is brought.

The defendants are right to note that Section 145 requires the board of an indemnifying company to make a full determination of whether the plaintiffs are due indemnification, including an investigation as to whether the indemnitee has acted in good faith, and in a manner reasonably believed to be in or not opposed to the best interests of the corporation.[47] This duty could be made easier if the SEC investigation produces additional information. Further, waiting to make a decision about indemnification could relieve the Old Hayes board from the uncomfortable position of voluntarily indemnifying the plaintiffs, and then later discovering that the SEC believes them liable on the basis of facts that suggest a lack of good faith. With $7.2 million at stake, the defendants reasonably believe that such a mistake would expose them to suit from their own stockholders.

As reasonable as those concerns are, however, they cannot abrogate Old Hayes's responsibility to make a decision about the plaintiffs' indemnification rights with regard to the class actions, which, under our law, have definitively been concluded, and as a result of which the plaintiffs have paid a substantial amount of money from their own pockets.

V.

For the foregoing reasons, the defendants' motion to dismiss is DENIED IN PART and GRANTED IN PART. IT IS SO ORDERED.

2000), this court noted it maintained the right, as a matter of "litigative efficiency," to stay indemnification claims where an appeal of the underlying case was pending. As the court observed, in a case where the reason that the plaintiff had a right to indemnification was that the trial court had found in his favor, the court should be wary of granting indemnification when "any prior decision on [the claim] for indemnification might be undone depending on the basis of the [appeal court's] ruling." *Id.* at *33. The defendants rely on *Simon* for their belief that this court should stay the current proceeding until the SEC investigation is concluded. In contrast to *Simon*, however, the only effect of the SEC investigation here would be to unearth additional information about the plaintiffs' behavior. If the SEC pursues a claim, and if that claim is ever brought to trial, it can have no legal effect whatsoever on the settlement reached by the outside directors and their insurers with the class action plaintiffs. This case presents none of the concerns about judicial efficiency, therefore, which were behind the court's observations in *Simon*.

[47]DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.2(a) (2005).

LIONS GATE ENTERTAINMENT CORP. v. IMAGE ENTERTAINMENT INC.

No. 2011-N

Court of Chancery of the State of Delaware, New Castle

June 5, 2006

J. Travis Laster, Esquire, and Matthew F. Davis, Esquire, of Abrams & Laster LLP, Wilmington, Delaware; and John P. Stigi III, Esquire, and R. Anthony Young, Esquire, of Sheppard, Mullin, Richter & Hampton LLP, Los Angeles, California, of counsel, for plaintiff.

Kelly A. Herring, Esquire, and Titania R. Mack, Esquire, of Greenberg Traurig, LLP, Wilmington, Delaware; Roger A. Lane, Esquire, of Greenberg Traurig, LLP, Boston, Massachusetts; of counsel; and John C. Kirkland, Esquire, of Greenberg Traurig, LLP, Los Angeles, California, of counsel, for defendant.

CHANDLER, *Chancellor*

This case raises novel issues regarding the construction of corporate instruments providing for a classified board of directors, and the reformation of bylaws of a publicly traded company. Lions Gate Entertainment Corp., a British Columbia corporation ("Lions Gate"), commenced this action against Image Entertainment, Inc., a Delaware corporation ("Image"), seeking: first, a declaration that Image's board of directors will not become classified until Image's 2006 annual stockholders meeting and that all of Image's board seats are up for election at the 2006 annual meeting; second, a declaration that the board does not have the authority to amend Image's bylaws; and third, a declaration that the board does not have the authority to amend Image's certificate of incorporation without a vote of Image's shareholders.

Image answered the complaint, raised affirmative defenses, and asserted a counterclaim seeking reformation of its charter and bylaws. Lions Gate has since moved for summary judgment on the three declarations it seeks, and has moved to strike Image's affirmative defenses

and its counterclaim. To the extent that the affirmative defenses and counterclaim survive Lions Gate's motion to strike, Lions Gate seeks summary judgment on Image's affirmative defenses and counterclaim.

I. FACTUAL BACKGROUND

Lions Gate is a diversified independent producer and distributor of motion pictures, television programming, and home entertainment. Lions Gate beneficially owns 4,033,996 shares of Image's common stock, representing 18.94% of Image's outstanding shares and making Lions Gate currently Image's second largest shareholder. Lions Gate has a market capitalization of approximately $900 million and its shares trade on the New York Stock Exchange.

Image is the surviving corporation of a reincorporation merger in which Image's then-parent Image Entertainment, Inc., a California corporation ("Image-California") merged into Image. Image is a home entertainment company engaged in the domestic acquisition and wholesale distribution of content for release on DVD. Image is a direct competitor of Lions Gate. Image has a market capitalization of approximately $80 million, and its shares trade on Nasdaq.

This action concerns three provisions of Image's Charter and bylaws: (i) a bylaw provision establishing a classified board (the "Classified Board Provision"); (ii) a bylaw provision purporting to give the Image board the power to amend the bylaws (the "Bylaw Amendment Provision"); and (iii) a charter provision purporting to give the Image board the power to unilaterally amend the charter (the "Charter Amendment Provision"). It is undisputed that these provisions appeared in Image's original charter as filed with the Delaware Secretary of State on August 1, 2005, and Image's original bylaws adopted by the board on August 1, 2005. Nonetheless, a more complete history of the adoption of the charter and bylaws is appropriate.

With the 2005 annual meeting of Image-California's shareholders approaching, Image-California's board received a draft proxy statement describing a proposed merger that would result in Image-California becoming a Delaware corporation. On July 12, 2005, the board approved the draft proxy statement. Appended to the draft proxy statement was a draft merger agreement that included the charter and bylaws that would govern the Delaware company surviving the reincorporation (Image). Those operative documents contain the provisions that are the subject of this litigation. The Classified Board Provision, the most contentious of the provisions, provides as follows:

> The directors shall be divided into three classes, designated Class I, Class II, and Class III, as nearly equal in number as the then total number of directors permits. At the 2006 annual meeting of stockholders, Class I directors shall be elected for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. At each succeeding meeting of stockholders beginning in 2007, successors to the class of directors whose terms expire at that annual meeting shall be elected for a three-year term . . . .[1]

Pursuant to a written consent dated July 12, 2005, the Image-California board approved both the reincorporation and the merger agreement.

On July 27, 2005, Image filed its definitive proxy statement with the SEC. The proxy statement discussed Image-California's proposal to reincorporate in Delaware through the merger of Image-California with its Delaware subsidiary Image. The proxy statement summarized the terms of the charter and bylaws to govern the reincorporated Image and attached the actual merger agreement, the charter and the bylaws. The proxy statement summarized the effect of the second proposal as follows:

> If Proposal 2 is accepted, Messrs. Greenwald and Epstein (Class I) will serve for a term of one year, Messrs. Huxley and McCloskey (Class II) will serve for an initial term of two years, and Messrs. Coriat and Haber (Class III) will serve for an initial term of three years. As each director's term expires, successor directors will serve for three year terms.[2]

The proxy statement also summarized the effect of the reincorporation proposal as follows:

> Shareholder approval of the reincorporation proposal will constitute approval of: [...] (ii) the articles of incorporation and the bylaws of Image-Delaware. [...] The following discussion summarizes all of the material terms of the charter documents, bylaws, and law of California and Delaware as they pertain to stockholder rights. *The*

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[1]Plaintiff's Opening Brief in Support of its Motion for Summary Judgment, Motion to Strike, and Motion to Dismiss ("POB") Ex D. at IE0994-95.

[2]POB Ex. J at K000342.

> *summary is not intended to be complete and is qualified in its entirety by reference to the attached Merger Agreement, including the certificate of incorporation and bylaws of Image-Delaware attached as Exhibits B and C thereto.*[3]

Significantly, Image-California disclosed clearly and prominently that the summary descriptions of the charter and bylaws in the body of the proxy statement were subject to and "qualified in their entirety" by the documents themselves.

On August 1, 2005, Dennis H. Cho, Image-California's General Counsel and Secretary, formed Image by filing the charter with the Delaware Secretary of State. The Charter contained the Charter Amendment Provision. As of August 1, 2005, the Image board acted by unanimous written consent to adopt the bylaws, which included the provisions at issue in this lawsuit. As of the same date, the Image-California board acted by unanimous written consent to approve the reincorporation merger.

On September 9, 2005, Image-California held its 2005 annual meeting. Martin Greenwald, Image-California's President, CEO and Chairman of the Board, conducted the 2005 annual meeting according to a script. There is no mention in the script of the board becoming classified at the 2005 annual meeting. When nominating the candidates for election to the board, Greenwald stated that he was nominating individuals to serve until the next annual shareholders meeting. Likewise, at the close of the meeting and following the announcement of the voting results, Greenwald declared the names of the six directors who had been elected as directors of the company to serve until the next annual shareholders meeting and until their respective successors are elected and qualified.

Also on September 9, 2005, Image filed a current report on Form 8-K disclosing that the stockholders had approved the election of the six nominees to the board, and approved the reincorporation from California to Delaware. Image further disclosed that the instruments defining the rights of Image common stockholders were now governed by the Image charter and bylaws. Finally, on that same day, Cho executed a "Secretary's Certificate of Adoption of Bylaws" certifying that the bylaws were those adopted by the Image board on August 1, 2005; the bylaws contained the two bylaw provisions at issue in this case.

On September 13, 2005, Lions Gate filed a Schedule 13D with the

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[3] *Id.* at K000343 (emphasis added).

SEC disclosing its purchases of stock and an offer to acquire Image at a substantial premium to Image's pre- and post-offer trading price. From September through November 2005, Lions Gate engaged in discussions with Image regarding a negotiated acquisition. The Image board ultimately rejected Lions Gate's proposal and terminated discussions.

On December 12, 2005, Charles Schilling, an associate with Lions Gate's financial advisor, identified the disputed language in the bylaws, which provides that the Image board will not become classified until the 2006 annual meeting. Schilling consulted with Lions Gate's California and Delaware counsel regarding the provision. After focusing on such language for the first time, Lions Gate considered its strategic alternatives regarding Image over a period of three months. On March 16, 2006, Lions Gate filed an amendment to its Schedule 13D with the SEC. Lions Gate disclosed it had lost confidence in the ability or desire of Image's current board of directors to maximize shareholder value. Lions Gate further disclosed that it was contemplating nominating a slate of six directors for Image's 2006 annual meeting. On the same day it filed the amendment to its Schedule 13D, Lions Gate filed this action.

On May 12, 2006, Image conceded that the Charter Amendment Provision was invalid. It then withdrew the allegations in its counterclaim that the Charter Amendment Provision was the result of drafting error and waived its related request for reformation.

II. STANDARD OF REVIEW

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law."[4] In ruling on the motion, this Court must view the facts in the light most favorable to the non-moving party, and make all reasonable inferences in favor of the non-moving party.[5] In the event that the moving party demonstrates that no genuine issue of material fact exists, the non-moving party must then produce evidence that creates a triable issue of material fact, lest summary judgment be entered against the non-moving party.[6]

Image resists the application of a summary judgment standard, and mistakenly claims that on March 24, 2006, this Court agreed to hear only

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[4]CT. CH. R. 56(c).

[5]*Judah v. Del. Trust Co.*, 378 A.2d 624, 632 (Del. 1977).

[6]*McGowan v. Ferro*, 859 A.2d 1012, 1027 (Del. Ch. 2004), *aff'd*, 873 A.2d 1099 (Del. 2005).

Lions Gate's motion for judgment on the pleadings. During the March 24 hearing, however, the Court expressly invited the parties to file case dispositive motions to be heard simultaneously, including a motion for summary judgment by Lions Gate.[7] Although Image declined to file a motion to dismiss, Lions Gate was nonetheless entitled to file its motion for summary judgment. Rule 56 provides that "[a] party seeking to recover upon a claim . . . may, at any time after the expiration of 20 days from the commencement of the action . . . move with or without supporting affidavits for summary judgment in the party's favor upon all or any part thereof."[8] The motion for summary judgment was filed twenty-two days after the complaint was filed, and forty-six days before the May 23 oral argument. Lions Gate's summary judgment motion was properly filed, and complied with Rule 56.[9]

III. ANALYSIS

A. *Count I: Determination of the Plain Meaning of the Classified Board Provision*

Count I of Lions Gate's complaint seeks a determination as to the plain meaning of the Classified Board Provision. "It is a fundamental principle that the rules used to interpret statutes, contracts, and other written instruments are applicable when construing corporate charters and bylaws.[10] Absent ambiguity, their meaning is determined solely by reference to their language.[11] To demonstrate ambiguity, a party must show

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[7]Plaintiff's Rely Brief in Support of its Motion for Summary Judgment, Motion to Strike, and Motion to Dismiss ("PRB") Ex. Y at 27 (The Court: "I would assume Mr. Laster would be moving for summary judgment, or something akin to that, and you [Image] could move for judgment on the pleadings [or] move to dismiss . . . and have that briefed simultaneously. . . ."); see also *id.* at 41 ("Mr. Laster: I also understood, I take it, that this will be parallel briefing. If Image moves to dismiss, there will be parallel briefing between our motion for summary judgment and their motion to dismiss?" The Court: "That's what I was trying to accommodate [Ms. Reese] on, Mr. Laster. . . .").

[8]CT. CH. R. 56(a).

[9]Even were I to conclude that service, rather than filing, marks "commencement of the action" for purposes of Rule 56, the Court may truncate the 20-day period when doing so aids judicial efficiency without prejudicing the defendant. *Loppert v. WindsorTech, Inc.*, 865 A.2d 1282, 1290 (Del. Ch. 2004). Here, I invited the parties during the March 24 conference to file case-dispositive motions, including a potential motion for summary judgment in light of the upcoming proxy contest. Due to Image's decision to hold its 2006 annual meeting in September rather than the earlier date originally indicated, the parties were afforded adequate time for discovery and to prepare the case-dispositive motions.

[10]*Gentile v. SinglePoint Fin., Inc.*, 788 A.2d 111, 113 (Del. 2001).

[11]*Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342-43 (Del. 1983).

that the instruments in question can be reasonably read to have two or more meanings.[12] The language of the instrument, if simple and unambiguous, is given the force and effect required.[13] The proper construction of any contract is purely a question of law,[14] and numerous decisions of this Court have interpreted provisions found in certificates of incorporation or bylaws on motions for summary judgment.[15]

The sole issue with respect to Count I is whether the Classified Board Provision establishes a classified board that will become staggered at the 2006 annual meeting, or whether the classified board became effective at the 2005 annual meeting. Section 141(d) of the Delaware General Corporation Law (the "DGCL") provides the authority for a Delaware corporation to implement a classified board.[16] The statute does not require that the classification take place immediately, and this Court has upheld a classified board provision that would create a classified board at a future date.[17] Further, a provision establishing a classified board does not necessarily create a board in which directors serve staggered three-year terms. Section 141(d) contemplates at least two other types of classified boards, one in which a particular director or class of directors may be elected by the holders of a particular class or series of stock, potentially with different voting rights and a different term, and a second in which a particular director or class of directors may have "voting powers greater than or less than those of other directors," regardless of whether or not that class of directors is elected by the holders of a particular class or series of stock.[18]

In this case, no ambiguity infects the Classified Board Provision. The first sentence states that the directors shall be divided into three classes, while the second and third sentences address the issue of when the classification shall become effective and how the classes will differ:

> The directors shall be divided into three classes,

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[12]*Rhone-Poulenc Basic Chem. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

[13]*Gentile*, 788 A.2d at 113 (citations omitted).

[14]*OBrien v. Progressive N. Ins. Co.*, 2000 WL 3313833, at *4 (Del. Super. Dec. 18, 2000).

[15]*See, e.g.*, *Matthews v. Groove Networks, Inc.*, 2005 WL 3498423, at *1-3 (Del. Ch. Dec. 8, 2005) (granting defendant's motion for summary judgment after interpreting certificate of incorporation).

[16]8 *Del. C.* § 141(d) ("The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of stockholders, be divided into 1, 2 or 3 classes. . . .").

[17]*See Comac Partners, L.P. v. Ghasnavi*, 793 A.2d 372 (Del. Ch. 2001).

[18]*Id.*

> designated Class I, Class II, and Class III, as nearly equal in number as the then total number of directors permits. At the 2006 annual meeting of stockholders, Class I directors shall be elected for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. At each succeeding meeting of stockholders beginning in 2007, successors to the class of directors whose terms expire at that annual meeting shall be elected for a three-year term. . . .[19]

The first, second and third sentence of the Classified Board Provision work together to establish a board that becomes classified "at the 2006 annual meeting of stockholders," with the three classes differing as to their terms. It is only at the 2006 annual meeting that the scheme is implemented through the election of Class I directors for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. Consistent with this plain meaning, the first paragraph of Section 3.1 of the bylaws provides that "[e]lected directors shall hold office until the next annual meeting and until their successors shall be duly elected and qualified."[20] Such language is inconsistent with an immediately-effective classified board, in which elected directors initially hold office for staggered terms and subsequently serve three-year terms.

Image insists that the language of the Classified Board Provision is ambiguous. It is not. "Ambiguity does not exist where the court can determine the meaning of a contract without any other guide than acknowledgement of the simple facts on which, from the nature of language in general, its meaning depends."[21] Notwithstanding the crystal clarity of the Classified Board Provision, Image contends that the use of numerical years in the bylaws, without specifying whether fiscal or calendar years, is ambiguous. Anticipating that the bylaws alone cannot be reasonably read to have these two divergent meanings, Image points to its proxy materials in support of such purported ambiguity. This tact is unavailing, however.

Image incorrectly relies on a single case to justify relying upon extrinsic evidence to demonstrate ambiguity. In *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, the Delaware Supreme Court considered accompanying proxy materials instructive in determining whether any

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[19]POB Ex D. at IE0994-95.

[20]*Id.* at IE0995.

[21]*Rhone-Poulenc Basic Chem. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

ambiguity existed in a certificate of incorporation.[22] In that case, however, the proxy materials simply confirmed the plain reading of the purpose of the amended charter and the provision in question.[23] Further, after *Centaur Partners* was decided, the Delaware Supreme Court sharply limited the extent to which courts may consider extrinsic evidence in determining the plain meaning of a contract.[24] In particular, the Court held that extrinsic evidence could not be used to create an ambiguity.[25] Therefore, disregarding Image's presentation of copious extrinsic evidence purporting to create an ambiguity,[26] I find the Classified Board Provision to be clear and unambiguous.

Even were I to agree with Image that the Classified Board Provision is ambiguous, Lions Gate would still be entitled to summary judgment on Count I. Under Delaware canons of interpretation, "[w]hen a corporate charter is alleged to contain a restriction on fundamental electoral rights of stockholders under default provisions of law . . . the restriction must be clear and unambiguous to be enforceable."[27] Importantly, these interpretive canons apply before the consideration of parol evidence.[28]

The presumption of annual director elections is a fundamental electoral right that exists under the default provisions of Delaware law.[29] The implementation of a classified board is a fundamental governance

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[22]582 A.2d 923, 928 (Del. 1990).

[23]*Id.* at 929 ("Centaurs argument for a 50% threshold is contrary to the clear purpose reflected in the language of the amended certificate of incorporation.").

[24]*Eagle Indus. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232-33 & n.7 (Del. 1997).

[25]*Id.* at 1232; *Harrah's Entmt, Inc. v. JCC Holding Co.*, 802 A.2d 294, 313 & n.45 (Del. Ch. 2002).

[26]I say purporting to create ambiguity, because even were I to consider it, the extrinsic evidence shows only the possibility of error, not ambiguity. In its feeble attempt to create ambiguity, Image presents isolated portions of the proxy statement (mistakenly) informing shareholders that the bylaws provide for an immediately effective classified board. Unfortunately, this does not create an ambiguity of interpretation, *i.e.*, it does nothing to specifically support Image's contention that the term "2006 annual meeting" could actually be referring to the "fiscal 2006 annual meeting." Support for that contention would be further obfuscation of fiscal and calendar year terminology, or proof that simple numerical years "XXXX" were regularly used in Image parlance to mean "fiscal year XXXX." Certain statements in the proxy materials that plainly contradict the bylaws only suggest that certain portions of the proxy statement are mistaken, or that the bylaws were wrongly scribed. Neither conclusion warrants a different construction of the bylaws. Finally, Image cannot rely on its disclosures to such an extent because all of the disclosures in the body of the proxy statement were "qualified in their entirety" by the language of the charter and bylaws.

[27]*Harrahs Entmt v. JCC Holding Co.*, 802 A.2d 294, 309 (Del. Ch. 2002).

[28]*Id.* at 311.

[29]*Preston v. Allison*, 650 A.2d 646, 649 (Del. 1994).

change.[30] The loss of a final opportunity to elect the whole board has an obvious disenfranchising effect, and any ambiguity in the Classified Board Provision must therefore be construed against the drafter, Image.

B. *Counts II and III: Determination of the Validity of the Bylaw Amendment Provision and the Charter Amendment Provision*

Lions Gate seeks determinations that the Bylaw Amendment Provision and the Charter Amendment Provision are *ultra vires*, invalid and void. Facial challenges to the legality of provisions in corporate instruments are regularly resolved by this Court.

Regarding the Bylaw Amendment Provision, § 109 of the DGCL is instructive: after a corporation has received any payment for any of its stock, a board of directors has the power to amend the corporation's bylaws only if the certificate of incorporation "confer[s] the power to adopt, amend or repeal bylaws upon the directors."[31] In the absence of a provision in the certificate of incorporation conferring power upon the directors to adopt, amend or repeal bylaws, a bylaw cannot confer this power on the board of directors.[32] Image's proxy statement evidences this common knowledge.[33]

On August 1, 2005, the Image board issued 100 shares to Image-California in return for consideration of $10.[34] From that point on, the board could only amend the bylaws if the Image charter granted that power to the board.[35] Image "admits that the certificate of incorporation does not include express authorization for the board to amend the bylaws."[36] The Bylaw Amendment Provision, however, purports to give the Image board precisely this authority. Because the charter does not confer the power to amend the bylaws upon the board, the Bylaw Amendment Provision is invalid, *ultra vires*, and void. Additionally, Image has admitted that if its counterclaim for reformation of the Charter is rejected, the Bylaw Amendment Provision is invalid.[37] Finally, implicitly acknowledging the merits of this claim, Image has failed even to address Lions Gate's

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[30]*Chesapeake Corp. v. Shore*, 771 A.2d 293, 346 (Del. Ch. 2000).

[31]8 *Del. C.* § 109.

[32]*Id.*

[33]POB Ex. J at 15 ("Under Delaware law, directors may amend the bylaws of a corporation only if such right is expressly conferred upon the directors in its certificate of incorporation.").

[34]*See* POB Ex. N at IE1027.

[35]8 *Del. C.* § 109.

[36]POB Ex. F, Answer 25.

[37]POB Ex. W.

arguments in its brief or in oral argument. The Bylaw Amendment Provision is therefore invalid.

The Charter Amendment Provision purports to provide that the charter can be amended by the board *or* the shareholders. Under § 242 of the DGCL, after a corporation has received payment for its capital stock, an amendment to a certificate of incorporation requires both (i) a resolution adopted by the board of directors setting forth the proposed amendment and declaring its advisability *and* (ii) the approval of a majority of the outstanding stock entitled to vote on the amendment.[38] Because the Charter Amendment Provision purports to give the Image board the power to amend the charter unilaterally without a shareholder vote, it contravenes Delaware law and is invalid; Image has so conceded in its May 12, 2006 admission.

C. Summary Judgment on Image's Affirmative Defense and Counterclaim for Reformation

Image asks that the charter and bylaws be reformed to (i) classify the Board effective as of the 2005 annual meeting, (ii) add a provision to the Charter authorizing the Bylaw Amendment Provision, and (iii) revise the Charter Amendment Provision to say "and" instead of "or." Image requests reformation on two grounds. First, Image contends that as between Image and its sole incorporator before the reincorporation, the charter and bylaws as filed were the result of a mutual mistake. Second, Image argues that as between Image and its stockholders following the reincorporation, the charter and bylaws were either (a) the result of mutual mistake, or (b) the result of unilateral mistake on the part of Image, coupled with knowing silence on the part of Image's stockholders.

For purposes of this motion for summary judgment, I will assume that (i) Image and its incorporator intended the charter and bylaws to read as Image now claims and (ii) the Image-California board and the Image board likewise intended the charter and bylaws to read as Image now claims. Assuming these facts to be true, Lions Gate is nonetheless entitled to judgment as a matter of law.

"The purpose of reformation is to make an erroneous instrument express correctly the intent of, or the real agreement between, the parties."[39] "The Court of Chancery has jurisdiction to reform a document to make it conform to the original intent of the parties . . . [including] a certificate of incorporation."[40]

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[38] 8 *Del. C.* § 242.

[39] *In re Estate of Justison*, 2005 WL 217035, at *10 (Del. Ch. Jan. 24, 2005).

[40] *Waggoner v. Laster*, 581 A.2d 1127, 1135 (Del. 1990).

In *Waggoner*, the Delaware Supreme Court describes the principles governing the doctrines application:

> Generally, reformation is appropriate, when an agreement has been made, or a transaction has been entered into or determined upon, as intended by all parties interested, but in reducing such agreement or transaction to writing, either through the mistake common to both parties, or through the mistake of the plaintiff accompanied by the fraudulent knowledge and procurement of the defendant, the written instrument fails to express the real agreement or transaction. In such a case the instrument may be corrected so that it shall truly represent the agreement or transaction actually made or determined upon according to the real purpose and intention of the parties.[41]

When reformation is applied to a certificate of incorporation and by strong analogy to a corporation's bylaws, *Waggoner* suggests two additional requirements: "(i) it must be clear that all present and past shareholders intended [the] provisions to be included within the certificate or bylaws, and (ii) there must not be any intervening third party interest."[42]

A party seeking reformation must establish the need for the remedy by clear and convincing evidence,[43] and may introduce parol evidence to meet this burden.[44] The existence of a scriveners error, without more, is not sufficient to meet the "clear and convincing" test.[45] The standard requires proof higher than mere preponderance, but lower than proof beyond a reasonable doubt.[46] It requires evidence that would cause the trier of fact to believe that the truth of the factual contention is highly probable.[47]

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[41] *Id.*

[42] *Id.*

[43] *Interactive Corp. (a/k/a USA Interactive) v. Vivendi Universal, S.A.*, 2004 WL 1572932, at *15 (Del. Ch. July 6, 2004).

[44] *James River-Pennington Inc. v. CRSS Capital, Inc.*, 1995 WL 106554 (Del. Ch. Mar. 6, 1995).

[45] *Amstel Assocs., LLC v. Brinsfield-Cavall Assocs.*, 2002 WL 1009457, at *5 (Del. Ch. May 9, 2002).

[46] *Cerebrus Int'l, Ltd. v. Apollo Mgmt. L.P.*, 794 A.2d 1141, 1151 (Del. 2002).

[47] *Id.*

1. Image Cannot Establish the Intent of All Its Present and Past Stockholders

Reformation is unavailable in this case as a matter of law under the *Waggoner* test for the simple reason that Image cannot establish the intent of "all parties interested," including all of Image's present and past stockholders.[48] According to publicly available information,[49] Image has 13.15 million shares outstanding and an average daily volume over the past three months of over 70,000 shares. At this rate, Image had literally thousands of record and beneficial holders as of the record date for the 2005 annual meeting and it has literally thousands of record and beneficial stockholders today. It is simply impossible for Image to show that all present and past shareholders intended the provisions to read as Image now claims.[50] Image's Rule 30(b)(6) witness effectively conceded the futility of such quixotic endeavor: "You can't really roll-call 20 million shares of stock."[51]

Image argues that the *Wagonner* standard requiring the establishment of the intent of *all* shareholders, both past and present, to reform a certificate of incorporation or bylaws is either inapplicable to the present set of facts or is simply too draconian a policy. Image is incorrect in both respects.

a. The *Wagonner* Standard Requiring Unanimity Applies to the Facts at Hand

Attempting to distinguish *Wagonner* from the facts in this case, Image points to the different procedural postures of each case. Procedurally, the Court of Chancery's decision in *Wagonner* was entered after discovery and a full trial.[52] In our case, Image argues, the parties have conducted discovery limited by the expedited nature of the claims and, therefore, unanimity should not be required at this stage. The summary judgment standard requires that I view the facts in the light most favorable

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[48]581 A.2d at 1135. The requirement that all present and past stockholders agree on the intent arises out of the basic principle that for reformation to be appropriate, "all parties to the written instrument" must agree on its meaning. 27 Williston on Contracts § 70:13 (4th ed. 2006); *See also id.* § 70:19 ("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.").

[49]*See, e.g.*, www.finance.yahoo.com.

[50]*Waggoner*, 581 A.2d at 1136.

[51]PRB, Ex GG. at 183.

[52]*Id.* at 1130.

to the non-moving party and make all reasonable inferences in favor of the non-moving party; it does not require the suspension or dilution of a clearly applicable requirement for reformation. Therefore, construing the record in the light most favorable to Image, and making all reasonable inferences in its favor, there is no possibility that Image can show by clear and convincing evidence that *all* past and present shareholders intended managements purported understanding of the Classified Board Provision.

Further attempting to distinguish *Wagonner* from the instant facts, Image points to the different rights implicated in each case. *Wagonner* involved the requested imposition of preferred voting rights and Image argues that the requirement for unanimity should be narrowly limited to such cases. I see no reason, in the circumstances here, to accept Image's distinction. As discussed earlier, the presumption of annual director elections is a fundamental electoral right that exists under the default provisions of Delaware law.[53] A rule applying to a party seeking reformation of a charter or bylaws that would affect preferred voting rights should, in the circumstances of this case, likewise apply to a party seeking to deprive shareholders of their ordinary voting rights at an annual election of directors.

b. The Application of the *Wagonner* Standard is Supported by Policy Considerations

Image argues that the *Waggoner* standard for unanimity is draconian and incorrect, and that Image need only establish the intent of shares sufficient to effect the corporate action in question.[54] This is not what *Waggoner* held. There is a fundamental difference between seeking stockholder approval on a matter when voting standards requiring less than unanimity clearly and regularly apply, and seeking to reform a matter that stockholders already have voted upon. In the latter situation, the corporation is asking the Court to depart from the result of the stockholder vote and divine what stockholders really wanted. To protect against error in such a difficult enterprise, the *Waggoner* requirement of unanimity logically applies. Additionally, such strict measures encourage clarity in drafting and dissuade managers and controlling shareholders from casually

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[53]*Preston*, 650 A.2d at 649.

[54]Even assuming Image's laxer standard, it is unclear to me that unanimity should give way to a simple majority requirement (mimicking the requirement to give effect to the corporate action in question), instead of an 80% requirement (as required by the bylaws themselves when modifying the Classified Board Provision). *See* POB Ex. J, at K000396.

littering their operative instruments with mistakes that they might reform—or might not—depending on the contingencies that arise.

Finally, I find support for the strict application of *Wagonner*'s unanimity requirement in the similarly strict standards required for the retroactive application of a certificate of correction. Under 8 *Del. C.* § 103(f), a corporation may correct any inaccurate or defectively executed instrument authorized under the Delaware General Corporation Law to be filed with the Delaware Secretary of State.[55] That section also provides that the correction will operate retroactively to the date of the original certificate, except as to persons who would be "substantially and adversely" affected by the correction.[56] This rule has an effect similar to *Wagonner*'s unanimity requirement. In a case such as this, involving an alleged "clerical error," § 103(f) would prevent the retroactive classification of a board because of the substantial and adverse effects such classification would have on shareholders who expected to vote upon an entire slate of directors at the upcoming shareholders meeting. Section 103(f) demonstrates how a statutory analog to reformation gingerly treats the retroactive application of a correction to constitutive documents, especially when the "correction" will materially affect the interests of public shareholders.[57]

2. Image Has Failed to Establish a Specific Prior Understanding as Required for Reformation

Following briefing and oral arguments, Image can no longer point to the "specific prior understanding that differed materially from the written agreement."[58] Image has undermined its ability to establish a specific prior understanding by failing to identify what it believes the Classified Board Provision was intended to say and instead arguing two different versions.

Rather than asserting that there was a specific prior understanding about what the Classified Board Provision was meant to provide, Image now contends that the use of "2006" in the Classified Board Provision *might* have been in lieu of "2005" or that it *might* have been in lieu of

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[55]*Turner v. Bernstein*, 1999 WL 66532, at *9 (Del. Ch. 1999).

[56]*Id.*

[57]One might imagine unusual circumstances, however, where reformation would not have a substantial and adverse effect upon *any* shareholder. In that circumstance, a court of equity might relax the unanimity standard. This is not such a case. Here, the retroactive classification of a board indisputably affects present shareholders both substantially and adversely. *Waggoner*'s unanimity standard is thus properly invoked.

[58]*Cerberus*, 794 A.2d at 1151-52.

"fiscal 2006." These are two quite different understandings. The first would refer to a calendar year starting on January 1, 2005 and ending on December 31, 2005, and could not be shifted. The second would refer to a fiscal year starting on April 1, 2005 and ending on March 31, 2006, and might be shifted in accordance with relevant accounting rules. To plead and prove a claim for reformation, Image must point to the "specific prior understanding" that the Classified Board Provision was supposed to implement. By trying to claim both calendar 2005 and fiscal 2006, Image has failed to plead and cannot prove a specific prior understanding as to the correct text of the Classified Board Provision. For these reasons, judgment on the reformation claim must be entered in favor of Lions Gate.

D. Summary Judgment on Image's Other Affirmative Defenses

In addition to seeking reformation, Image also has invoked the affirmative defenses of acquiescence and waiver, laches, and unclean hands. Each of these equitable defenses, however, cannot be used in this case to alter the terms of a corporation's constitutive documents, such as Image's charter and bylaws. Section 141(d) permits the classification of a board, though only in a corporation's charter or bylaws. Image requests that this Court alter the clear terms of Image's bylaws due to the alleged inequitable conduct of a single shareholder. The Delaware Supreme Court has limited the application of such equitable powers in similar circumstances involving void corporate actions.

In *Waggoner*, stockholders of STAAR Surgical Corporation ("STAAR") who believed they held convertible preferred stock with super-majority voting rights sued to enforce a written consent they purportedly executed removing the STAAR board of directors. STAAR defended on the grounds that the preferred stock was void because the blank check authority on which the board had relied to issue the stock did not empower the board to give the preferred stock voting rights. As with Image, the blank check provision was inserted in STAAR's charter as part of the corporation's reincorporation to Delaware. The Court of Chancery held that the super-voting rights were unauthorized and void. On appeal, the stockholders "maintain[ed] in equity that estoppel should prevent the appellees from denying the validity of the preferred stock."[59] The Delaware Supreme Court rejected the attempt by the stockholders to invoke equitable principles: "Estoppel, however, has no application in cases where the corporation lacks the inherent power to issue certain stock or where the

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[59]581 A.2d at 1133.

corporate contract or action approved by the directors is illegal or void."[60] The Supreme Court held that equitable estoppel was inapplicable "as a matter of law."[61] This holding was revisited and approved by the Supreme Court in a second decision involving the same convertible preferred stock.[62]

Because the Classified Board Provision clearly and unambiguously provides that the board will become classified and staggered at the 2006 annual meeting, and because Image's claims for reformation fail as a matter of law, Image does not presently have a classified board and all six of its board members must stand for election at the 2006 annual meeting. To rely on this Court's equitable powers to declare that Image's board was classified as of the 2005 meeting would circumvent the explicit statutory requirements of § 141(d). Image cites no authority to support the proposition that equity may properly be invoked to rescue a corporate act that violates a statutory command.[63] Furthermore, the Supreme Court has made it clear that equitable principles cannot be employed to change the terms of authoritatively binding corporate documents. "The law properly requires certainty in such matters."[64]

For all the foregoing reasons, summary judgment is entered in favor of Lions Gate on all claims, affirmative defenses, and counterclaims. An Order has been entered in accordance with this decision.

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[60] *Id.* at 1137.
[61] *Id.*
[62] *See Staar Surgical v. Waggoner*, 588 A.2d 1130 (Del. 1991).
[63] *McKesson Corp. v. Derdiger*, 793 A.2d 385, 394 (Del. Ch. 2002).
[64] *Staar*, 588 A.2d at 1136.

OLIVER v. BOSTON UNIVERSITY

No. 16,570-NC

Court of Chancery of the State of Delaware, New Castle

April 14, 2006

Michael A. Weidinger, Esquire, of Morris, James, Hitchens & Williams LLP, Wilmington, Delaware; Michael J. Maimone, Esquire, of Gordon, Fournaris & Mammarella, P.A., Wilmington, Delaware; and Thomas G. Griffin, Esquire, of Griffin Law Offices, LLC, Chicago, Illinois, of counsel, for plaintiffs.

William O. LaMotte, III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and John F. Sylvia, Esquire, and Paul P. Poth, Esquire, of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., Boston, Massachusetts, of counsel, for defendants Boston University, John R. Silber, Leon C. Hirsch, Gerald S.J. Cassidy, and Kenneth G. Condon.

NOBLE, *Vice Chancellor*

Seragen, Inc. ("Seragen") was a financially troubled biotechnology company nurtured and controlled by Defendant Boston University ("BU") and its friends and affiliates, who, on several occasions, came to its short-lived fiscal rescue in transactions implemented without procedures reasonably designed to protect the interests of minority shareholders. With Seragen on the precipice of financial doom, Ligand Pharmaceuticals, Inc. ("Ligand") offered merger consideration of approximately $75 million to acquire Seragen. That amount would have to satisfy the various stakeholders in Seragen—including holders of preferred stock, creditors, and holders of Seragen's common stock—even though the claims of those stakeholders asserting rights to priority payment exceeded Ligand's offer. Several stakeholders carved up the consideration to be paid by Ligand; that effort, however, was not burdened by anyone acting on a counseled and informed basis on behalf of the common shareholders who, from among various stratagems, could have injected into the allocation process (i) various derivative claims based upon earlier self-interested, capital-raising transactions and (ii) arguments against specific steps taken in that process that were inconsistent with the rights of the common shareholders. A group of minority shareholders, led by Plaintiff Sergio M. Oliver ("Oliver"), brought to trial a series of claims challenging certain transactions before

Seragen's merger with Ligand in August 1998 and the process by which the merger proceeds were divvied up. This is the Court's memorandum opinion following trial.

I. FINDINGS OF FACT

A. *The Players*

Seragen was a Delaware corporation engaged in the business of developing, manufacturing and marketing various biotechnology products known as Fusion Proteins.[1]

BU, a Massachusetts charitable educational institution, was the controlling stockholder of Seragen. The individual defendants are John R. Silber ("Silber"), a former Chancellor and trustee of BU and a director of Seragen,[2] Leon C. Hirsch ("Hirsch"), a trustee of BU, and an individual identified as a BU Affiliate in Seragen's public filings,[3] Gerald S. J. Cassidy ("Cassidy"), director of Seragen, a paid consultant to BU, and a close friend of Silber,[4] and Kenneth G. Condon ("Condon"), treasurer of BU and a member of Seragen's Board.[5] The other individual defendants were Reed R. Prior ("Prior"), board chairman, chief executive officer, and treasurer of Seragen from November 1996 through the merger with Ligand, Jean C. Nichols ("Nichols"), a director of Seragen and its chief technology officer, and Norman A. Jacobs ("Jacobs"), an independent director of Seragen from

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[1]"Seragen's proprietary Fusion Proteins consist of fragments of diphtheria toxin genetically fused to a ligand (a targeting and binding mechanism) that targets specific receptors on the surface of disease-causing cells. The Fusion Proteins are designed to bind to specific receptors present on the surface of disease-causing cells, penetrate the target cells and destroy the target cells' ability to manufacture proteins, thereby killing the targeted cells." Joint Trial Exhibit ("JX") 262 at 8.

[2]Trial Transcript ("Tr.") 193, 198. Silber became the president and a trustee of BU in January of 1971 and remained a member of the Board of Trustees until November 1, 2003. Silber served on Seragen's Board from the late 1980's until the merger with Ligand.

[3]Tr. 158-59. Hirsch founded United States Surgical Corporation ("USSC") and was its chairman and chief executive officer during the 1990's. He invited Silber to sit on USSC's Board, and Silber invited Hirsch to become a BU Trustee. Hirsch was a member of the BU Board of Trustees from the early 1990's until 2004, and he was a member for the duration of his investment in Seragen.

[4]Tr. 703-06. Cassidy sat on Seragen's Board from 1987 until the merger with Ligand. Cassidy was also a member of the BU Board of Trustees from October 2003 through October 2004.

[5]Tr. 454-56. Condon became BU's treasurer in 1992 and joined Seragen's Board shortly thereafter. As part of his duties as BU's treasurer, Condon attended meetings of the audit committee, the investment committee, the executive committee and Board of Trustees' meetings. For convenience, BU, Silber, Condon, and Cassidy are sometimes referred to as the "BU Defendants."

the time Seragen began trading publicly until the merger.[6]

Plaintiffs are former holders of Seragen's common stock and represent the class of persons, other than Defendants and their affiliates, who owned Seragen common stock on November 4, 1997 and August 12, 1998, when Seragen merged with Ligand.

B. *BU Acquires Seragen and the Massachusetts Attorney General is Unhappy*

In August 1987, BU purchased a controlling interest in Seragen for $25 million.[7] Sometime after BU gained its controlling interest in Seragen and before Seragen went public, BU elected various persons, including Silber, Cassidy, and Condon, to Seragen's Board.

As a result of BU's significant investment in Seragen, the Massachusetts Attorney General investigated the relationship between BU and Seragen. On January 15, 1992, the Trustees of BU and the Attorney General entered into a letter agreement under which BU committed to "use best efforts to reduce significantly its financial exposure resulting from the Seragen investment and its financial commitment to Seragen."[8] BU also agreed to make monthly reports to the Attorney General on the "status of this reduction of financial exposure" and "all further expenditures and financial commitments made to or on behalf of Seragen." In addition, BU agreed to obtain the consent of the Attorney General before making any other investment in Seragen.

C. *Seragen Goes Public*

In April 1992, Seragen completed its initial public offering, raising $36 million.[9] Also in April 1992, BU established the Seragen Oversight Committee "to exercise Trustees' responsibilities to manage the University's investment in Seragen."[10] The Oversight Committee was "composed of persons who [had] no personal financial interest, direct or indirect, in

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[6]Pretrial Stipulation ("PT Stip.") at 5-6. Shortly before trial, Prior, Nichols, and Jacobs settled with the Plaintiffs. The settlement was approved on November 2, 2005.

[7]Tr. 195; JX 131 at BU06250.

[8]JX 1. The Massachusetts Attorney General was concerned that "the Seragen Investment may constitute an undue concentration in a risky venture." *Id.*

[9]PT Stip. at 6; Tr. 459.

[10]JX 26 at BU12301.

Seragen"[11] and was chaired by Earle C. Cooley ("Cooley").[12] In March 1993, Seragen raised an additional $16.5 million in a second public offering.[13] Later, in 1994, Seragen obtained $6.5 million through a private placement of common stock.[14]

Continuing the effort to raise capital, in August 1994 Seragen entered into a strategic alliance with Eli Lilly and Company ("Lilly"), by which Seragen received $10 million from Lilly and the prospect of procuring an additional $45 million.[15] The Lilly partnership created substantial optimism within BU and Seragen and throughout the investing public. Seragen had continually reported high hopes for itself and its upcoming products to BU's Board of Trustees and to the public.[16]

D. *The Loan Guarantee Transaction*

Seragen, as a biotechnology company without a product in the marketplace, was required to commit relatively large sums to research and, thus, was spending its cash almost as soon as it was raised. Despite Seragen's partnership with Lilly and the funds that the relationship brought with it, it was clear, by February 1995, that Seragen was in a severe cash crunch and could potentially run out of funds sometime in July.[17] Addressing this desperate need for financing, Seragen entered into the Loan Guarantee Transaction on June 7, 1995.[18] This transaction, which raised $23.8 million, was described by Seragen as:

> [T]hree separate lines of credit which are guaranteed by three different entities for a total of $23.8 million in bank financing for the Company. Boston University, the Company's majority stockholder, is the lead guarantor,

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[11] *Id. See also* Tr. 205-06. Many members of BU's Board of Trustees were in some way invested in Seragen.

[12] Tr. 459. *See also* JX 131.

[13] Tr. 459. *See also* JX 131.

[14] JX 181; Tr. 460-61.

[15] JX 131. JX 26 at BU12327-28; JX 27 at BU12371 (George Masters ("Masters"), former chief executive officer of Seragen, stating at a BU Board of Trustees meeting that "[t]hrough the agreement with Lilly, we got $45 million, $10 million up front, another $10 million for milestone payments and an additional $25 million to come through the exercise of options. In addition to that $45 million opportunity, Lilly also committed to spend $17 million in clinical trials pushing forward our cancer opportunities.").

[16] Masters, as a representative of Seragen, often reported at the BU Board of Trustees meetings. *See, e.g.*, JX 26 at BU12301 (March 1994 Meeting), BU12313 (July 1994 Meeting), BU12330 (October 1994 Meeting).

[17] JX 36.

[18] JX 84 at 18.

> providing a guarantee of $11.8 million. Two other guarantors [Hirsch and Cassidy] have guaranteed a total of $12 million. Upon the closing of the lines of credit, the Company issued warrants to the guarantors to purchase 2,776,664 shares of its common stock at an exercise price of $4.75 per share. The warrants are exercisable immediately and expire in 2005. The Company has estimated the fair market value of the warrants to be $1.50 per warrant or $4,164,996 for the 2,776,664 issued and outstanding warrants.[19]

The Plaintiffs have characterized this transaction as "the beginning of the end" for Seragen's minority common shareholders because they believe that it was at this juncture that BU first caused Seragen to avoid the public equity markets in favor of the Loan Guarantee Transaction which prevented a significant dilution of BU's interest in Seragen. Although any challenge to this transaction is time barred, the question of whether other financing options existed in June 1995 is important to an understanding of the context in which the pending dispute arose, and, thus, a digression may be appropriate.

By mid-1994, it had become apparent to both BU and Seragen management that Seragen would have to raise additional funds or it would be unable to continue its operations. Also, if Seragen failed, BU, as a large investor in Seragen, would suffer significant losses. Seragen turned to loan guarantees by BU-associated investors for two reasons. First, it could not borrow funds conventionally; the banks would not lend the needed funds on Seragen's credit alone. Second, BU was concerned that the issuance of more stock would dilute its equity interest in Seragen.

Various Seragen and BU representatives in 1994 painted a rather self-serving portrait of BU's motivations for pursuing the Loan Guarantee Transaction. For example, as early as July of 1994, Silber, when describing the Loan Guarantee proposal to the BU Executive Committee, stated:

> [I]f we can expand [Seragen] now, and develop [Seragen] by bank loans, instead of by dilution, it's going to be far better for [BU] . . . if we take all these steps, it's going to be pretty hard for the Attorney General to say no because it would require us not to fulfill our fiduciary responsibility to seek the interests of [BU] and protect the

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[19] *Id.*

> interests of [BU], but to ignore those concerns entirely on the instructions of the Attorney General.[20]

Not only had Silber informed the members of BU's Executive Committee of the importance of maintaining BU's majority position in Seragen, but also he stated that to do otherwise would leave them in breach of their duties to BU, seemingly with no worries about duties that BU's Seragen directors owed to Seragen and Seragen's other common stockholders. At trial, Silber expressed his concern for the consequences of dilution on all holders of Seragen common stock as follows:

> I'm a little concerned for the best interest of all the stockholders of Seragen, including [BU] and including myself, in which I had a major investment. It would not be fair to the stockholders to engage in a deal which involved a great deal of dilution if it were possible to find another means of financing the company that did not involve that dilution.[21]

At the October 1994 annual meeting of the BU Board of Trustees, Cooley told the Trustees that Seragen's issuing between three and four million shares pursuant to its business plan would reduce BU's holdings and the potential value of these holdings.[22] Additionally, Cooley stated:

> In view of the significant dilution that [the issuance of shares] represents in the value of the University's holdings of Seragen common stock as well as the holdings of a majority of the other stockholders that would result from any sale . . . at prices within the recent range[,] Mr. Masters requested the Seragen Oversight Committee to consider, in the interest of avoiding dilution, approval of a bank Loan Guarantee by [BU] for Seragen up to $30 million. In return . . . [BU] would receive a substantial number of warrants to purchase Seragen common stock at attractive prices. If [BU] were to provide this guarantee it

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[20]JX 26 at BU12319. At the same meeting Silber stated: "If we can avoid [public offerings], and do some of this by bank loans, and have the two million shares come to Boston University, it will be greatly in our favor. And, for us to fail to do this now, when the risk is so substantially reduced by virtue of this agreement, seems to me it would be a great mistake and a great lost opportunity." *Id.* at BU12320.

[21]Tr. 245-47.

[22]JX 26 at BU12336-37.

> could avoid at least 3/4 of the dilution anticipated by the issuance of the new shares, thus preserving the value of its holdings. . . . [This] method of financing Seragen's development without further dilution is clearly in the interest of both [BU] and all other stockholders.[23]

At this time, BU was optimistic about Seragen's future, its potential for profitability, and its ability to raise capital in the market.[24] Thus, the Plaintiffs suggest that BU pursued the Loan Guarantee Transaction not only to protect its own controlling position but also to turn a tidy profit on its investment. But for the evidence of Seragen's inability to raise capital) and the viable time bar defense available to the Defendants, such optimism, combined with the self-centered concern about dilution of BU's interests, may have led the Court to conclude that the Loan Guarantee Transaction was a deliberate avoidance of the public market in order to prevent dilution of BU's control of Seragen as well as to maintain BU's profit potential in Seragen.

Sometime in late 1994 or early 1995 Silber began soliciting high net worth individuals to participate in the Loan Guarantee financing.[25] Silber, by letter dated January 26, 1995, reported to Masters that Hirsch had made a commitment for a "loan guarantee of $5 million with the understanding that he would be given warrants for 500,000 shares of [Seragen common stock.]"[26] In a letter to Hirsch, dated January 27, 1995, Silber expressed his hope that the Attorney General would approve BU's participation in the Loan Guarantee.[27] He also told Hirsch, "I think we have squeezed virtually all the risk out of this enterprise except the risk

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[23]*Id.* at BU12337. The Seragen Oversight Committee adopted a resolution approving the Loan Guarantee Transaction, subject to clearance by the Attorney General.

[24]*See* Tr. 662-63. According to Condon, the Lilly announcement was good news and it authenticated Seragen's technology. Masters stated at the July 1994 Executive Committee meeting that "[m]ore importantly, what this Lilly agreement means to us, it validates our technology as far as the outside world is concerned. That's why we got so many, what I would call positive endorsements in terms of the media." JX 26 at BU12317. Masters also shared his optimism: "[w]e now have, on the strength of the Lilly announcement a number of bankers chasing us, and we have financial opportunities that we are going to review . . . . So, I think from our perspective, the Lilly deal really puts us in solid shape." *Id.* at BU12318. Even Defendants' own expert testified that following the Lilly announcement Seragen may have been able to raise more capital in the market. Tr. 1578. Seragen's management eventually took a less favorable view of the Lilly arrangement. *See infra* text accompanying note 113.

[25]It should be noted that the Loan Guarantee had not yet been approved by Seragen or the Attorney General and at this point Silber was just building his list of potential investors. Hirsch testified that Silber told him that Seragen would be a great investment. Tr. 161; 166-67.

[26]JX 30.

[27]JX 31.

associated with having the necessary financing to reach profitability."[28] Cassidy also agreed to participate and to provide a loan guarantee of $1 million for which he would receive warrants to purchase 116,600 shares of Seragen common stock.[29] Silber, despite sending enthusiastic letters to other potential investors, was unable to persuade anyone else to participate in the Loan Guarantee.[30]

Initially, BU committed $11.8 million, Hirsch committed $7.5 million and Cassidy committed $1 million, for a total of $20.3 million.[31] However, sometime after March 28, 1995, Cassidy and Hirsch increased their commitments, bringing the total to $23.8 million.[32] Although Cassidy served on Seragen's Board, he did not involve himself in the negotiations or the decision-making process surrounding the Loan Guarantee, and, instead, it appears that Cassidy accepted the terms that Seragen offered.[33] Cassidy did testify, however, that he believed that Hirsch might have negotiated the terms of the Loan Guarantee.[34] The final Loan Guarantee terms were unanimously approved on March 6, 1995, by Seragen's Board, including its three disinterested members.[35]

The Loan Guarantee Transaction was not without its other procedural issues. For example, both BU and Seragen were represented in the transaction by the same law firm, a troubling fact which repeats itself. Silber stated that he did not believe "there was any conflict of interest because the interest of [BU] and the interest of the stockholders of Seragen was one and the same."[36] Apparently, the terms were negotiated by Hirsch, Hirsch's banking representatives, and Masters.[37] Hirsch, however, failed to recall having any involvement in the Loan Guarantee Transaction beyond

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[28]*Id.*

[29]JX 37.

[30]For example, Silber sent a letter dated January 28, 1995 to one potential investor in which he wrote, "The risks involved in providing a loan guarantee are exceedingly low, not only because of the strength of Seragen's patents, the soundness of its science and its extraordinary success in so many different clinical trials. The risk is also low because the patents and the technology by themselves can easily be sold to our partner Lilly . . . for a good deal more than $30 million." JX 32. *See also* JX 35.

[31]JX 44.

[32]*Id.*

[33]Tr. 734-35.

[34]*Id.* Tr. 737. After the terms of the Loan Guarantee were proposed, the three independent directors declined to meet separately. *Id.*

[35]JX 41. The other members of Seragen's Board were Silber, Cassidy, and Condon—all closely connected to BU.

[36]Tr. 294. *See also* Tr. 487-91 (Condon testified that he could not recall that anything had been done to ensure the fairness of the transaction.).

[37]*Id.* Thomas Konatich (Konatich), Seragen's chief financial officer at the time, also participated. Tr. 488.

simply implementing its terms.[38]

While Silber was trying to assemble a roster of investors for the potential Loan Guarantee Transaction, executives at Seragen, especially Masters, were continuing to look for alternate methods to raise essential additional capital, particularly through public financing. It appears, however, that no alternative public or favorable private financing was available to Seragen. For example, a February 7, 1995 letter from Morgan Stanley to Masters recited that "[i]t would seem there is not a lot of support by our partners to make investments in biotech companies."[39] Additionally, minutes from Seragen Executive Committee meetings and memoranda from Seragen executives to the Board indicate that, although Seragen was investigating the potential for a public equity sale and even a private placement, those opportunities were either unavailable or would have been less beneficial and more costly than the Loan Guarantee Transaction.[40] According to Masters, Seragen had sought every financing "vehicle known to man," yet it was unable to find a bank that was willing to back an effort to raise capital in the public markets.[41] Perceiving bankruptcy as the only other option, Masters, as well as Konatich, recommended the Loan Guarantee Transaction.[42] Even at the March 6, 1995 Seragen Board meeting, the very meeting at which the Loan Guarantee Transaction was approved, there was a discussion of alternatives to the Loan Guarantee in which the Board recognized that "[t]he Company's investment bankers have advised that [a private placement] would most likely require shares to be sold at a significant discount from current market price, in addition to the issuance of warrants" and that a public offering was unavailable as "all of

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[38]*See* Tr. 158-67, 191.

[39]JX 34.

[40]Notes from the February 22, 1995 Executive Committee meeting state that the Loan Guarantee was the "best mechanism for raising capital" and that there were "three investment bankers willing to do an offering when the public market recovers and [Seragen's] share price is at an appropriate level," but none was willing to proceed at that time. JX 36. The named banks were Oppenheimer & Co., Dillon Read, and A.G. Edwards. Additionally, a March 3, 1995 memorandum from Konatich to Seragen's Board states that Konatich had a discussion with a banker at Goldman Sachs and that the banker believed that there was "no public market for biotechnology companies like Seragen" and that no public offering could approach the amount already secured in the Loan Guarantee. JX 39. Konatich reported that Goldman had "little interest in managing a private equity offering for Seragen" and that "[a]ny private placement would likely require a substantial discount from the current markets, or warrants, or a combination of both." *Id. See also* JX 39A (memorandum from Konatich to the Seragen Executive Committee in which he demonstrated that, based upon the then-current market for biotechnology companies, the current share price, and advice he had received from Goldman Sachs, the dilution from the Loan Guarantee would be 800,000 shares less than would have been required for a private placement or other equity sale).

[41]Dep. of George Masters at 25-27.

[42]*Id.* at 30; JX 39A.

the investment bankers [that] the Company has spoken to do not believe a reasonable offering could be accomplished at this time."[43]

The Plaintiffs contend that, despite the written and testimonial record of Seragen's efforts to secure alternative financing, no such attempt was truly made and, if Seragen had chosen to do so, it could have found alternative financing on materially superior terms to the Loan Guarantee Transaction.[44] The Court is convinced that however self-serving the motivations may have been to enter into the Loan Guarantee Transaction, and however positively some may have viewed Seragen's prospects, Seragen did not in fact have other reasonable financing alternatives available to it.

E. *The Series B Transaction*

Not long after the loans secured through the Loan Guarantee Transaction infused $23.8 million into Seragen, Seragen encountered more serious financial problems. NASDAQ, the exchange on which Seragen's shares traded, classified the $23.8 million from the Loan Guarantee Transaction as debt instead of equity, and, on April 16, 1996, NASDAQ threatened to delist Seragen because Seragen did not meet its net tangible asset requirement.[45] NASDAQ requested that Seragen submit its proposal for achieving compliance by April 30, 1996.[46] Immediately following the receipt of this letter, Masters and other members of the Seragen Board devised alternative strategies to avoid delisting. Two suggestions were (1) convince NASDAQ that the $23.8 million was in fact equity and, if that failed, (2) persuade the three loan guarantors to pay off the loans that they had guaranteed in exchange for an enhanced equity position in Seragen.[47] Additional financing options were also discussed, including contacting other high net worth individuals about potential investments in Seragen, BU's possible sale of a major asset with the proceeds going to Seragen, and a possible Regulation S offering through Scharff, Witchel & Co. ("Scharff,

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[43]JX 41.

[44]The Plaintiffs have argued that the BU Defendants should have produced at trial the bankers who informed Seragen's management that no other form of financing was available or feasible. That is a fair argument, but it does not alter the Court's conclusion.

[45]JX 88. Condon testified that at the time of the Loan Guarantee that he was "not aware of the NASDAQ regulations with respect to their listing/delisting requirements" and that he did not incorporate this possibility into his analysis of the Loan Guarantee Transaction. Tr. 477. All parties agree that delisting would have had serious, negative consequences for Seragen and its shareholders.

[46]JX 88.

[47]*See* JX 89. *See also* Tr. 507, 522-24.

Witchel").[48] All attempts to convince NASDAQ that the $23.8 million loan obligation was equity quickly proved fruitless.[49]

On May 13, 1996, Seragen's Board unanimously authorized the Company to engage Scharff, Witchel to act as an agent to raise $4 million in a Regulation S offering.[50] According to Condon, all major decisions regarding this financing were influenced by the need for prompt action in light of the threatened NASDAQ delisting.[51] Through this transaction, Seragen issued its Series A Preferred stock ("Series A") to a third party investor.[52] Seragen expected a financing comprised of two separate $4 million tranches, one to be completed in June of 1996 (the Series A), and the second tranche to be completed by July or August of 1996.[53] The principal terms of the Series A were as follows: the Series A shares were convertible at the option of the holder, beginning in July 1996, into shares of Seragen's common stock at a conversion price equal to the lesser of: the closing bid price on NASDAQ on May 28, 1996; or 73% of the average closing bid prices for a specified period prior to the conversion date.[54] The Series A shares also provided for dividends payable in shares of Seragen's common stock.[55] Issuance of the Series A raised $4 million for Seragen (because of costs associated with the offering, Seragen netted $3.8 million).[56] However, this was not nearly enough additional capital to avert NASDAQs potential delisting.

At the same time, there were serious ongoing discussions both within Seragen and by the Seragen Oversight Committee concerning what to do with the Loan Guarantee financing. By May 14, 1996, Seragen's counsel, who also represented BU, had sent to all three loan guarantors

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[48]JX 89.

[49]The Plaintiffs suggest that the Loan Guarantee Transaction created the delisting crisis and, thus, the purported immediate need for the Series B transaction. The Series B transaction (which would convert the debt of the Loan Guarantee Transaction into equity) was an available solution to the delisting challenge. It is, however, not fair to say that the crisis was created by the Loan Guarantee financing. The crisis, instead, was the result of the overall fiscal condition of Seragen—if it had not been spending its cash at such a prodigious rate, the balance sheet conditions that aroused NASDAQs concerns would not have existed (or existed as soon). Accordingly, the "problem" addressed by the Series B financing was not the Loan Guarantee Transaction; it was more fundamental: Seragen's unfortunate financial circumstances.

[50]JX 97; JX 103.

[51]Tr. 530-31.

[52]Tr. 530.

[53]JX 102.

[54]JX 104; JX 109.

[55]JX 104. The final terms were established on May 28, 1996, and did not materially differ from the earlier terms of May 13, 1996. JX 109.

[56]*Id.*

draft letters of intent describing a proposed restructuring of the loans.[57] On July 1, 1996, Seragen and the loan guarantors proceeded with the restructuring by issuing the Series B Preferred Stock ("Series B").[58] In exchange for the guarantors assuming or satisfying Seragen's $23.8 million liability to the banks, the guarantors were issued 23,800 shares of the newly created Series B at a per share price of $1,000.[59] Effectively, for each $1 million of loan amount guaranteed and satisfied (or assumed), Seragen issued $1,000 in Series B shares with a liquidation preference, a floating dividend, equal initially to the interest rate payable on the guaranteed loan, and voting rights, not exercisable as a separate class, equal to 250,000 shares of common stock; the shares were redeemable at Sera gen's option after May 1999 at a redemption price equal to the purchase price per share plus accrued dividends.[60] The Series B shares were also convertible at the holders option: each Series B share would convert into the number of shares of common stock equal to $1,000 divided by the average of the closing sale price of the common stock as reported by NASDAQ for the preceding ten consecutive trading days.[61] Furthermore, BU, Hirsch, and Cassidy received warrants to purchase Seragen common stock at $4.00 per share,[62] in addition to the warrants already received for the original Loan Guarantees.[63] No dividend was ever paid to the Series B shareholders and no Series B shares were ever converted into shares of common stock. This transaction ended, for a time, NASDAQs threatened delisting because it provided sufficient equity to allow Seragen to meet NASDAQs standards. However, Seragen received no "new" money; the transaction only served to reclassify the debt from the Loan Guarantee Transaction to equity. On the day the Series B restructuring was announced, Seragen common stock gained 22%.[64]

The Plaintiffs contend, and this Court concurs, that the Defendants failed to adopt or follow any procedures or safeguards that would have ensured that the Series B transaction was entirely fair to Seragen's minority shareholders. Condon testified that, as with the Loan Guarantee Transaction, both BU and Seragen were represented by the same law firm.[65]

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[57]JX 99. A second draft went out on May 22, 1996. JX 101.

[58]JX 118.

[59]JX 112; JX 118.

[60]JX 101; 118.

[61]*Id.*

[62]Although valued by Seragen at $8.6 million, the warrants issued in connection with the Series B were "under water" when issued and never reached the surface. JX 262 at 122.

[63]In its 1996 annual report, Seragen reported the fair market value of the warrants issued in connection with the Loan Guarantee Transaction as $4,104,996. JX 84 at 005912.

[64]Tr. 976.

[65]Tr. 502-04.

No independent committee was formed to evaluate or to negotiate issuance of the Series B.[66] Condon also testified that the terms of the Series B issuance were set by Konatich.[67] However, Condon indicated that both Hirsch and Cassidy played some part in the Series B negotiations, and he recalled:

> [T]here was a discussion with respect to offering the same opportunity to other shareholders [to buy into the Series B], but what it came down to [was] that [Hirsch], who was not . . . a related party with Seragen, if you will, was the one who we would have to follow with respect to his structuring the deal. And it was sort of a take it or leave it kind of thing.[68]

Hirsch, however, had no recollection of any involvement with the Series B transaction except for having his shares converted.[69] In other words, Hirsch claims that he took no part in the Series B negotiations. Cassidy also testified that he did not negotiate the terms of the Series B.[70]

Silber's approach to the retention of counsel is symptomatic of the interrelationship of BU and Seragen. When asked if Seragen had retained independent legal counsel during the Series B negotiations, Silber stated that he believed that the lawyers "were independent counsel, because there is no separation of interest between Boston University and the [minority] stockholders of Seragen. Consequently, there was no conflict of interest, and that means that the counsel that represented both was independent counsel."[71] When Silber was asked what, if anything, was done to establish the fairness of the Series B, he responded that he thought:

> [T]hese nonparticipating shareholders of Seragen, including myself, were highly benefited by the fact that money came in that kept us from going bankrupt. . . . [T]he wonderful thing was that [BU] and the people it persuaded to join them in that loan guarantee saved the company and consequently saved the interest of every single stockholder who had invested in Seragen.[72]

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[66] *Id.*
[67] Tr. 658.
[68] Tr. 505.
[69] Tr. 168.
[70] Tr. 736.
[71] Tr. 305.
[72] Tr. 306-07.

F. *The Series C Transaction*

Because of Seragen's continuing high cash burn rate, the Series B did not permanently remedy the delisting problem, and NASDAQ, on August 21, 1996, again notified Seragen that, if it did not meet certain capital requirements, Seragen would be delisted.[73] On September 12, 1996, NASDAQ granted Seragen an extension on its potential delisting until November 15, 1996.[74] That extension was predicated upon Seragen's "us[ing] its best efforts to complete a private placement of $4 million of convertible preferred stock."[75] Seragen had represented that the private placement would be completed by September 30, 1996.[76] The preferred shares which Seragen had planned to issue, with Scharff, Witchels assistance to the holder of the Series A shares, were to have a 34% conversion discount to market plus 250,000 ten-year common stock warrants per million dollars invested.[77]

According to Condon, the delisting crisis arose again at this time because the Series A holder which had a right of first refusal on the additional financing, wanted more generous terms in the second tranche than it had received under the Series A, and Seragen was forced to look elsewhere for the $4 million it had expected to receive from the Series A holder.[78] Scharff, Witchel, however, was unable to secure additional financing and, on September 24, 1996, as the September 30, 1996, deadline for completing the private placement approached without any other potential investors available, Cooley, also the Chairman of BU's Board of Trustees, approved an emergency $5 million cash investment in Seragen to avoid a NASDAQ delisting; these funds were delivered to Seragen the next business day, September 27.[79] Cooley, on his own, had concluded that Seragen needed an immediate cash infusion from BU, and he expected that the cash would "be replaced or returned to [BU] through a private

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[73]JX 132; JX 133; Tr. 555-56

[74]JX 141.

[75]*Id.*

[76]*Id.*; JX 142. It appears that before retaining Scharff, Witchel, Seragen had some contact with MeesPierson Inc. about raising funds but they could not agree on terms. *See* JX 140. It also appears that there were some discussions concerning a possible financing with RBC Dominion Securities. JX 132. *See also* JX 136. Additionally, there may have been some discussions concerning a possible sale of Seragen to another entity, and Seragen went so far as to hire Lehman Brothers to provide financial services with respect to the possible sale. JX 146; JX 154. However, for reasons that were not explained at trial, the sale did not occur.

[77]JX 142.

[78]Tr. 557, 561, 574; JX 127.

[79]JX 171 at 12417-21; Tr. 643

placement by the end of the fiscal year on June 30, 1997."[80]

When Cooley decided to proceed with the transaction, he had not yet been presented with any terms of the Series C. Condon testified that the terms of the Series C were not determined until after the $5 million had been invested and that the documents memorializing the transaction were backdated.[81] However, Condon later recanted this testimony and stated that the deposit of the funds with Seragen and the issuance of the Series C were simultaneous.[82] For the Court's purposes, it is not so much when the terms of the Series C were determined but who negotiated them because, as with the Series B, insiders negotiated the terms of the Series C.

The Seragen Board voted to issue the Series C shares on September 27, 1996, and the shares were issued on September 30, 1996.[83] The terms of the Series C were that BU, for its $5 million investment would receive 5,000 shares; they were convertible at BU's discretion into Seragen common stock at a per share conversion price equal to the lesser of $2.75 or 73% of the average closing bid prices for the five-day period prior to the conversion date, up to a maximum of 3,360,625 shares; if not previously converted, all shares would be converted to common shares on March 31, 1998, except that those Series C shares which could not be converted because of the conversion maximum would be repurchased by Seragen for $1,150 per share; and Seragen had the right to redeem the shares upon the repayment of principal only.[84] However, NASDAQ questioned the requirement that Seragen repurchase the unconverted shares; it suggested that this provision might prevent treatment of the $5 million from the Series C as equity. On November 25, 1996, BU, to satisfy NASDAQ and to avoid delisting, irrevocably waived the right to have Seragen buy back any Series C shares that did not convert because of the conversion limit.[85]

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[80]JX 171 at 12418. *See also* Tr. 575-77.

[81]Tr. 574-77.

[82]Tr. 641-42.

[83]JX 145; JX 146.

[84]JX 145; JX 262 at 127.

[85]JX 167. The waiver reads in part:

> Notwithstanding said paragraph 3.c.ii [the paragraph which allows the buyback] the undersigned [Condon on behalf of BU] hereby agrees to waive forever its right to exercise the option set forth in the last sentence of such paragraph to cause the Company to repurchase its Series C Shares in the event that it is unable to convert such shares as a result of the limitation set forth in the penultimate sentence of such paragraph (the "Repurchase Option"). The undersigned further agrees that it will not transfer its Series C Shares unless its transferee aggress to execute a waiver in the form of this letter and to cause any further transferee(s) to do the same.

See also Tr. 581-82. This waiver will take on added significance. Briefly, as of March 30, 1998, 1,060 Series C shares automatically converted into 3,360,625 shares of common stock, and

The procedures followed in issuing the Series C also raise fundamental questions about its fairness to the other holders of Seragen common stock. As with the Series B, Silber was unable to recall whether an independent investment advisor opined as to the fairness of the Series C transaction, or whether any steps were taken to insure the fairness of the Series C transaction.[86] Cassidy and Condon also testified that they were unaware of any steps taken to insure the fairness of the Series C.[87]

Although process to assure fairness was lacking, BU, nonetheless, took the Series C on less desirable terms than Seragen had privately negotiated at arms-length with the Series A holder through Scharff, Witchel.[88] The proposal to the Series A holder involved a 36% discount to market while the Series C shares received by BU, on a converted basis, only carried a 27% discount to market (or $2.75 per share, if less).[89]

G. *The Lack of Financing Alternatives*

As to the Series B, and to a lesser extent the Series C, the Plaintiffs have again argued that BU caused Seragen not to take advantage of other sources of funding and instead to engage in the Series B and Series C transactions, because it served to benefit BU and its affiliates. Both sides have presented experts on the question of financing available to Seragen in the summer and fall of 1996,[90] and for reasons set forth below, the Court concludes that there were no reasonable financing alternatives.[91] The Court relies upon Defendants' expert Katherine Kirk ("Kirk").[92]

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although BU had waived the right to have Seragen repurchase its outstanding unconverted Series C shares, Seragen repurchased the remaining 3,940 Series C shares for an aggregate purchase price of $4,530,461. PT Stip. ¶ II(D)(3). Defendants assert that BU was entitled to receive not only $4,530,461 as the $1,150 payment per outstanding unconverted share, but also $2,453,256.25 as the payment of $0.73 per share merger price of the Series C shares that did convert to common shares. BU, the Series C shareholder, accepted $5 million from the merger proceeds as total satisfaction for what it believed it was owed; however, it did so by ignoring the irrevocable waiver it signed.

[86]Tr. 311-12.

[87]Tr. 585, 715-16.

[88]*See* JX 272 at 13.

[89]*Id.*; JX 262 at 127.

[90]Expert testimony must be both relevant and reliable to be admitted, and the Court may look to testing, peer review, error rates and acceptability in the relevant scientific community when determining reliability. *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513 (Del. 1999) (citing *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589 (1993)).

[91]As the Lehman Brothers representative who advised Seragen about the merger with Ligand put it: "[t]he biotech industry is the single most capital-intensive industry in the world, which means that raising capital is the single biggest issue . . . ." Dep. of Frederick Frank ("Frank Dep.") at 19.

[92]Kirk is a former managing director of Hambrecht & Quist, an investment bank that

In reaching her conclusion that Seragen was not financeable from 1995 through 1997, Kirk drew upon her significant and successful experience as a banker who had raised funds for many biotechnology companies.[93] The factors considered in determining whether a biotechnology company could raise capital were "the company's technological capabilities, [its] ability to formulate and complete clinical trials; the projected time frame to revenues and profits; the size of the ultimate market [and the] intellectual property portfolio."[94] In addition, the product pipeline was "absolutely crucial" in determining whether a biotechnology company could raise capital because progress in clinical trials was "really the only litmus test that investors had that was tangible."[95]

After examining Seragen's product pipeline from the end of 1995, Kirk concluded that Seragen was foundering because, of Seragen's seven products in clinical trials, five had stalled with insignificant results or no response from patients, and one trial was halted due to serious side effects in a test subject.[96] Kirk drew similar conclusions concerning the clinical development outlook in 1996, finding that Seragen had dropped several trials, including those for large markets, and that Seragen's clinical drug program had "been severely diminished."[97]

Kirk also stated that, beyond the product pipeline, investors would typically look to the company's finances because it needed the resources to develop its products, and "if a company had less than one year's cash . . . they were vulnerable and on the rocks."[98] Examining Seragen's finances, Kirk ascertained that Seragen was running out of cash by the end of 1995; that it was in "dire straights," and that Seragen's auditors had issued going concern qualifications.[99] Additionally, Kirk concluded that the addressable markets for the drugs that Seragen was developing had drastically shrunk from initial projections, and that they were so small, in fact, that they could not be profitable enough to cause investors to have any interest in

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specialized in high technology offerings, especially for biotechnology companies. *See* JX 272. She testified that she had raised capital for more than 100 companies during her tenure, and that more than fifteen of those had been biotechnology companies. She had met with Seragen in 1992 or 1993 and determined that it was not a potential client for Hambrecht & Quist because it did not have any near term prospects that she thought were encouraging. Tr. 1543.

[93]JX 272. *See also* Tr. 1535.

[94]Tr. 1514.

[95]Tr. 1514-15.

[96]Tr. 1521-24. *See also* JX 272 at 21. Kirk also noted that in the beginning of 1995 these trials had looked very promising. Tr. 1522.

[97]Tr. 1524-28. According to Kirk, "from the time [Seragen] went public . . . there was waning interest in [Seragen]" because its product pipeline continued to deteriorate. Tr. 1615.

[98]Tr. 1515-16.

[99]Tr. 1528.

Seragen.[100] After evaluating Seragen's product development pipeline, Seragen's financial situation in 1995-96, and the ever-shrinking potential markets for Seragen's potential products, Kirk concluded that "Seragen at the time . . . was not financeable."[101]

Plaintiffs' expert, J. Mark Penny ("Penny"), opined that in the summer of 1996 Seragen did in fact have a number of alternative financing options available to it that would have been more beneficial than the Series B transaction.[102] Penny, however, does not have the relevant work experience and has not relied on generally accepted methods for determining whether Seragen could have obtained alternative financing in 1996. The Defendants, with some persuasive force, have argued that his testimony should be excluded. The Court, however, has determined that it is appropriate to deal with Penny's opinions on their merits instead of excluding him as an expert.

Penny's report asserts, in a disconcertingly generalized manner, that because the biotechnology market had product sales of $10.8 billion in 1996 (up from $9.3 billion in 1995), because the period from mid-1995 to mid-1996 was strong for biotechnology public offerings, and because other biotechnology firms were able to raise significant capital through public offerings, Seragen must have been able to raise significant capital and simply opted not to do so.[103] It is the Court's perception, as confirmed by Kirk, that simply because peer companies were able to raise funds does not signify that Seragen would have been able to raise funds because "[p]eople were going to look at Seragen. [T]hey weren't going to care if some other company was raising money."[104] What mattered was whether Seragen was a good investment opportunity, and Penny took no meaningful steps to evaluate Seragen in that light. Penny instead testified that Seragen's weak financial condition at the beginning of 1996 was due to the Loan Guarantee Transaction, but Penny had no opinion on the effect the poor trial results

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[100]Tr. 1529-33. *See also* JX 272 at 22.

[101]Tr. 1535. Kirk testified that despite Ontak's (a drug that Seragen had developed) $25 million revenue during 2004 and projected 2005 revenue of $30 million, that type of revenue return would not be considered a success because "companies spend hundreds of millions of dollars and more than five years of time developing a product" and bankers look for potential profits in "excess of a billion dollars . . . not $30 million opportunities." Tr. 1536. The success (or failure) of a product six years after a merger is of limited, if any, value in assessing conduct before the merger. It does, however, undercut the Plaintiffs' concerns about (and any possible reliance on) post-merger developments.

[102]JX 271. Penny is a managing director of Hempstead & Company. Hempstead is a financial consulting company that specializes in valuation and related financial analysis. Penny, however, has never participated in raising funds for companies. Tr. 777.

[103]JX 271. Kirk said it best: "I don't believe [Penny] draws a conclusion . . . at all. He just makes the statement that companies comparable were raising substantial funds." Tr. 1544.

[104]Tr. 1545.

may have had upon Seragen's ability to raise financing.[105] Penny's opinion on this matter, beyond simply being outside his field of expertise, is based on only the slightest bit of scientific/technical knowledge, and he provides no data, rationale, or research specific to Seragen in order to support his conclusion. For these reasons, the Court accords no weight to his opinion that Seragen had viable or practicable alternative financing available.

H. *New Management for Seragen*

Shortly after the Series C transaction, Seragen hired Prior as its new chief executive officer.[106] Before taking the position at Seragen on November 6, 1996, Prior, had made a name for himself in the biotechnology world as a "turn-around executive."[107] Seragen was Prior's fifth biotechnology company, and, before he was hired, Prior interviewed with Silber, Hirsch, Cassidy, and Nichols, among others.[108] In addition to a yearly salary of $350,000, Prior's contract included stock options equal to 8.5% of the then outstanding common stock of Seragen measured on a fully diluted basis.[109] The options would vest in accordance with a schedule of 2.0833% on the date of his hiring and the same percentage on the first of each month thereafter so that all of the options would become vested before the fourth anniversary of his hiring.[110] However, in the event of a change of ownership, the options were to vest retroactively with 25% on the effective date and an additional 2.0833% on the first of each calendar month so that 100% shall be fully vested following the third anniversary of the effective date. Additionally, Prior was to receive 8.5% of the net proceeds resulting from a change of ownership during Prior's employment. This payment was known as the "Asset Value Realization Bonus."[111]

Prior described Seragen's condition upon his arrival as dire, with less than three months of money left in the bank and no prospects of raising any more.[112] Specifically, Prior noted:

> Shortage of cash was [the] number one [problem]. The four plus million dollars due [under an existing license

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[105]Tr. 824-26.
[106]*See* JX 168.
[107]Tr. 1176.
[108]Tr. 168-69, 720-21, 1777-78.
[109]JX 168 at 3-5.
[110]*Id.* at 4-5.
[111]*Id.* at 11.
[112]Tr. 1178.

> agreement] . . . was number two right up there. The constant selling, converting and selling of Series A . . . shares [was] depressing the stock price. The Lilly deal . . . was really terrible, had transfer prices basically below any projected potential manufacturing costs. And also the inability to do other corporate deals because of provisions in the Lilly agreement that prevented that . . . . [W]e had a serious problem there.[113]

On accepting a position with Seragen, Prior's plan was to reduce Seragen's cash burn rate by turning the company into a virtual biotechnology company through sale of the physical plant[114] and to raise additional capital by restructuring some of the preferred stock into common stock.[115]

I. *The Sale to Marathon*

Prior's first significant act as chief executive officer was the sale of Seragen's operating division to Marathon Biopharmaceuticals, LLC ("Marathon"), an entity created by BU expressly for the purposes of this sale, for $5 million. Silber presented the potential transaction to the Seragen Oversight Committee at its December 10, 1996 meeting and told the BU Board of Trustees that the proposed acquisition cost would be $5 million and that BU would be expected to enter into a services agreement under which BU would fund the facility's operating expenses for two years, up to a maximum of $9 million per year, or a total of $18 million.[116] Additionally, Seragen retained the right to re-purchase the facility for the original sale price, $5 million, plus any expenses incurred by BU and interest at ten percent.[117] The Seragen Oversight Committee approved the proposal, as did the Seragen Executive Committee,[118] and the transaction was consummated on February 19, 1997.[119] Prior expressed gratitude and felt "lucky" that BU was willing take the operating division because, in his opinion, the operating division was devouring cash at an incredible rate and nobody else was interested in purchasing the facility.[120] Prior testified that

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[113]Tr. 1465-66.

[114]Tr. 1466-67. A virtual biotechnology company retains its research but outsources its production. Tr. 317-18.

[115]Tr. 721-24.

[116]JX 180 at BU12444-45; Tr. 1345.

[117]JX 211 at App. B, 10-11.

[118]*Id.*

[119]JX 183.

[120]Tr. 1466-71.

he relied on the advice of a representative of Lehman Brothers which had been working with Seragen; the investment banker expressed the view that the transaction was necessary because otherwise Seragen could not survive with the operating division's cash consumption.[121]

For reasons not clear in the record, almost ten months later, the Seragen Board submitted this transaction for a shareholder vote during its December 16, 1997 Annual Meeting of Shareholders and provided substantial information in its November 4, 1997 proxy statement regarding both the Marathon transaction and the financial status of Seragen at the time.[122] The shareholders approved the Marathon transaction, although, it is unclear what would have happened at this late date had the shareholders failed to approve the transaction.[123] As with the Loan Guarantee, the Series B, and the Series C, this was yet another transaction with BU on both sides, and prudent steps to assure the fairness of this transaction are not evident.

J. *The USSC Transaction*

Between the Marathon transaction and the shareholder approval of that transaction, Seragen entered into a technology licensing arrangement that has become known as the USSC transaction. This transaction involved a licensing agreement executed by Seragen and USSC on July 31, 1997, under which Seragen granted USSC certain rights related to Seragen's fusion protein technology in exchange for $5 million.[124] Hirsch was both a director and officer of USSC; Silber was also a director in USSC and held a stake in the company. Hirsch, however, claims not to have been involved in any aspect of the USSC licensing agreement.[125] The agreement conferred upon USSC the option to pay an additional $5 million to affirm the agreement within fifteen months of the initial date.[126] However, if USSC chose not to exercise that option, USSC would receive $5 million in Seragen common stock based on the lower of the average of the market price for the preceding ten days or the stock price on the day the agreement was signed.[127] Seragen, if optimistic results were achieved, also stood to receive as much as $40 million from USSC over the ensuing three to four

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[121]Tr. 1467.

[122]JX 211 at 27-40.

[123]Because the Court previously dismissed the disclosure claims concerning the Marathon proxy statement, there is no need to consider the adequacy of that proxy statement.

[124]JX 194; JX 203.

[125]Tr. 186.

[126]JX 194.

[127]*Id. See also* Tr. 367.

years in potential milestone payments.[128]

K. *The Accord Agreement and the Merger*

With no end in sight to its financial problems, Seragen began to consider merger opportunities.[129] After months of discussion, an agreement in principle was reached between Seragen and Ligand for the acquisition by Ligand, on February 20, 1998, of Seragen and its operating assets (including Marathon) for aggregate consideration of approximately $75 million, with $70 million to be paid for Seragen and $5 million to be paid for the Marathon facility.[130] One of the conditions to the merger was that no more than ten percent of the common shares be presented for appraisal.

Although the Seragen Board believed that $75 million was a sufficient combined price for Seragen and Marathon, it remained necessary to allocate the merger proceeds among the various stakeholders of Seragen before definitive agreement could be reached and a proxy statement concerning the merger could be distributed.[131] To determine how best to allocate the proceeds of the merger, the BU defendants, other Seragen and BU insiders, and Hirsch (or his representatives) negotiated primarily among and against themselves to establish the discounts that they were willing to take on their various investments while at the same time taking into consideration the least amount of proceeds that it would be necessary to divert to the common shareholders in order to avoid the exercise of appraisal rights for more than ten percent of the common shares.

Although less than clear, the better inference is that Prior and Robert Crane ("Crane"), Seragen's chief financial officer, began the effort to provide the numbers to the various inside investors in their attempt to come to a final agreement on the discounts each would take.[132] The agreement allocating the merger proceeds among the various stakeholders came to be known as the "Accord Agreement."[133] Despite the fact that the allocation was to be decided by many interested parties, the Seragen Board, once again, failed to adopt or to follow any procedures to assure that the

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[128]JX 197.

[129]Despite the various efforts to raise capital, NASDAQ delisted Seragen on September 9, 1997. JX 262 at 117.

[130]JX 232; JX 262 at App. C (Agreement and Plan of Reorganization ("Merger Agreement")). The dispute before the Court is not a challenge to the fairness of the consideration paid by Ligand. The dispute is over its allocation among the various Seragen stakeholders.

[131]*See* Tr. 1368-69.

[132]Tr. 1372-74, 1404-05.

[133]JX 262 at App. F (Accord and Satisfaction Agreement, May 11, 1998) ("Accord Agreement").

division of the merger proceeds and the ensuing Accord Agreement and Merger Agreement were fair to Seragen's minority common shareholders.[134] The only disinterested member of the Board was Jacobs, and he was unavailable to perform any separate evaluation and negotiation.[135] Moreover, although Silber and Prior both testified that they relied on the opinions of a representative of Lehman Brothers for the fairness of the final allocation, no written opinion which stated that any such allocation was fair was ever presented.[136] Because the Court has not been provided with details of this opinion or the grounds for any such opinion, the Court is unable to rely on any such opinion in its entire fairness inquiry.

Describing the negotiations, Prior testified, "[w]e took the amount of money we thought we would have in total proceeds. We tried to figure out where we thought there were stakeholders who would be willing to take less in consideration of others doing the same and where there were ones that wouldn't."[137] Silber recalled that Prior:

> [n]egotiated [the allocations] and negotiated the steepest haircut that he could arrange from all the people that had to have their interest converted from preferred to common and with regard to warrants and with regard to their rights to certain intellectual properties, all of which had to be forfeited. And I think that [Prior] was the one who negotiated this and negotiated it so severely that I think that obviously the interest of the average stockholders and

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[134]*See* Tr. 1449-50.

[135]The only explanation for Jacobs absence was that he "was unavailable time-wise to do any kind of separate valuation." Tr. 1450.

[136]Indeed, Lehman Brothers' fairness opinion expressly disclaims any opinion regarding the fairness of the allocation. *See* JX 262 at App. A; *infra* text accompanying notes 268-70. The minutes of the Seragen board meeting, held on May 1, 1998, to approve the merger (JX 258), recite that Lehman Brothers reported that the merger consideration to the common shareholders (then expected to be $0.73 per share) "would be fair, from a financial point of view, to holders of Company Common Stock." Lehman Brothers fairness opinion contains the same statement. Although the minutes indicate that the Board was informed of the basis for this opinion, they do not include the reasoning. Thus, it is unclear whether Lehman Brothers had considered the various potential derivative claims, the question about the payments to BU for its Series C shares, or the new, and increased, price for the Marathon facility. The better inference is that no detailed assessment of the validity of those transactions was undertaken. *See* Frank Dep. at 158-59. Lehman Brothers did consider the typical financial data, trading history of Seragen's common stock, and operating information. JX 262 at 49. The "fair, from a financial point of view" conclusion appears to be premised upon understanding (1) that the consideration paid by Ligand for the enterprise was fair and (2) that the preferred stockholders took a substantial discount to the face value of their claims and the common shareholders received a substantial premium to market. Frank Dep. at 144-45.

[137]Tr. 1374.

> the minority stockholders was certainly clearly represented in that negotiation.[138]

Silber also stated that this was all one transaction; that nobody separately represented BU, Seragen, or Marathon in these negotiations, and that BU accepted a discount because it was the only alternative to the possible loss of its entire investment.[139] Prior testified that Ligand wanted the stakeholders in Seragen, including the common shareholders, to be satisfied with the deal, and even though the $75 million in merger consideration did not change from February through the close of the merger in August, the transaction remained cloaked in uncertainty until the final allocations were agreed upon by the interested parties.[140] Prior characterized the allocation negotiations as:

> an overall negotiation . . . [in which] we were just trying to get a fair allocation for the commons. We were trying to get rid of the creditors . . . . I remember trying to fight for total amounts; but where individual parties wanted divvied up amongst their pieces, we were as accommodating as we could be to get the darn deal done.[141]

Lastly, Prior "believed that if the commons got anything, it was fair."[142]

The principal participants in the process of negotiating the Accord Agreement recognized that there was a significant risk of litigation by

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[138]Tr. 347.

[139]*Id. See also* Tr. 352-53.

[140]Tr. 1396-99. The participation (or lack of participation) of the common shareholders in the allocation process is clear from the minutes of Seragen's board meeting on May 1, 1998 (JX 258): "Mr. Prior briefed the Board on the proposed agreement among the Company's preferred stockholders, creditors and obligees regarding the allocation of proceeds to be paid by Ligand in connection with the Merger." Absent is any reference to the common shareholders.

[141]Tr. 1413. It can be assumed that Prior meant that various parties were invested in more than one way in Seragen; thus, they were willing to take discounts on certain investments in return for payment on others. For example, Prior stated that Hirsch was willing to take a discount on his Series B shares as long as USSC received the full $5 million from the license agreement. *See* Tr. 1414-15. Hirsch has no recollection of this.

[142]Tr. 1463. If the preferred shareholders and other creditors had refused to accept less than their priority claims suggested that they were owed, there would have been nothing left for the common shareholders. However, if the common shareholders had received nothing, they likely would have either voted against the merger (which, as such, might not have mattered because of BU's voting control) or sought appraisal, at which point the merger very well may have failed (because of the ten percent cap on appraisal demands), and all parties would have lost their investments (except for what might have been salvaged in bankruptcy).

unhappy minority common shareholders. They were aware of the history of related party transactions between Seragen and BU and its affiliates. They also appreciated the importance of obtaining a premium for the common shareholders, especially because of the potentially adverse consequences for the merger if "too many" shares were presented for appraisal. In short, it is unlikely that the filing of this action came as much of a surprise to the defendant fiduciaries.[143]

Without the benefit of an independent advisor or even a dedicated advocate, the negotiations evolved into a process in which the principal concern was the division of the merger pie in such a way as to appease the minority common shareholders while at the same time ensuring transfer of the greatest amount of merger consideration to those invested in the various preferred shares and other credit arrangements. While Prior may have done his best, and the Court concludes that Prior did what he could under the difficult conditions, it is clear that he was too concerned with completing the merger to commit himself to representing the interests of the minority common shareholders. Additionally, Prior himself was faced with accepting discounts on payments that were owed to him under his

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[143]The Plaintiffs rely upon a February 25, 1998 memorandum (JX 234), purportedly authored by Robert Crane, Seragen's chief financial officer, that was directed to, among others, Cassidy, Hirsch, Prior, Silber and counsel for BU. *See* Pls.' Opening Post-Trial Br. at 11, referring to JX 232, but quoting from JX 234. That memorandum offered several interesting observations:

> The total proceeds of $70 million [the $5 million for Marathon had been omitted] are not sufficient to permit all shareholders to be paid in full and at the same time allow for the common shareholders to receive a premium to the market price. Company counsel strongly advises that Seragen pay a substantial premium to the current market price to the common shareholders, since Seragen will be unable to have an independent Committee of the Board of Directors approve the transaction and since there are numerous related party transactions between Seragen, [BU] and [USSC]. . . . In order to assure that at least $1.00 per share is allocated to the common stock, a number of concessions, including a discount of approximately 22% would be required of the [Series B], the [Series C], the investment bankers and management.

This document, thus, appears to support several key aspects of the Plaintiffs' case: (1) suggesting that the price for the Marathon facility at that point was $5 million; (2) recognizing the conflicts among members of Seragen's Board and the minority common shareholders; and (3) acknowledging the related party transactions. There is one problem: the exhibit was never admitted into evidence. No witness remembered it or identified it. Crane did not testify and there are no deposition designations that support the exhibits admissibility. It is the sponsoring party's responsibility to provide the necessary foundation for admission of an exhibit. Admittedly, cases of this nature usually involve a large number of exhibits; in this case, that number approached 300. There may be a tendency to assume that there will be no difficulty in introducing file documents into the record, especially because of the nature of a bench trial. It is difficult to accept that the Plaintiffs were unable to succeed in their efforts to introduce this exhibit, but they left the Court with little choice.

employment contract (the Asset Value Realization Bonus) and, therefore, it cannot be said that Prior did not have a personal interest in keeping the amount allocated to the minority shareholders low in order to avoid increased reductions in the sums owed to him. To this end, neither Prior nor anyone else on Seragen's Board ever questioned the value of the potential derivative claims held by Seragen concerning the Series B, the Series C, the Marathon transaction or the USSC transaction, and they therefore never took the potential derivative claims into account when determining or negotiating what the common shareholders should receive.[144]

Although the total consideration offered by Ligand did not change from late February through the closing of the merger in August 1998, the allocation to the purchase of Marathon did increase from $5 million to $8 million.[145] At some point before May 1, 1998 it was decided that Marathon, a BU entity, would receive $8 million instead of $5 million, thereby reducing the amount to be allocated among Seragen's various stakeholders to $67 million.[146] When asked to explain how the number allocated for the purchase of Marathon went from $5 million to $8 million, Silber, stated that, although he did not know for certain, it was likely because BU had been absorbing Marathon's operating losses and that it had continued to do so since the initial merger figures were established in February.[147] On this same point, Prior speculated that the increase from $5 million to $8 million was the result of strong negotiating by BU's counsel who believed that because Marathon had absorbed so many millions of dollars in operating losses that Marathon was owed more than $5 million.[148] Prior acknowledged that the losses incurred by Marathon far exceeded the $3 million dollar increase in the cost of Marathon.[149] Although Prior and Silber may have believed that an additional $3 million was owed to BU from Seragen because of Marathon's operating costs, the defendants have provided no persuasive evidence of this, and they have not demonstrated why BU was entitled to payments in addition to proceeds it otherwise received for the cost of the Marathon operation.[150]

The merger proxy statement, which was distributed on or about

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[144]Tr. 1408-09.

[145]*Compare* JX 232 at BU00661 *with* JX 262 at D-12. *See also* Tr. 1400.

[146]Tr. 1398, 1400, 1421; JX 262 at 50. It appears that the consideration to be paid to the common shareholders started out at approximately $1.00 per share, had at least one intermediate point of $0.83 per share (JX 254), and settled at $0.73 per share.

[147]Tr. 351-52.

[148]Tr. 1400-02.

[149]Tr. 1402.

[150]*See infra* note 256 and accompanying text.

July 14, 1998, informed the shareholders that:

> Pursuant to the Accord Agreement, the Compromising Claimants [BU, BU related entities, including BU Holding and Marathon, USSC, Hirsch, . . . Cassidy, Mrs. Cassidy, Prior, Nichols, and others] agreed, in order to facilitate the Merger, to accept the right to receive Merger Consideration in satisfaction of certain of their claims against Seragen. The amount of Merger Consideration allocated to [Hirsch, . . . Cassidy, Prior, Nichols, and others] and, to the extent of its claims arising from its holdings of (i) Seragen Series B Preferred Stock and (ii) those shares of Seragen Common Stock issued, and those debt obligations of Seragen owed, to it in connection with the conversion of the Seragen Series C Preferred Stock, BU Holding . . . under the terms of the Merger Agreement constitutes what Seragen management expects to be a discount from 25% to 40% (with the exact amount of the discount depending on the date of the Closing and the amount of Seragen's payables as of the Closing) on amounts otherwise owed by Seragen to such persons in respect of their relevant claims.[151]

The shareholders were advised that $67 million of the merger proceeds would be split among Seragen's shareholders and creditors, and $8 million would be paid to purchase the Marathon facility.[152] The Merger Proxy also informed the shareholders that their portion of the merger proceeds would be paid in part with Ligand stock: each common share of Seragen would exchange into 0.035736 shares of Ligand. When the Proxy was issued, Ligand was trading at $13.9875 per share.[153] Accordingly, each share of common would convert into $0.49999, or $0.50 worth of Ligand stock. Additionally, holders of Seragen common stock might also be entitled to "Milestone Consideration" of $0.23 per share.[154] Effectively, the shareholders expected, under the Merger Agreement as described in the Proxy Statement, to receive $0.73 per share.[155] The shareholders, however,

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[151] JX 262 at 67.

[152] *Id.* at 11, 77-80, D-12. The $67 million in merger proceeds included $30 million at closing and up to $37 million in "Milestone Consideration." *Id.* at 11.

[153] *Id* at 2.

[154] *Id.* at 79. At Ligand's option, the "Milestone Consideration" was payable in stock or cash.

[155] *Id.* at 77-79. This allocated to the common shareholders a substantial premium above

did not receive $0.73 per share because they bore the risk that the price of Ligand stock might decrease, which it did. By the time the merger closed, Ligand shares had declined to $9.6875 per share,[156] and Seragen's common shareholders received only $0.35 per share, plus the $0.23 per share milestone payment, for a total of roughly $0.58 per share.[157] The Merger Proxy, however, did not disclose to the shareholders any of the negotiations that took place in arriving at the allocation.[158] Ten percent of the common shares were not submitted for appraisal, and the merger was approved and consummated by Ligand on August 12, 1998, a few days after the Plaintiffs had filed this action.

II. CONTENTIONS

The Plaintiffs contend that the BU Defendants breached their fiduciary duties to Seragen's common shareholders by approving the Series B transaction, the Series C transaction, and the Accord Agreement. The Series B and Series C transactions precluded, according to the Plaintiffs, access to capital markets, thus causing the financial stress which resulted in the choice of (i) a merger for less than what Seragen should have been worth or (ii) Seragen's demise. In short, they argue that the Defendants bear the burden, but did not satisfy the burden, of proving that the initial transactions were entirely fair to the minority shareholders. Similarly, they contend that the Defendants failed to meet that burden with respect to the Accord Agreement and the allocation of merger proceeds. Not only was there no properly prepared and supported advocate for the common shareholders at the bargaining table, but also no one used the potential derivative claims springing from not only the Series B and Series C transactions, but also the USSC transaction and the Marathon transaction, as bargaining chips. In addition, the process allowed (1) BU to avoid its waiver of its right to a minimum price for its remaining Series C shares and (2) BU and Marathon to obtain a premium on the sale of the Marathon facility to Ligand for $8 million, instead of the initially agreed upon amount of $5 million. Because of all this, the Plaintiffs contend that the various transactions were not fair to the common shareholder as a matter of price and process. Moreover, the Plaintiffs insist that the disclosures made in the merger proxy statement were insufficient to inform the shareholders in their

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Seragen's trading price, less than $0.50 per share, when the merger was announced. JX 274 at 178; JX 262 at 50.

[156]JX 273 at Ex. 6.

[157]*Id.*

[158]The Plaintiffs challenge the sufficiency of the proxy statement. Those claims, and additional factual background, are reviewed in Part III(E), *infra*.