Unreported Cases

INTRODUCTION

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CASE INDEX

This Issue

Page

H&N MANAGEMENT GROUP, INC. & AFF COS FROZEN MONEY PURCHASE PLAN V. ROBERT M. COUCH ET AL.,
No. 12847-VCMR (Del. Ch. Aug. 1, 2017).
MONTGOMERY-REEVES, *Vice Chancellor*...............................191

FORTIS ADVISORS LLC v. SHIRE US HOLDINGS, INC.,
No. 12147-VCS (Del. Ch. Aug. 9, 2017).
SLIGHTS, *Vice Chancellor*...203

IN RE MARTHA STEWART LIVING OMNIMEDIA, INC. STOCKHOLDER LITIGATION,
No. 11202-VCS (Del. Ch. Aug. 18, 2017).
SLIGHTS, *Vice Chancellor*...221

CARL ZEISS VISION, INC. v. REFAC HOLDINGS, INC. AND U.S. VISION, INC., No. 11513-VCS (Del. Ch. Aug. 24, 2017).
SLIGHTS, *Vice Chancellor*...261

ADT HOLDINGS, INC., IN ITS INDIVIDUAL CAPACTIY AND AS ATTORNEY-IN-FACT FOR ZONOFF, INC., ANDADT LLC, V. MICHAEL HARRIS AND RING INC.,
NO. 2017-0328-JTL (DEL. CH. SEP. 28, 2017).
LASTER, *Vice Chancellor*...273

STATUTES CONSTRUED*
This Issue

Page

DEL. CODE ANN. tit. 10

§ 5702(a), (c) 261

9 U.S.C.

§§ 1-16 261
§ 10(a) 261

RULES OF COURT
This Issue

Del. Court of Chancery Rule 5.1 273
Del. Court of Chancery Rule 12(b)(6) 191, 203, 221
Del. Court of Chancery Rule 23.1(a) 261

*Page reference is to the page where the rule or statute is discussed.

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

TAMIKA R. MONTGOMERY-REEVES VICE CHANCELLOR	Leonard L. Williams Justice Center 500 N. King Street, Suite 11400 Wilmington, Delaware 19801-3734

Date Submitted: June 2, 2017
Date Decided: August 1, 2017

Ned Weinberger, Esquire Thomas Curry, Esquire Labaton Sucharow LLP 300 Delaware Avenue, Suite 1340 Wilmington, DE 19801	Anne C. Foster, Esquire Brian F. Morris, Esquire Richards, Layton & Finger, P.A. One Rodney Square 920 North King Street Wilmington, DE 19801

RE: *H&N Management Group, Inc. & Aff Cos Frozen Money Purchase Plan v. Robert M. Couch et al.,* Civil Action No. 12847-VCMR

Dear Counsel:

This letter opinion addresses Defendants' motion to dismiss Plaintiff H&N Management Group, Inc. & Aff Cos Frozen Money Purchase Plan ("H&N")'s Verified Amended Stockholder Derivative Complaint (the "Complaint") for failure to make demand under Court of Chancery Rule 23.1 and failure to state a claim for breaches of fiduciary duty under Court of Chancery Rule 12(b)(6). For the reasons discussed below, I hold that Plaintiff has sufficiently alleged a reason to doubt the board was adequately informed when approving each transaction at issue. Because the relevant exculpation provision does not protect the board from liability for gross negligence, and Plaintiff has met the heightened pleading standard for demand futility under *Aronson v. Lewis*, I deny the defendants' motion to dismiss.

I. BACKGROUND

The facts are taken from the Complaint and all documents incorporated therein.[1] Plaintiff H&N is a stockholder of AGNC Investment Corp. (the "Company"), a Delaware real estate investment trust ("REIT") that invests primarily in mortgage-backed securities. The Company was externally managed by American Capital Mortgage Management, LLC (the "Manager"), a wholly-owned subsidiary of the private equity firm, American Capital, Ltd. ("American Capital"). The Manager also managed another REIT, American Capital Mortgage Investment Corporation ("MTGE"). Defendant Malon Wilkus founded American Capital and serves as its Chairman and CEO. Wilkus also was the CEO of the Company and MTGE until March 2016 and the CEO of the Manager until September 2016.

From February 2013 until May 2016, the Company and MTGE had the same board. In March 2016, Defendant Gary Kain became CEO, President, Chief Investment Officer ("CIO"), and a director of the Company and MTGE. Kain has been President of the Manager since 2011; and he served as a Senior Vice President and Managing Director of American Capital from January 2009 to July 2009.

The Manager managed the operations of both the Company and MTGE, as neither had employees of their own. The Manager managed the Company pursuant to an agreement executed on May 20, 2008, and amended on July 29, 2008 and September 30, 2011 (the "Management Agreement"). The Management Agreement specifically allowed for termination after the initial term ended in 2011; but the agreement was renewed each year through the 2016 term (the "Renewals"). On July 1, 2016, the Company acquired the Manager in a $562 million cash deal (the "Internalization"), and the Manager's subsidiary continued to manage MTGE.

Plaintiff filed this action on October 21, 2016. On December 12, 2016, Plaintiff filed the operative Complaint. Plaintiff alleges that the individual defendants breached their fiduciary duties by allowing the agreement to automatically renew for the years 2014, 2015, and 2016. Plaintiff argues that the Company was overpaying for the Manager's services and bankrolling MTGE's operations year after year. Plaintiff contends that the board did not consider all material information and did not have access to the entire financial picture when deciding whether to renew. Plaintiff also alleges that certain individual defendants knowingly

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[1] *In re Morton's Rest. Gp., Inc. S'holders Litig.*, 74 A.3d 656, 659 n.3 (Del. Ch. 2013); *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006).

withheld material information from the board, including the Company's payment of more than double the Manager's costs.

The Complaint also asserts that the individual Defendants did not act in the best interests of the Company when considering the Internalization. Rather, Plaintiff alleges that the Defendants acted collectively for MTGE and the Company, even though the two entities had diverging interests. Plaintiff argues that the Company unnecessarily paid an exorbitant amount for the Manager while MTGE, a competing REIT, paid nothing. Plaintiff contends that much more reasonable options were available, such as the termination of the Management Agreement. Finally, Plaintiff alleges that the Internalization constituted waste because the terms of the transaction were so lop-sided that no person acting in good faith would have approved the deal.

On January 12, 2017, Defendants filed their motion to dismiss. Defendants assert that the majority of the board is disinterested, is independent, and does not face a substantial threat of liability from either the Renewals or the Internalization. Therefore, in Defendants' view, Plaintiff has failed to plead demand futility. Additionally, Defendants move to dismiss on the grounds that Plaintiff has failed to state a claim for breach of fiduciary duty or waste. On June 2, 2017, the Defendants filed a letter correcting their opening brief, and this Court held oral argument.

II. ANALYSIS

In order to bring a derivative action under Rule 23.1, a stockholder must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[2] In considering a motion to dismiss under Rule 23.1, "[t]he Court must assume the truthfulness of all well-pleaded facts in the complaint and is required to make all reasonable inferences that logically flow from the face of the complaint in favor of the plaintiff."[3] The Complaint does not allege that Plaintiff made demand on the Company's board. Therefore, in order for this action to go forward, Plaintiff must allege that demand on the board is futile.

"Under Delaware law, the Court applies one of two tests to determine whether a plaintiff's demand upon the board would be futile."[4]

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[2] Ct. Ch. R. 23.1(a).

[3] *McPadden v. Sidhu*, 964 A.2d 1262, 1269 & n.7 (Del. Ch. 2008).

[4] *Reiter ex rel. One Fin. Corp. v. Fairbank*, 2016 WL 6081823, at *6 (Del. Ch. Oct. 18, 2016).

"[W]hen a plaintiff is challenging a decision of the board of directors," the two-prong *Aronson v. Lewis* test applies.[5] Under *Aronson*, demand is futile if "under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[6]

The *Rales v. Blasband* test applies, however, "where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit."[7] Specifically, this type of situation arises

> (1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where . . . the decision being challenged was made by the board of a different corporation.[8]

Under *Rales*, the inquiry is whether "the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to the demand."[9]

To survive a motion to dismiss under Rule 12(b)(6), the Court accepts all "well-pleaded factual allegations" as true.[10] "[E]ven vague allegations are 'well- pleaded' if they give the opposing party notice of the claim."[11] "[T]he Court must draw all reasonable inferences in favor of the non-moving party;" and the Court cannot dismiss the case "unless 'the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof.'"[12] If the complaint survives the "more onerous" pleading standard required by Rule 23.1, "assuming that it otherwise contains sufficient facts to state a

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

[6] *Aronson*, 473 A.2d at 814.

[7] *Rales v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993).

[8] *Id.*

[9] *Id.* at 934.

[10] *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002)).

[11] *Id.*

[12] *Id.*

cognizable claim,"[13] it necessarily will survive the Rule 12(b)(6) notice pleading standard.[14] Thus, "the issue of whether demand is futile so as to be excused is logically antecedent to whether plaintiff states a claim because, if demand is not made or is not otherwise excused, the complaint will be dismissed without any further inquiry into the merits of the complaint."[15] Therefore, I analyze the claims under demand futility first.

"[U]nder Delaware law, the demand futility analysis 'is conducted on a claim-by-claim basis.'"[16] Here, Plaintiff challenges the board's annual review process in allowing the Renewals and the board's decision to approve the Internalization. The current board approved the Internalization and three of the four current directors, approved the Renewals.[17] Thus, the *Aronson* test applies to each of the Renewals and the Internalization.[18]

Here, Plaintiff argues that demand is excused under *Aronson*'s second prong because there is a reasonable doubt that the Renewals and the Internalization were the products of the valid exercise of business judgment.[19] Under the second prong of *Aronson*, "plaintiffs must plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision."[20] When considering whether the board was adequately informed, "[p]re-suit demand will be excused in a derivative suit only if the . . . particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process, *measured by*

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[13] *McPadden v. Sidhu*, 964 A.2d 1262, 1270 (Del. Ch. 2008) (citing *Ryan v. Gifford*, 918 A.2d 341, 357 (Del. Ch. 2007)).

[14] *Id.* at 1269-70 (citing *Gen. Motors*, 897 A.2d at 168)).

[15] *Id.* at 1270 (citing *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984)).

[16] *Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, 119 A.3d 44, 58 n.71 (Del. Ch. 2015) (quoting *Cambridge Ret. Sys. v. Bosnjak*, 2014 WL 2930869, at *4 (Del. Ch. June 26, 2014)).

[17] *Teachers' Ret. Sys. of Louisiana v. Aidinoff*, 900 A.2d 654, 666 (Del. Ch. 2006) ("One of the reasons why contracts have termination clauses is to permit a fresh business decision to be made about continuing past practices. Here, the complaint clearly pleads that the AIG board breached its fiduciary duties by deciding to continue dealings with Starr, even though the MGA Agreements gave them the opportunity to stop.").

[18] The parties dispute whether *Aronson* or *Rales* applies. "Whether the *Rales* test or the *Aronson* test applies ultimately makes no substantive difference in my view because 'the *Rales* test, in reality, folds the two-pronged *Aronson* test into one broader examination.'" *Reiter ex rel. Capital One Fin. Corp. v. Fairbank*, 2016 WL 6081823, at *6 n.35 (Del. Ch. Oct. 18, 2016) (quoting *Baiera*, 119 A.3d at 67 n.131); *see also Ryan v. Armstrong*, 2017 2062902, at *14 & n.144 (Del. Ch. May 15, 2017).

[19] Pl.'s Answering Br. 28-58.

[20] *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003).

concepts of gross negligence, included consideration of all material information reasonably available."[21]

A. *Plaintiff Has Raised a Reason to Doubt that the Board was Adequately Informed When Approving the Renewals*

Plaintiff alleges that demand is excused as to the Renewals because: (1) the board did not adequately inform itself before making the decision to continue the Management Agreement; and (2) the majority of the board also was on the MTGE board and, thus, had the "dual fiduciary problem identified in *Weinberger v. UOP, Inc*., 457 A.2d 701, 710 (Del. 1983)."[22]

The initial term of the Management Agreement ended on May 20, 2011, but Section 10(b) of the Management Agreement provided: "After the Initial Term, this Agreement shall be deemed renewed automatically each year for an additional one-year period (an "*Automatic Renewal Term*") unless the Company or Manager elects not to renew this Agreement."[23] The Management Agreement provided that after the initial term, either the Company or the Manager "may, without cause, in connection with the expiration of the Initial Term or any Automatic Renewal Term, decline to renew this Agreement."[24] If the Company terminated the agreement, it was obligated to pay a Termination Fee that was three times the average annual management fee paid to the Manager during the prior 24-month period.[25]

Every year in October, the Company's Compensation and Corporate Governance Committee (the "Compensation Committee") met to dec*id*e whether to renew the Management Agreement on its existing terms. An examination of the minutes reveals the same process for each review for the years 2013, 2014, and 2015. The Compensation Committee consisted of people on both the boards of the Company and MTGE. The Compensation Committee met for 15 minutes or less either concurrently with or after the board meeting.[26] The minutes do not reflect

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[21] *In re Goldman Sachs Gp., Inc. S'holder Litig.*, 2011 WL 4826104, at *15 (Del. Ch. Oct. 12, 2011) (quoting *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)).

[22] Pl.'s Answering Br. 29 (citing *In re Trados S'holder Litig*., 73 A.3d 17, 46 (Del. Ch. 2013)).

[23] Compl. n.3.

[24] Morris Aff. Ex. 3, at 20.

[25] *Id.*

[26] For example, at the 2014 renewal meeting, the Compensation Committee met an hour-and-a-half after the full board meeting for fifteen minutes. Compl. ¶ 59. At the 2015 meeting, they met concurrently with the board for ten minutes without adjourning the full board meeting. Compl. ¶ 70.

any pause, break out session, or other opportunity to suggest that the Compensation Committee further considered the Renewals. At the 2015 and 2016 renewal meetings, a 250-page slide deck was included in the Compensation Committee's materials but distributed only during the brief meetings. The slide decks were prepared by the Manager that the Compensation Committee was considering firing. The Compensation Committee never had any advisor, despite the fact that this was the company's biggest business decision (in terms of expenditures) every year. Each year, the Compensation Committee recommended that the board approve the Renewals, and each year, the board approved the Renewals.

Further, Plaintiff contends that the Company was subsidizing the management of MTGE because the Company paid over $100 million in management fees annually, whereas MTGE paid less than $20 million, which on its own, would not cover the Manager's costs.[27] Also, Plaintiff maintains that the Company and MTGE were competitors in the agency-backed securities market, and this arrangement gave MTGE investment opportunities to which it otherwise would not have access.

Defendants respond that (1) the board adequately considered the Renewals and did not act in bad faith or with gross negligence; and (2) there is no material conflict because MTGE's and the Company's interests were aligned with respect to the Renewals. Defendants argue that Plaintiff's reading of the board minutes is "tortured" and that the board had adequate information regarding the Manager's performance to consider whether to incur the termination fee or keep a well-performing manager in place. Additionally, Defendants contend that the Company and MTGE both were incentivized to keep the Manager within the fold, and any fee paid by MTGE was well within market rates.[28]

In order to rule in Defendants' favor, I would need to read words into the Compensation Committee minutes that do not appear and take inferences in their favor. At this stage in the pleadings, I must take all reasonable inferences in favor of the non-moving party. Plaintiff alleges that for the board's biggest yearly decision, (1) the Compensation

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[27] Under the Management Agreement, the Company pays monthly management fees to the Manager equal to one-twelfth of 1.25% of the Company's month-end stockholders' equity, adjusted to exclude the effect of any unrealized gains or losses included in retained earnings or other comprehensive income. American Capital and Wilkus entered into a similar arrangement for the Manager to manage MTGE; however, MTGE's monthly fee was one-twelfth of 1.5% of its month-end stockholders' equity, rather than 1.25%. MTGE is significantly smaller than the Company—whereas the Company paid over $100 million in fees to the Manager annually ($113 million, $136 million, $119 million, and $116 million in 2012, 2013, 2014, and 2015, respectively), MTGE paid less than $20 million annually ($10 million, $19 million, $18 million, and $17 million, in each of these years, respectively). Compl. ¶¶ 25, 32.

[28] Defs.' Reply Br. 18-20, 23-24.

Committee met briefly as a formality during or after the board meeting; (2) the Compensation Committee did not retain advisors; (3) the Compensation Committee was conflicted because non-renewal would directly affect MTGE, a company to which all the members also owed fiduciary duties; (4) the Compensation Committee received its only information (which it did not have time to review in the meeting) from the self-interested Manager; and (5) the Compensation Committee purportedly relied on the previous year's "review," even though a detailed review never occurred. The Complaint alleges particularized facts sufficient to raise a reason to doubt that the board was adequately informed in its consideration of the Renewals. Thus, demand on the board is futile under *Aronson*.

B. *Plaintiff Has Raised a Reason to Doubt that the Board was Adequately Informed When Approving the Internalization*

Plaintiff argues that demand is excused as to the Internalization because (1) the committee that considered the transaction breached its duty of care; (2) Wilkus and Kain breached their fiduciary duties; (3) the committee members acted in bad faith by working for the collective interests of MTGE and the Company in approving the Internalization; and (4) the board committed waste.[29]

On November 25, 2015, American Capital announced that it was conducting a "full strategic review of all alternatives,"[30] including a possible sale. In response to American Capital's announcement, the Company and MTGE formed a joint subcommittee to act on behalf of both companies consisting of board members of both the Company and MTGE (the "Joint Committee"). The Joint Committee retained legal and financial advisors to advise the Company and MTGE "in their strategic planning and evaluation of potential alternatives . . . ."[31]

The Joint Committee met for the first time on March 6, 2016 and noted that "no significant information had been provided by American Capital or its advisors . . . despite multiple requests that had been made by individual directors and their attorneys."[32] Minutes from a meeting three days later state that an American Capital special committee member wanted to give information to the Joint Committee but that

[29] Pl.'s Answering Br. 49.
[30] Compl. ¶ 91.
[31] *Id.* ¶ 100.
[32] *Id.* ¶ 105.

"Wilkus had prevented him from providing more information to the Funds about the American Capital strategic review process."[33]

The March 15, 2016 meeting minutes state:

> Goldman Sachs and Credit Suisse stated that if the Funds do not work with [American Capital], the Funds would be treated as a counterparty and no information would be provided to the Funds about the [American Capital] strategic review process until such time that the consent of the independent directors is requested to approve the potential purchaser. . . .
>
> Mr. Wilkus and Mr. Flax were surprised and upset at the Funds' initiating their own process.[34]

At the March 15, 2016 Joint Committee meeting, the committee discussed Kain's expression of "his preference for internalization of the managers by the Funds, and that he believed that to be the optimal solution for the Funds' respective shareholders."[35] At the March 16, 2016 Joint Committee meeting, Kain informed a committee member that he "had received instructions to pursue the internalization of the managers with the funds."[36] On March 17, 2016, Wilkus resigned as CEO of the Company and MTGE, and Kain was appointed CEO, CIO, President, and a director of the Company and MTGE. Kain also served as President of the Manager during that time.[37]

At the March 23, 2016 Joint Committee meeting, a committee member "conveyed Mr. Kain's strong desire for [the Company] and [MTGE] to internalize its managers."[38] At the March 25, 2016 Joint Committee meeting, J.P. Morgan's representative "proposed that Mr. Kain be asked to conduct an analysis on internalization, refine the analysis with J.P. Morgan, and then present it to the independent directors of the Funds."[39] The Joint Committee unanimously agreed. At the March 30, 2016 meeting, the Joint Committee requested that J.P.

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[33] *Id.*

[34] Morris Aff. Ex. 22, at 1.

[35] *Id.* at 2.

[36] Compl. ¶ 113.

[37] Kain was promoted to CEO of the Manager on July 1, 2016. Compl. n.25. As of January 1, 2016, Kain's annual base salary from the Manager was $4,384,744.00 with incentive compensation tied to the performance of the Company and MTGE that was several times greater than his base salary. *Id.* n.26.

[38] Compl. ¶ 115.

[39] *Id.*

Morgan "work[] with Messrs. Kain and Federico to present an internalization proposal to the Funds."[40]

At an April 10, 2016 meeting, J.P. Morgan and Jones Day outlined four options: (1) joint acquisition of the Manager by the Company and MTGE; (2) sole acquisition of the Manager by the Company, which would then externally manage MTGE; (3) sole acquisition of the Manager by the Company and the liquidation of MTGE; and (4) liquidation of both the Company and MTGE. The Joint Committee deferred deciding which avenue to pursue "until J.P. Morgan had an opportunity to review the liquidation analysis conducted by Gary Kain and the independent directors had an opportunity to have further discussions with J.P. Morgan . . . ."[41]

By the next day, the Joint Committee had decided to pursue internalization and at an April 11, 2016 meeting, Kain told the Joint Committee that "he believed a safe, clearing level purchase price [for the Manager] would be around $600 to $650 million, but given the situation and the steps of the Funds thus far, a purchase price of $525 to $550 million could also be acceptable to [American Capital]."[42] Kain also stated "that a price in the $400 million range would be too close to what [American Capital] is entitled to under the management agreement."[43]

At the April 14, 2016 meeting, the directors agreed to submit an initial bid of $500 million to American Capital. American Capital rejected this initial bid. Subsequently, a $575 million bid was made and agreed to by American Capital. At the April 22, 2016 meeting, Kain "shared with the group that his preferred transaction structure would be for [the Company] to purchase [the Manager] and manage MTGE externally."[44] J.P. Morgan delivered its fairness opinion as to the purchase price of the Manager based on an evaluation of the Manager's "standalone prospects as an independent entity" with a discounted cash-flow analysis based on the external management contracts with the Company and MTGE.[45] J.P. Morgan stated that the "intrinsic value" of the Manager was between $636 million and $787 million. The Company eventually agreed to pay $562 million in cash to acquire the Manager, with the Manager's subsidiary continuing to manage MTGE under the

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[40] *Id.* ¶ 116.
[41] *Id.*
[42] *Id.* ¶ 120.
[43] *Id.*
[44] *Id.* ¶ 124.
[45] *Id.* ¶ 125.

existing fee arrangement. The Internalization was completed on July 1, 2016.

Similar facts have been presented to this Court. Specifically, in *McPadden v. Sidhu*, the board at issue allowed a conflicted manager, whose affiliate ended up buying the company's subsidiary, to lead the sales process with minimal oversight.[46] This, the Court found, was enough to plead a duty of care violation and created a reasonable doubt that the transaction was the product of a valid exercise of business judgment, rendering demand futile.[47] As in *McPadden*, the Joint Committee here was fully aware of Kain's conflict as a fiduciary of the Company, MTGE, and the Manager; yet the Joint Committee allowed him to dominate their process, dictate the transaction structure, and direct the ultimate deal terms.[48] Kain repeatedly stressed his "strong desire" for internalization as "his preferred transaction structure" and that he had "received instructions" to pursue the Internalization.[49] The Joint Committee knew that the investment banker's analysis was prepared "at the direction" of Kain. In fact, the Joint Committee directed J.P. Morgan to work with Kain to present an internalization proposal.[50] Kain then suggested a price range that would be palatable to American Capital, and the Joint Committee accepted it. These facts are sufficient to raise a reason to doubt that the board was adequately informed when it approved the Internalization. Thus, demand is futile as to the Internalization.

C. *The Complaint States a Claim for Breach of Fiduciary Duty*

Because Plaintiff has alleged particularized facts sufficient to excuse demand based on potential breaches of the duty of care with regard to both the Renewals and the Internalization, Plaintiff meets the lesser pleading standard required by Rule 12(b)(6).[51] Defendants do not benefit from a provision that exculpates them for grossly negligent conduct; therefore, the complaint proceeds against the Defendants.

III. CONCLUSION

For the foregoing reasons, I hold that Plaintiff has adequately alleged that demand is futile under *Aronson* and stated a claim for breach

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[46] 964 A.2d 1262 (Del. Ch. 2008).
[47] *Id*. at 1270-71.
[48] *Id*.
[49] Compl. ¶¶ 113, 115, 124.
[50] *Id.* ¶ 116; *see McPadden*, 964 A.2d at 1272.
[51] *See McPadden*, 964 A.2d at 1269-70.

of fiduciary duty against Defendants. Thus, the motion to dismiss is denied.

IT IS SO ORDERED.

Sincerely,
/s/ Tamika Montgomery-Reeves
Vice Chancellor

TMR/jp

FORTIS ADVISORS LLC
v.
SHIRE US HOLDINGS, INC.

In the Court of Chancery of the State of Delaware

C.A. No. 12147-VCS

MEMORANDUM OPINION

Date Submitted: June 2, 2017
Date Decided: August 9, 2017

Joel Friedlander and Christopher Quinn of FRIEDLANDER & GORRIS, P.A., Wilmington, Delaware; William S. Ohlemeyer, Robin A. Henry, and Jack Wilson, of BOIES, SCHILLER & FLEXNER LLP, Armonk, New York, *Attorneys for Plaintiffs*.

Stephen C. Norman and Jaclyn Levy of POTTER, ANDERSON & CORROON LLP, Wilmington, Delaware; John D. Donovan, Jr., of ROPES & GRAY LLP, Boston, Massachusetts; and David B. Hennes and Adam M. Harris of ROPES & GRAY LLP, New York, New York; *Attorneys for Defendant*.

SLIGHTS, *Vice Chancellor*.

Parties to a merger agreement dispute the right of the seller's representative to receive certain contingent post-closing payments. Plaintiff, Fortis Advisors LLC ("Fortis"), in its capacity as Stockholders' Agent for the former stockholders of SARcode Bioscience Inc. ("SARcode"), alleges that Defendant, Shire US Holdings, Inc. ("Shire"), has breached the provisions of the parties' agreement by refusing to pay so-called milestone payments that Fortis alleges are past due.

Shire acquired SARcode pursuant to an Agreement and Plan of Merger by and among Shire, Owl Merger Sub, Inc., SARcode Bioscience Inc., and Fortis Advisors LLC, as Stockholders' Agent Dated as of March 23, 2013 (the "Merger Agreement"). At the time the parties entered into the Merger Agreement, SARcode was in the process of developing and seeking regulatory approval for a drug, Lifitegrast, that showed promise to treat the signs and symptoms of dry eye disease. The Merger Agreement set forth a structure whereby the parties agreed to share the risks and rewards of developing Lifitegrast by allocating merger consideration between fixed up front payments and subsequent contingent payments that depended on Shire's ability to shepherd the

drug through clinical trials and regulatory approvals. This arrangement allowed SARcode to monetize its at-risk investment in Lifitegrast while securing the promise of financial rewards if the drug continued to be developed successfully and ultimately was commercialized. For Shire, the milestone payments allowed it to hedge against future risks inherent in the drug's development and commercialization by allocating the price it would ultimately pay for SARcode between an initial upfront payment and subsequent payments that would become due only if the defined milestones were reached per the agreed upon schedule.

In its Verified First Amended and Supplemental Complaint (the "Complaint"), Fortis alleges that two of the designated milestones have been achieved. This, in turn, has triggered Shire's obligation to make $425 million in milestone payments to former SARcode stockholders. Shire denies that the two milestones have been met and has refused Fortis' demands to make the milestone payments. The Complaint asserts a single Count for breach of contract. Shire has moved to dismiss the Complaint under Court of Chancery Rule 12(b)(6) on the ground that Fortis' claim of breach is premised on a construction of the Merger Agreement that cannot be reconciled with its clear and unambiguous terms.

After carefully considering the parties' arguments, I conclude that Shire's proffered construction of the relevant provisions of the Merger Agreement is the only reasonable construction. Because Fortis has failed to proffer a competing reasonable construction of the operative language, it has failed to state a claim for breach of contract. Accordingly, the motion to dismiss must be GRANTED.

I. FACTUAL BACKGROUND

The facts are drawn from allegations in the Complaint, documents integral to the Complaint and matters of which the Court may take judicial notice.[1] As it must at this stage of the proceedings, the Court assumes all well-pled facts in the Complaint are true.[2]

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[1] *1 In re Crimson Exploration Inc. S'holder Litig*., 2014 WL 5449419, at *8 (Del. Ch. Oct. 24, 2014); *In re Gardner Denver, Inc*., 2014 WL 715705, at *2 (Del. Ch. Feb. 21, 2014). See also *Reiter v. Fairbank*, 2016 WL 6081823, at *5 (Del. Ch. Oct 18, 2016) ("where a complaint quotes or characterizes some parts of a document but omits other parts of the same document, the Court may apply the incorporation-by-reference doctrine to guard against the cherry-picking of words in the document out of context.").

[2] *Crimson*, 2014 WL 5449419, at *8.

A. *The Parties*

Prior to the Merger Agreement, SARcode was a privately-held biopharmaceutical company based in Brisbane, California. By the terms of the Merger Agreement, Fortis serves post-merger as the "sole agent and attorney-infact" for and on behalf of the former SARcode stockholders.

Shire is a Delaware corporation and subsidiary of Shire PLC, a global biopharmaceutical company, whose United States headquarters is located in Lexington, Massachusetts. Shire acquired SARcode in March 2013.

B. *SARcode's Development of Lifitegrast*

Prior to the Shire acquisition, SARcode developed Lifitegrast as a treatment for dry eye disease. Dry eye disease is diagnosed by an eye care professional based on tests for objective signs of the disease, such as staining or tear break-up time (signs), and subjective symptoms reported by patients, such as eye dryness or discomfort (symptoms).

SARcode developed Lifitegrast to Phase III clinical trials. Phase III clinical trials are performed to test both efficacy and safety of drugs using larger patient populations than are involved in Phase I and Phase II trials. Prior to the Merger Agreement, SARcode had conducted a Phase II clinical trial and a Phase III clinical trial (OPUS-1) that had successfully established the efficacy and safety of Lifitegrast in reducing the signs of dry eye disease. These clinical trials demonstrated the commercial potential of Lifitegrast and their results attracted the interest of several pharmaceutical companies that sought to acquire development rights for the drug.

A second Phase III clinical trial (OPUS-2) was designed and initiated in late 2012 to evaluate the efficacy, safety and tolerability of Lifitegrast. The OPUS-2 Study had two co-primary efficacy endpoints that were specified in the OPUS-2 Study Protocol. One efficacy endpoint, the co-primary sign endpoint, was designed to evaluate Lifitegrast's effectiveness in treating the signs of dry eye disease while the other efficacy endpoint, the co-primary symptom endpoint, would evaluate the drug's effectiveness in treating the symptoms of dry eye disease. The OPUS-2 Study was underway when Shire approached SARcode with an interest in acquiring the company and, by extension, Lifitegrast. Shire and SARcode began negotiating the Merger Agreement in early 2013.

C. *The Merger Agreement*

At the time SARcode and Shire entered into the Merger Agreement, the OPUS-2 Study was ongoing and Lifitegrast was many steps away from commercialization. To share the risks and rewards of further development of the drug, the parties included in the Merger Agreement a number of additional payments to SARcode stockholders that were contingent upon the drug successfully achieving certain defined milestones. These milestones are divided into several categories, described in § 9.1 of the Merger Agreement, only one of which is relevant to the current dispute. That category of milestone payments, the "Base Case Milestones," is triggered by the occurrence of the OPUS-2 Study Endpoint Achievement Date (the "Achievement Date"). When the Achievement Date is reached, former SARcode stockholders are entitled to receive $175 million for the OPUS-2 Successful Completion Milestone.

Following achievement of the OPUS-2 Successful Completion Milestone and regulatory approval of the drug, Shire is required to make an additional $250 million payment for the Base Case Approval Milestone. If certain revenue targets are met following commercialization, former SARcode stockholders would be eligible for another $100 million for the Base Case Revenue Milestone. Fortis alleges that it is currently due the OPUS-2 Successful Completion Milestone Payment and the Base Case Approval Milestone Payment.

As noted, all of the Base Case Milestones are contingent upon the occurrence of the Achievement Date. That term is defined in the Merger Agreement as follows:

> "OPUS-2 Study Endpoint Achievement Date" shall be deemed to occur upon receipt by or on behalf of Parent, or one of its Affiliates, Licensees, or other transferees, of audited final tables, figures and listings from the OPUS-2 Study (x) that demonstrate that both components of the co-primary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol have been achieved and (y) which do not, in a significant and clinically meaningful respect, result in a materially less favorable safety/tolerability profile (e.g., treatment emergent adverse events, Serious Adverse Effects, etc.), taken as a whole, for the Product than for corresponding data generated for the Product in the OPUS-1 Study, which less favorable safety/tolerability profile would reasonably be expected to

> significantly reduce anticipated Product Sales (it being understood that such determination pursuant to this clause (y) shall be made in accordance with Section 9.3).[3]

If the Achievement Date is reached, the former SARcode stockholders are eligible to receive the Base Case Milestones payments at various designated intervals defined, in relevant part, as:

> (a) Base Case Milestones. If the OPUS-2 Study Endpoint Achievement Date shall have occurred:
> (i) OPUS-2 Success. Within ten (10) business days following the OPUS-2 Study Endpoint Achievement Date (the "OPUS-2 Successful Completion Milestone"), Parent shall notify the Stockholders' Agent that the OPUS-2 Successful Completion Milestone has been satisfied and shall, within twenty (20) business days following the date of achievement of the OPUS-2 Successful Completion Milestone, pay or cause to be paid in accordance with Section 9.2(b), $175,000,000 (such amount, the "OPUS-2 Successful Completion Milestone Payment");
> (ii) Base Case Regulatory Approval. Within ten (10) business days following receipt by or under the authority of Parent (or any of its Affiliates, Licensees or other transferee) of the first Regulatory Approval in the United States for a Product for the Covered Indication with the co-primary Sign and Symptom specified in the OPUS-2 Study Protocol included in the "Indications and Usage" section of the label of the Product (the "Base Case Approval Milestone"), Parent shall notify the Stockholders' Agent that the Base Case Approval Milestone has been satisfied and shall, within twenty (20) business days following the date of achievement of the Base Case Approval Milestone, pay or cause to be paid in accordance with Section 9.2(b), $250,000,000 (such amount, the "Base Case Approval Milestone Payment") . . . .
> (iii) Base Case Revenue Milestone. If the Base Case Approval Milestone has been achieved, then within sixty (60) days following the first time on which Product Sales within any four consecutive calendar quarters exceed $750,000,000 (the "Base Case Revenue Milestone"), Parent

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[3] Opening Br. of Shire US Hldgs., Inc. in Supp. of its Mot. to Dismiss the Verified First Am. and Supplemental Compl. ("Opening Br."), Ex. 1 ("Merger Agreement") §1.1.

> shall notify the Stockholders' Agent that the Base Case Revenue Milestone has been satisfied and shall, within five (5) business days after such notification, pay or cause to be paid in accordance with Section 9.2(b), $100,000,000 (such amount, "Base Case Revenue Milestone Payment").[4]

The Merger Agreement defines several other terms that appear in the definition of Achievement Date and are relevant to the determination of whether the Achievement Date has occurred. The term "OPUS-2 Study" is defined as:

> "OPUS-2 Study" means the Phase III clinical trial for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol, as further described on Schedule C.[5]

The OPUS-2 Study Protocol is defined as:

> "OPUS-2 Study Protocol" means the Company's Protocol Number 1118-Dry-300, dated November 6, 2012, as amended from time to time in accordance with this Agreement.[6]

Importantly, the Merger Agreement separately defines the prior Phase III clinical trial, the OPUS-1 Study, as:

> "OPUS-1 Study" means the Phase III clinical trial for Lifitegrast conducted by or on behalf of the Company in accordance with the Company Protocol Number 1118-KCS-200, dated May 27, 2011, as amended August 5, 2011.[7]

Both parties were represented by sophisticated counsel in connection with the negotiation, drafting and execution of the Merger Agreement. As noted, the Merger Agreement was finalized on March 23, 2013.

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[4] Merger Agreement § 9.1(a)(i)–(iii).
[5] Merger Agreement § 1.1
[6] *Id.*
[7] *Id.*

D. *Regulatory Approval of Lifitegrast*

Following the Merger Agreement, and at the completion of the OPUS-2 Study in November 2013, Shire informed Fortis that the OPUS-2 Study had achieved the co-primary symptom endpoint but had failed to achieve the co-primary sign endpoint. In a December 5, 2013 press release, Shire publicly reported that "Lifitegrast did not meet the pre-specified co-primary endpoint for the sign of inferior corneal staining score (change from baseline to Week 12) using fluorescein staining compared with placebo (p-value = 0.6186)."[8]

Shire designed and initiated an additional Phase III clinical trial called the OPUS-3 Study in November 2014. In early 2015, Shire filed a New Drug Application ("NDA") with the United States Food and Drug Administration ("FDA") for Lifitegrast. The data Shire submitted to the FDA included evidence from the OPUS-2 Study, the OPUS-1 Study and other previous trials. In October 2015, the FDA issued a complete response letter in which it declined to approve Lifitegrast based on the data submitted in the NDA and requested additional data demonstrating the efficacy of the drug to treat the symptoms of dry eye disease.

On October 16, 2015, apparently believing that the Achievement Date had occurred, Fortis wrote to Shire to inquire whether it intended to make the $175 million OPUS-2 Successful Completion Milestone Payment. Later that month, on October 27, 2015, Shire announced that the OPUS-3 Study had been completed and the data from that clinical trial showed that Lifitegrast had achieved the symptom endpoint, data which would be provided to the FDA in a refiled NDA. Shire responded to Fortis' inquiry regarding the OPUS-2 Successful Completion Milestone Payment on November 12, 2015, stating that none of the Base Case Milestones had been met (or ever would be met) because the Achievement Date had not occurred given that the OPUS-2 Study had failed to meet the sign co-primary endpoint.

In February 2016, Shire refiled its NDA with the FDA and included the OPUS-3 Study data in its application. With this data in hand, on July 11, 2016, the FDA approved Lifitegrast, under the brand name Xiidra, to treat the signs and symptoms of dry eye disease. The FDA also approved the language and content of the Xiidra label that had been proposed by Shire. On July 12, 2016, the label appeared on the Shire website and showed graphical representations of the results from the clinical trials submitted to the FDA. Following approval by the FDA of Lifitegrast under the brand name Xiidra, Fortis alleged that the former

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[8] Pl. Fortis Advisor LLC's Verified First Am. and Supplemental Compl. ("Compl.") ¶ 21.

SARcode stockholders were now due the Base Case Approval Milestone Payment in addition to the previously earned OPUS-2 Successful Completion Milestone Payment.

E. *Procedural History*

On March 29, 2016, Fortis filed its Verified Complaint alleging a breach of the Merger Agreement. Shire moved to dismiss the complaint on April 19, 2016. On July 29, 2016, with briefing on the motion to dismiss complete, Fortis moved to amend the complaint to update its allegations with facts relating to the FDA approval of Lifitegrast and the approval of the Xiidra label, which Fortis alleged entitled the former SARcode stockholders to the Base Case Approval Milestone Payment. Fortis opposed the motion. After a hearing on the motion to amend, the Court granted Fortis leave to file its amended complaint which it did on November 8, 2016.

The Complaint sets forth a single count of breach of contract. Shire moved to dismiss on December 9, 2016, arguing that Fortis' reliance upon an unreasonable interpretation of the plain and unambiguous language of the Merger Agreement as the basis for its breach of contract claim warranted dismissal under Court of Chancery Rule 12(b)(6) for failure to state a claim.

II. ANALYSIS

While the parties agree that the language of the Merger Agreement is clear and unambiguous, they disagree on how that language should be interpreted. Shire's motion to dismiss can be granted at this procedural stage only if its proffered interpretation stands apart as the lone reasonable construction of the Merger Agreement. After carefully considering both parties' proffered constructions of the relevant provisions of the Merger Agreement, for the reasons that follow, I conclude

that Shire's construction is reasonable and that Fortis' construction is unreasonable.

A. *Motion to Dismiss Standard*

The standards governing this motion to dismiss for failure to state a claim under Rule 12(b)(6) are now well settled:

(i) all well-pleaded factual allegations are accepted as true;

> (ii) even vague allegations are 'well-pleaded' if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the 'plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof.'[9]

Questions involving contract interpretation can be answered as a matter of law on a motion to dismiss "[w]hen the language of a contract is plain and unambiguous."[10] Dismissal of a contract dispute under Rule 12(b)(6) is proper, however, "only if the defendants' interpretation is the only reasonable construction as a matter of law."[11] If the Plaintiff has offered a reasonable construction of the contract, and that construction supports the claims asserted in the complaint, then the Court must deny the motion to dismiss even if the defendant's construction isalso reasonable.[12]

B. *The Parties' Competing Constructions of the Operative Language*

By the clear terms of the Merger Agreement, the Base Case Milestone payments are not due unless the Achievement Date has occurred.[13] Under Fortis' interpretation of the Merger Agreement, the clinical data that may be considered when determining whether both co-primary efficacy endpoints have been achieved for purposes of assessing whether the Achievement Date has occurred is not limited to the OPUS-2 Study, but can incorporate data from prior clinical trials as well. As Fortis points out, the sign endpoint was achieved in the OPUS-1 Study. The symptom endpoint was achieved in the OPUS-2 clinical trial. Therefore, according to Fortis, the Achievement Date has occurred. Once that occurred, Fortis argues it was due the OPUS-2 Successful Completion Milestone Payment. And because Lifitegrast has now received regulatory approval following the Achievement Date, Fortis claims that Shire must also make the Base Case Approval Milestone Payment.

Shire, on the other hand, argues that the Achievement Date has not

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[9] *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002) (citations omitted).

[10] *Capital Corp. v. GC Sun Hldgs., L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006).

[11] *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 615 (Del. 2003).

[12] See *Vanderbilt Income and Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996) ("On a motion to dismiss for failure to state a claim, a trial court cannot choose between two differing reasonable interpretations of ambiguous documents.").

[13] Merger Agreement § 9.1(a).

occurred, which forecloses Fortis from claiming that either the OPUS-2 Successful Completion Milestone Payment or the Base Case Approval Milestone Payment are due.[14] Under Shire's construction of the definition of Achievement Date, the clinical data must demonstrate that both sign and symptom co-primary efficacy endpoints were achieved in a specific clinical trial, the OPUS-2 Study. Because the OPUS-2 Study did not establish the sign efficacy endpoint, Shire contends that the Achievement Date did not and never will occur.

C. *Shire's Construction of the Merger Agreement is Reasonable*

In support of its construction, Shire begins by pointing to the definition of Achievement Date which occurs "upon receipt . . .of audited final tables, figures and listings from the OPUS-2 Study (x) that demonstrate that both components of the co-primary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol have been achieved . . ."[15] Shire notes that this definition explicitly requires that the data triggering the occurrence of the Achievement Date come "from the OPUS-2 Study." The OPUS-2 Study, in turn, is defined as "the Phase III clinical trial for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol, as further described on Schedule C."[16] The parties separately defined the OPUS-1 Study to mean "the Phase III clinical trial for Lifitegrast conducted by or on behalf of the Company in accordance with the Company Protocol Number 1118-KCS-200, dated May 27, 2011, as amended August 5, 2011."[17] According to Shire, by separately defining the OPUS-1 and OPUS-2 studies, the Merger Agreement makes clear that the studies and the data from each study are distinct. And by expressly linking the Achievement Date to the receipt of data "from the OPUS-2 Study," and no other study, Shire argues that the only reasonable construction of the definition of Achievement Date is that the OPUS-2 Study data is the exclusive data relevant to determining whether the Achievement Date has occurred.

Moreover, Shire contends that any results reached in the OPUS-2

[14] Although not directly at issue in this action, Shire's construction would also forever preclude payment of the Base Case Revenue Milestone Payment regardless of Shire's ability to hit the defined revenue targets. This is because, under Shire's construction, the Achievement Date has not occurred and will never occur. As noted, the occurrence of the Achievement Date is a precondition to all of the Base Case Milestones payments, including the Base Case Revenue Milestone.

[15] Merger Agreement § 1.1.

[16] *Id.*

[17] *Id.*

Study must be statistically significant in order to "achieve" the co-primary endpoints. In this regard, Shire points to the OPUS-2 Study Protocol which specifies that "[s]tatistical significance is required for both the sign and the symptom for treatment success."[18] As Shire highlights, the OPUS-2 Study Protocol goes on to provide that statistical significance for the co-primary sign and symptom endpoints was a "p-value" of less than or equal to 0.05.[19]

If the Merger Agreement is construed to require that the determination of whether the Achievement Date has occurred be assessed by reference to OPUS-2 Study data only, and that the OPUS-2 Study data must reach statistical significance in order to "achieve" the co-primary endpoints, Fortis' demand for payment of the Successful Completion Milestone Payment and the Base Case Approval Milestone Payment fizzles. This is because the Merger Agreement clearly provides that to reach the Achievement Date, "both components of the co-primary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol [must] have been achieved . . ."[20] With this construction in mind, Shire maintains that the payments Fortis has demanded in this litigation are not due and will never become due.

Shire's interpretation of the Merger Agreement is reasonable. By its clear terms, the definition of the Achievement Date requires that data "from the OPUS-2 Study" demonstrate that the sign and symptom co-primary efficacy endpoints have been achieved. No other data is referenced in the definition and no other provision of the Merger Agreement suggests that the parties intended other data to be relevant to the determination of whether the Achievement Date has occurred. Shire's construction harmonizes and gives meaning to all of the provisions in the Merger Agreement, including those that identify and define the OPUS-1 Study as separate and distinct from the OPUS-2 Study. It is also reasonable to construe the definition of Achievement Date as requiring that results from the OPUS-2 Study be statistically significant given that the OPUS-2 Study Protocol, which lays out how the OPUS-2 study is to be conducted, requires statistically significant results.[21]

Having determined that Shire's proffered construction is reasonable, however, does not end the inquiry. Shire's construction

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[18] Opening Br., Ex. 2 ("OPUS-2 Study Protocol") at 73.

[19] *Id.* at 71, 73. As explained in the Complaint, a "p-value is the probability of obtaining a result at least as extreme as the result that was actually observed when the then null hypothesis (in this case, that there is no relationship between Lifitegrast and the observed symptom or sign) is true." Compl. ¶ 21.

[20] Merger Agreement § 1.1 (emphasis supplied).

[21] OPUS-2 Study Protocol at 73 ("Statistical significance is required for both the sign and the symptom for treatment success.").

cannot prevail on a motion to dismiss if Fortis' construction of the same provisions is also reasonable.

D. *Fortis' Construction is Unreasonable*

Fortis maintains that the Merger Agreement makes clear that data from clinical trials other than the OPUS-2 Study can be considered when determining whether the Achievement Date has occurred. This construction rests on three principal arguments. First, Fortis contends that the absence of any language expressly excluding data from clinical trials other than the OPUS-2 Study in the definition of Achievement Date reflects the parties' intent that such data could and should be considered when determining whether the Achievement Date has occurred. Indeed, according to Fortis, in order for Shire's construction of the operative language to make sense, the Court would have to insert additional language into the definition of Achievement Date. Specifically, Fortis argues that the following bracketed and bold language would need to be added:

> "OPUS-2 Study Endpoint Achievement Date" shall be deemed to occur upon receipt . . . of audited final tables, figures and listings from the OPUS-2 Study (x) that demonstrate that both components of the coprimary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol have been achieved [in the OPUS-2 clinical trial relying only on audited final tables, figures and listings from the OPUS-2 clinical trial and without reliance on any data from any other trial or study] . . .

Fortis contends that "without the addition of this language not contained in the actual text of the Merger Agreement, the OPUS-2 Study Endpoint Achievement Date simply does not have the limitation that Shire seeks to impose."[22]

Second, Fortis argues that not only does the definition of Achievement Date not explicitly exclude data from prior studies, it makes clear that the parties did, in fact, contemplate that data from other clinical trials would be included. Specifically, Fortis points to the definition of OPUS-2 Study, a term incorporated in the definition of Achievement Date, and argues that while the OPUS-2 Study Protocol is

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[22] Pl. Fortis Advisors LLC's Mem. in Opp'n to Shire's Mot. to Dismiss the Verified First Am. and Supplemental Compl. ("Answering Br.") 34.

defined separately from the OPUS-1 Study Protocol, the contractual language makes clear that a Phase III clinical trial need only be conducted "in accordance with" the OPUS-2 Study Protocol in order to constitute part of the OPUS-2 Study as referenced in the Achievement Date definition.[23] According to Fortis, in order "to be in accordance with" the OPUS-2 Study Protocol, the clinical trial need not be identical to the OPUS-2 Study, but rather need only be conducted in "a way that agrees with or follows" the OPUS-2 Study Protocol.[24] Furthermore, Fortis argues that while Shire highlights the use of the definite article "the" in the definition of OPUS-2 Study,[25] as in "the Phase III clinical trial,"[26] the Merger Agreement itself indicates that, when construing its provisions, "the singular . . . shall include the plural . . ."[27] Thus, Fortis would read that provision as stating "the Phase III clinical trials."[28]

Third, Fortis argues that once the Xiidra label was approved by the FDA and publicly made available on Shire's website, Fortis was able to confirm that, contrary to Shire's representations, the OPUS-2 Study had, in fact, achieved both co-primary efficacy endpoints. Indeed, according to Fortis, the FDA approval and the contents of the Xiidra label confirm that the former SARcode stockholders are entitled to an additional Base Case Milestone Payment as well as providing further evidence that both co-primary efficacy endpoints have in fact been achieved for purposes of determining whether the previously earned milestone payments are due.[29]

Fortis' construction of the Merger Agreement is unreasonable. As for its first argument—that the parties' intent to allow data from the OPUS-1 Study to be considered in the definition of Achievement Date

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[23] Merger Agreement § 1.1 (defining OPUS-2 Study).

[24] Answering Br. 20 n 7 (citing Merriam-Webster's Dictionary Online, https://www.merriam webster.com/dictionary/in%20 accordance%20with.).

[25] Specifically, Shire argues that "[t]he use of the definite article—'the'—means that the term that follows (*i.e.*, 'Phase III clinical trial') is a 'unique or a particular member of its class.'") Opening Br. 32 (citing to Merriam-Webster Dictionary Online, http://www.merriamwebster.com/dictionary/the). In this way, Shire contends that "[t]he word 'the' makes clear that the parties were referring to one particular clinical trial of Lifitegrast." *id.* (emphasis in original).

[26] Merger Agreement §1.1 ("OPUS-2 Study" means the Phase III clinical trial for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol, as further described on Schedule C.)

[27] Merger Agreement § 11.9(b).

[28] The definition of "OPUS-2 Study" would then read: "OPUS-2 Study" means the Phase III clinical trials for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol, as further described on Schedule C.

[29] Fortis argues that when the Xiidra product label was released by Shire it "contain[ed] data sufficient to show that the OPUS-2 clinical trial produced data demonstrating the efficacy of the sign and symptom endpoints such that the [Achievement Date] occurred" because "[i]t notes that a 'larger reduction . . . favoring Xiidra was observed in three of the four studies.'" Answering Br. 22.

can be gleaned from the absence of any express exclusion of such data from the definition—Fortis' proffered construction turns a "four corners" construction of the definition inside out. The canon of construction expresio unius est exclusio alterius—to express or include one thing implies the exclusion of the other—seems particularly apt here.[30] The fact that the parties decided separately to define the OPUS-1 and OPUS-2 studies as different Phase III clinical trials, and then designated the data "from the OPUS-2 Study" as relevant to the determination of whether the Achievement Date had occurred, clearly and unambiguously reflects an intent that only that data should be considered when assessing whether both the sign and symptom co-primary efficacy endpoints had been achieved. Indeed, as Shire points out, only Fortis' proffered construction requires the insertion of language not present in the Merger Agreement in order for the contract to get Fortis where it wants to go. Specifically, the Court would have to insert the bold and bracketed text in order for Fortis' construction to be reasonable:

> upon receipt . . . of audited final tables, figures and listings from the OPUS-2 Study [or the OPUS-1 Study] (x) that demonstrate that both components of the co-primary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol have been achieved

Of course, this new language that Fortis would have the Court blue-pencil into the Merger Agreement ignores that the Merger Agreement both defines the OPUS-2 Study as a separate Phase III clinical trial from the OPUS-1 Study and requires that the "audited final tables, figures and listings" that demonstrate both co-primary efficacy endpoints have been achieved come "from the OPUS-2 Study."[31] By ignoring these provisions, Fortis' proffered construction requires the Court to render them superfluous—something Delaware courts do not do when engaging in contact construction.[32]

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[30] *Shintom Co., Ltd. v. Audiovox Corp.*, 888 A.2d 225, 230 (Del. 2005). To require that parties to a contract expressly exclude all that they intend to exclude, when the relevant contact language is expressly inclusive, would present a challenge to scriveners that would be extraordinarily difficult, if not impossible, to meet. Here, the express reference to the OPUS-2 Study data within the definition of Achievement Date would have been unnecessary and, indeed, confusing if the parties had intended for the definition to include other, unspecified data as well.

[31] Merger Agreement § 1.1.

[32] See *O'Brien v. Progressive Northern Ins. Co.*, 785 A.2d 281, 287 (Del. 2001). For the first time at oral argument, Fortis raised a new argument that the phrase "from the OPUS-2 Study" is merely a "temporal trigger" that identifies the time at which the determination of

Fortis' second argument—that the definition of OPUS-2 Study clearly and unambiguously allows for data from other clinical trials to be used to satisfy the Achievement Date—is likewise unpersuasive. To support this contention, Fortis argues that, while the OPUS-2 Study is defined as "the Phase III clinical trial for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol . . .," the Merger Agreement makes clear that "the singular . . . shall include the plural" and, therefore, it is reasonable to include other unspecified Phase III clinical trials within that definition.[33] Fortis correctly quotes Section 11.9(b) but shoots well wide of the mark in arguing that it somehow supports its construction of Shire's milestone payment obligations.

Even when one changes singular terms to plural within the definition of OPUS-2 Study, the language from that definition still does not support the notion that data from multiple clinical trials should be considered when assessing whether both co-primary efficacy endpoints have been achieved as contemplated in the definition of Achievement Date. The OPUS-2 Study is clearly defined as a clinical trial that is "to be conducted."[34] Applying the Merger Agreement's rule of construction to change the singular terms to plural, the definition of OPUS-2 Study would read "the Phase III clinical trials for Lifitegrast to be conducted in accordance with the OPUS-2 Study Protocol . . ."[35] The OPUS-1 Study, however, had already been conducted by the time the Merger Agreement was executed. That fact is evident from the definition of OPUS-1 Study, which is "the Phase III clinical trial for Lifitegrast conducted by or on behalf of the Company in accordance with the Company Protocol Number 1118-KCS-200 . . ."[36] The Merger Agreement, therefore, clearly and unambiguously differentiates between the OPUS-1 Study that had been conducted and the OPUS-2 Study (and perhaps other Phase III

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whether the OPUS-2 Endpoint Achievement Date has occurred is to be made. Oral Arg. on Def.'s Mot. to Dismiss the Verified First Am. and Supplemental Compl. ("Oral Arg. Tr.") 37–38. This argument was not previously raised in Fortis' briefing and is therefore waived. See *Emerald P'rs v. Berlin*, 2003 WL 21003437, at *43 (Del. Ch. Apr. 28, 2003) ("It is settled Delaware law that a party waives an argument by not including it in its brief."). Even if the argument were not waived, however, I would reject it in any event. The unambiguous language of the Merger Agreement clearly states that the "audited final tables, figures, and listings from the OPUS-2 Study" must "demonstrate that both components of the co-primary efficacy endpoints of the OPUS-2 Study as specified in the OPUS-2 Study Protocol have been achieved . . ." Nothing in this language suggests that the parties intended it to mean that the receipt of OPUS-2 Study data would act simply as a "temporal trigger" after which data from any and all other Phase III clinical trials will be evaluated to determine whether both endpoints had been achieved.

[33] Merger Agreement § 11.9(b).

[34] Merger Agreement § 1.1.

[35] *Id*. (emphasis added).

[36] *Id*. (emphasis added).

trials) that were to be conducted. Adding plural terms to the definition of OPUS-2 Study does nothing to change this temporal reality.[37]

Fortis engages in even more strained interpretive gymnastics when it argues that any data from any clinical trial conducted "in accordance with" the OPUS-2 Study Protocol can be considered when determining whether the Achievement Date has occurred. This construction just outright ignores that the OPUS-1 and OPUS-2 studies were conducted pursuant to separately defined protocols. Moreover, even if the OPUS-1 Study was conducted "in accordance with" the OPUS-2 Study Protocol, a point Shire disputes at full throat, Fortis simply cannot explain how that clinical trial could fit within the definition of Achievement Date when that term is defined to include only clinical trials "to be conducted" in accordance with the OPUS-2 Study Protocol. To reiterate, the OPUS-1 Study had already been conducted at the time of the Merger Agreement, a fact that is undisputed and is, in any event, clear from the definition of the OPUS-1 Study in the Merger Agreement. For these reasons, it is unreasonable to construe the definition of OPUS-2 Study as encompassing data from multiple clinical trials in addition to the OPUS-2 Study.[38]

As for Fortis' third and final basis to argue that the Achievement Date has occurred—that the Xiidra label provides irrefutable evidence the OPUS-2 Study did achieve both co-primary efficacy endpoints—the argument ignores that the Merger Agreement clearly and unambiguously requires that the study data achieve statistical significance. And it glosses over the fact that Fortis has not pled that the Xiidra label showed a statistically significant result for the OPUS-2 Study. To get around the reference to statistical significance in the OPUS-2 Study Protocol, Fortis contends that the reference to the OPUS-2 Study Protocol within the definition of the Achievement Date is simply intended to identify the co-

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[37] This, of course, assumes that the context here requires singular terms to be converted to plural. The rule of construction upon which Fortis relies within § 11.9(b) applies only "wherever the context requires." Given that the OPUS-1 and OPUS-2 studies were both separately defined in the Merger Agreement, and the provisions at issue here are clear and unambiguous as drafted, it is difficult to discern anything about this "context" that "requires" a conversion of terms from singular to plural.

[38] I note that the Complaint is devoid of any well-pled allegations that would allow the Court reasonably to infer that the OPUS-1 Study, which was conducted in accordance with Company Protocol Number 1118-KCS-200, dated May 27, 2011, as amended August 5, 2011, was conducted "in accordance with" the OPUS-2 Study Protocol, a separately defined protocol designed well after the OPUS-1 Study. The Complaint makes no effort to compare the two protocols factually, scientifically or otherwise. Fortis' "in accordance with" construction, therefore, appears to be of post-pleading vintage. In any event, the construction cannot be squared with the clear and unambiguous terms of the contract and must be rejected for that reason alone.

primary efficacy endpoints as defined in the OPUS-2 Study Protocol; it does not, however, reflect an intent to incorporate all aspects of the OPUS-2 Study Protocol, including the requirement of statistical significance, within the Achievement Date definition. To characterize this construction as fanciful would be charitable.

In advancing its proffered construction, Fortis would have the Court ignore that the OPUS-2 Study Protocol, in its entirety, is an attached schedule to the Merger Agreement and is thereby expressly incorporated as part of the entire agreement.[39] By incorporating the entire OPUS-2 Study Protocol into their agreement without conditions or limitations, the parties unambiguously reflected their intent that all aspects of the protocol, including its detailed specifications for statistical significance, would become elements of their contract, equally as essential as any other element.40[40] Fortis' attempt to read out of the OPUS-2 Study Protocol the provisions that undermine its construction of the Achievement Date definition cannot be countenanced.

Moreover, as noted, Fortis has not attempted to plead that the Xiidra label shows that the co-primary efficacy endpoints were achieved in a statistically significant manner. Rather, it construes the data on the label as revealing only that the OPUS-2 Study demonstrated that the reduction for the sign endpoint was favorable for Lifitegrast as compared to the placebo.[41] Fortis contends that this means that the sign endpoint

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[39] *See* Merger Agreement, Schedule C. At § 11.4 of the Merger Agreement, the parties agreed that the schedules to the Merger Agreement were incorporated as part of the parties' entire agreement. *See* Merger Agreement § 11.4(a)(i) ("This Agreement and the documents and instruments delivered pursuant hereto, including the exhibits hereto, the Company Disclosure Schedule and the other schedules hereto, and the Escrow Agreement: (i) together constitute the entire agreement among the parties with respect to the subject matter hereof . . .").

[40] See *Realty Growth Inv. Council of Unit Owners of Pilot Pointe*, 453 A.2d 450, 454 (Del. 1982) (holding that documents incorporated by reference into a contract must be considered by the court when discerning the parties' intent); *Green Plains Renewable Energy, Inc. v. Ethanol Hldg. Co*., LLC, 2015 WL 590493, at *6 (Del. Super. Ct. Feb. 9, 2015) (holding that the operative contract's express "identification of all schedules to the [contract] as being part of the 'entire agreement' is sufficient to satisfy the incorporation by reference standard."); *accord Kerly v. Battaglia*, 1990 WL 199507, at *4 (Del. Super. Ct. Nov. 21, 1990) (noting that parties may limit the incorporation by reference of other agreements by designating "only certain provisions" of the other agreement to be incorporated into the contract at issue).

[41] Fortis argues that Shire has denied it access to the actual data from the OPUS-2 Study even though it is contractually entitled to this data. According to Fortis, the actual data would allow it to determine if the results in the OPUS-2 Study were, in fact, statistically significant. Yet this is not the breach of contract claim Fortis brought in this action. If Fortis believes that it has been denied access to information that it is entitled, by contract, to receive, it may bring that claim and Shire may raise its defenses. The fact that the information has not been produced thus far, however, does not and cannot alter the fact that the clear and unambiguous terms of the Merger Agreement do not support the breach of contract claim that

was "achieved" in the OPUS-2 Study if one construes the term "achieved," an undefined term, in accordance with its ordinary dictionary meaning. According to Fortis, as used in the operative language, "achieve" means "to reach or attain"; it does not mean or require that the study produce statistically significant results. This construction, of course, ignores the details of the OPUS-2 Study Protocol where the parameters of the study are set forth in detail, including the population of patients to be tested, the number of study participants and how they would be sourced and screened, the methodology by which participants would be assigned to the Lifitegrast or placebo cohorts, the mechanics for the testing procedures and, importantly, the manner by which the outcomes would be evaluated for statistical significance. Under these circumstances, there is simply no room to embed a general dictionary definition for "achieve" within the definition of Achievement Date when the detailed ingredients of the OPUS-2 Study Protocol fully occupy the space.[42]

III. CONCLUSION

To state a claim for breach of contract, Fortis must proffer a reasonable construction of the operative terms of the Merger Agreement that would support its claim of breach. It has not done so. On the other hand, Shire's construction is entirely reasonable. Because Shire's construction reveals that it has not breached the Merger Agreement, Shire's motion to dismiss the Complaint must be GRANTED.

IT IS SO ORDERED.

Fortis *has* asserted. As an aside, I cannot help but observe that it would be remarkable if the OPUS-2 Study actually did achieve statistically significant results when Shire reported to the FDA in a NDA, against its interest, that the study did *not* meet the co-primary Sign endpoint with statistical significance. *See* Transmittal Aff. Of Jaclyn C. Levy, Ex. A at 37 (the NDA was incorporated by reference in the Complaint).

[42] *See Brinckerhoff v. Enbridge Energy Co., Inc*., 159 A.3d 242, 254 (Del. 2017) (observing that "settled rules of contract interpretation requir[e] that the court prefer specific provisions over more general ones."). Although the Court is bound to a four corners analysis of the Merger Agreement unless the contractual language is ambiguous, I pause to note that it makes eminent sense that these two parties would require statistical significance as the measure for "achievement" in this context when seeking an objective means by which to determine whether milestones have been reached. While Fortis' interpretation would leave the trigger point for the milestone payments as something more fluid and open to debate, I cannot fathom that two sophisticated parties with hundreds of millions of dollars on the line would have been so cavalier.

IN RE MARTHA STEWART LIVING OMNIMEDIA, INC. STOCKHOLDER LITIGATION

In the Court of Chancery of the State of Delaware

C.A. No. 11202-VCS

OPINION

Date Submitted: July 24, 2017
Date Decided: August 18, 2017

Seth D. Rigrodsky, Brian D. Long, Gina M. Serra, and Jeremy J. Riley of RIGRODSKY & LONG, P.A., Wilmington, Delaware; Carmella P. Keener of ROSENTHAL, MONHAIT & GODDESS, P.A., Wilmington, Delaware; James S. Notis and Meagan Farmer of GARDY & NOTIS, LLP, New York, New York; Evan J. Smith and Marc L. Ackerman of BRODSKY & SMITH, LLC, Bala Cynwyd, Pennsylvania; and Gustavo F. Bruckner of POMERANTZ LLP, New York, New York, *Attorneys for Plaintiffs.*

Kevin R. Shannon, Matthew F. Davis, and Mathew A. Golden of POTTER ANDERSON & CORROON LLP, Wilmington, Delaware and Paul K. Rowe of WACHTELL, LIPTON, ROSEN & KATZ, New York, New York, *Attorneys for Defendant Martha Stewart.*

John L. Reed, Ethan H. Townsend, and Harrison S. Carpenter of DLA PIPER LLP (US), Wilmington, Delaware and Mitchell A. Karlan and Lauren Sager of GIBSON DUNN & CRUTCHER LLP, New York, New York, *Attorneys for Defendants Sequential Brands Group, Inc., Singer Madeline Holdings, Inc., Madeline Merger Sub, Inc., and Singer Merger Sub.*

SLIGHTS, *Vice Chancellor*.

Beyond the broad enabling provisions of the Delaware General Corporation Law, there is no official guidebook or manual to which fiduciaries of Delaware companies may turn when determining how best to fulfill their duties to shareholders once a decision has been made to sell the company. Even so, Delaware courts have addressed certain recurring transactional scenarios with sufficient regularity and consistency that, over time, our decisional law has drawn situational "road maps" that guide directors, officers and others involved in the sales process through these scenarios in a manner that will allow them to earn

the maximum deference for their decision making that our law allows under the circumstances.[1]

The proper means by which to manage the conflicts inherent in transactions involving controlling stockholders in various contexts has been the subject of several decisions of this court and our Supreme Court. Of particular relevance here, in the seminal *Kahn v. M&F Worldwide Corp.*,[2] our Supreme Court synthesized decades of jurisprudence to lay out the road map by which a controlling stockholder's buyout of its subsidiary in a negotiated merger will earn the controller the maximum deference our law allows, even at the pleadings-stage. Specifically, the court explained that if the relevant constituencies involved in the transaction precisely implement designated measures intended to replicate arms-length bargaining, then the standard by which the alleged conflicted transaction will be reviewed, even at the pleadings stage, will be the business judgment rule. If they deviate from the detailed road map laid out by the court, however, then the path to pleadings-stage deference will be closed and the default standard of review, entire fairness, will govern any motion to dismiss the complaint.[3]

In this consolidated class action, former stockholders of Martha Stewart Living Omnimedia, Inc. ("MSLO" or the "Company") have brought claims in a Verified Second Amended Class Action Complaint (the "Complaint") against the Company's former controlling stockholder and namesake, Martha Stewart, for breach of fiduciary duty and against the third-party buyer, Sequential Brands Group, Inc. ("Sequential"), for aiding and abetting that breach. The claims arise out of a transaction that closed in December 2015, whereby MSLO was acquired by Sequential in a merger (the "Merger"). Pursuant to the Merger, MSLO stockholders could elect to receive $6.15 per share either in cash or common stock of the newly formed company based on a conversion formula set forth in the merger agreement.

The gravamen of the claim against Stewart is that she leveraged

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[1] See William B. Chandler, III, *The Delaware Court of Chancery and Public Trust*, 6 Univ. of St. Thomas L.J. 421, 423–24 (2009) (noting that "one can, over time, weave [the decisions of the Court of Chancery] together to form a road map, an acceptable path for directors and officers of companies, so they can know what is expected of them.").

[2] 88 A.3d 635 (Del. 2014).

[3] *Id*. at 645 (holding that "the business judgment standard of review will be applied [in controller buyouts] if and only if" the prescribed steps—*ab initio* creation of a well functioning special committee comprised of independent directors and *ab initio* conditioning the consummation of the transaction on the informed, uncoerced approval of a majority of the minority stockholders—are taken as outlined) (emphasis in original).

her position as controller to secure greater consideration for herself than was paid to the other stockholders. In a motion to dismiss the Complaint, Stewart denies that she was paid disparate consideration but argues that even if the Complaint pleads that she engaged in a conflicted transaction, the Court should review the allegations under the business judgment rule standard since the transaction was structured in a manner that provided meaningful protections to the minority stockholders.

This court has not yet had occasion to address whether the transactional structure outlined in *M&F Worldwide* fits when the controller is a seller only and, if so, whether strict compliance with the prescribed steps is necessary to secure pleadings-stage business judgment rule review. For reasons I explain below, I have determined that *M&F Worldwide* does apply to conflicted one-side controller transactions. I have also determined that business judgment deference is appropriate at the pleadings stage in this case because the dual procedural protective measures deployed in connection with this transaction—the creation of an independent special committee and the adoption of a majority of the minority approval condition—followed the *M&F Worldwide* road map with precision and were in place at the moment Stewart began to negotiate for consideration over and above what would be paid to the other stockholders. Because the course of this transaction hit each point on the *M&F Worldwide* map, Plaintiffs' only path to challenge the Merger is via a claim of waste, which they have neither pled nor remotely suggested is viable here.

As explained below, I have also concluded that the Complaint does not adequately plead that Stewart, as controlling stockholder, engaged in a conflicted transaction in any event. The timeline of the negotiations surrounding the Merger and the "side deals" Sequential entered into with Stewart reveals that Plaintiffs will be unable, under any reasonably conceivable circumstance, to prove a central element of their claim, causally related damages. Contrary to the story chronicled in the Complaint, where Stewart allegedly diverted consideration from MSLO stockholders to herself, and thereby caused Sequential to lower its offer for the Company, the actual series of events described in the publicly filed documents on which the Complaint relies confirms that the consideration Sequential offered to MSLO stockholders actually increased after negotiations with Stewart began. Under these circumstances, it is not reasonably conceivable that Plaintiffs can prove their claim that Stewart engaged in a conflicted transaction through which she caused injury to the minority stockholders by diverting merger consideration to herself.

Plaintiffs have also failed to allege sufficient non-conclusory facts that would allow any inference that the side deals Sequential negotiated

with Stewart to ensure her continued commitment to the acquired company were materially different from or more lucrative to Stewart than the contractual arrangements Stewart already had in place with MSLO. Having failed to plead a conflict between Stewart and the minority stockholders, the appropriate standard of review is the business judgment rule even if the transactional structure strayed from the *M&F Worldwide* road map.

For its part, Sequential seeks dismissal of the aiding and abetting claim on two grounds: (1) the claim fails as a matter of law because the Complaint does not plead a viable claim for breach of fiduciary duty against Stewart; and (2) the Complaint fails to plead one of the required elements of an aiding and abetting claim, knowing participation in the breach by Sequential. Because I have determined that the Complaint fails to state a claim for breach of fiduciary duty against Stewart, I dismiss the Complaint against Sequential on that basis and need not reach the question of whether the Complaint adequately pleads the other elements of aiding and abetting a breach of fiduciary duty.

I. BACKGROUND

I have drawn the facts from the allegations in the Complaint, documents integral to the Complaint and matters of which I may take judicial notice.[4] I have assumed that all well-pled facts in the Complaint are true, except in those instances where the Plaintiffs fail adequately to explain contradictions between the facts as pled in the Complaint and the facts as recited in the Proxy on which the Complaint relies to describe the background of the Merger. In the face of outright contradictions between the Complaint and the Proxy, I have considered the Proxy for its truth, even at this procedural stage, because it is integral to Plaintiffs' claims.[5]

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[4] *In re Crimson Exploration Inc. S'holder Litig*., 2014 WL 5449419, at *8 (Del. Ch. Oct. 24, 2014) ("'A judge may consider documents outside of the pleadings only when: (1) the document is integral to a plaintiff's claim and incorporated in the complaint or (2) the document is not being relied upon to prove the truth of its contents.' Under at least the first exception, [the court finds] that consideration of the Proxy Statement is appropriate in resolving this dispute.") (citation omitted); *In re Gardner Denver, Inc*., 2014 WL 715705, at *2 (Del. Ch. Feb. 21, 2014) (on a motion to dismiss, the Court may rely on documents extraneous to a complaint "when the document, or a portion thereof, is an adjudicative fact subject to judicial notice.") (internal citation and quotation marks omitted); *Narrowstep, Inc. v. Onstream Media Corp*., 2010 WL 5422405, at *5 (Del. Ch. Dec. 22, 2010) (same).

[5] *See Orman v. Cullman*, 794 A.2d 5, 16 (Del. Ch. 2002) (explaining that the Proxy Statement could be considered for its truth because "it is [] integral to [Plaintiff's] complaint as it is the source for the merger-related facts as pled in the complaint. Therefore, the Proxy

A. *The Parties and Relevant Non-Parties*

Lead plaintiffs, Paul Dranove, Phuc Nguyen, Kenneth Steiner, and Richard Schiffrin, were at all relevant times the owners of Class A common stock of MSLO.

Defendant, Martha Stewart, is the founder and namesake of MSLO. She was indisputably MSLO's controlling stockholder at the time of the Merger.

Defendant, Sequential, is a Delaware corporation headquartered in New York City. Its business consists of owning, promoting, marketing and licensing a portfolio of consumer brands in the fashion, active and lifestyle categories. Defendant, Singer Madeline Holdings, Inc. ("TopCo"), is a Delaware corporation formed to effectuate the Merger. Defendants, Madeline Merger Sub, Inc. and Singer Merger Sub, were Delaware corporations and wholly-owned subsidiaries of TopCo that facilitated the Merger and ceased to exist thereafter (collectively, the "Sequential Defendants").

Pierre deVillemějane, a director of MSLO since August 2013, was the Chairman of a special committee formed in 2014 to consider possible strategic transactions on behalf of MSLO that ultimately negotiated the transaction with Sequential (the "Special Committee").[6] He is also the CEO of WWRD Holdings Limited ("WWRD"), a position he has held

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Statement, and any other documents incorporated into it, are incorporated by reference into the complaint and will be considered on this motion."). In this case, the exception that allows the court to consider a document outside the pleadings for its truth on a motion to dismiss takes on a heightened level of importance because there are starkly conflicting factual narratives in the Complaint and in the Proxy. Indeed, given the import and potentially case dispositive nature of this issue, I requested that the parties submit supplemental briefing on the extent to which the Court could rely upon factual statements in the Proxy. In their supplemental briefing, Plaintiffs cite to *In re Santa Fe Pac. Corp. S'holder Litig*., 669 A.2d 59 (Del. 1995) for the proposition that the Court cannot deem the contents of the Proxy as true. *Sante Fe* said no such thing. To be sure, our Supreme Court did emphasize that public filings, like a Proxy, should only be used to establish what was told to stockholders in public disclosures or to establish "formal, uncontested matters." *Id*. at 70. The Supreme Court made clear, however, that these limitations applied "[w]hen a proxy statement is merely appended to the complaint and relied upon for the disclosure claims, but is not put forth by plaintiffs as an admission of the truth of the facts referred to therein. . ." *Id*. In this case, Plaintiffs did much more than "merely append" the Proxy to their Complaint; they referred to it as the source of their merger-related facts on which their claims rest. In doing so, they can fairly be said to have made "an admission of the truth of the facts referred to therein." *Id*. Thus, contrary to Plaintiffs' argument, *Santa Fe* is consistent with the conclusion in *Orman* that when a public filing is "integral to [a Plaintiff's] complaint [because] it is the source for the merger-related facts as pled in the complaint," it should be "incorporated by reference into the complaint and []considered on this motion." *Orman*, 794 A.2d at 16.

[6] Plaintiffs initially brought claims against the members of the Special Committee for breach of fiduciary duty, but voluntarily dropped those claims when they filed the operative consolidated complaint. (DI 30).

since March 2009. WWRD offers products under various brand names, including Wedgwood and Waterford. Wedgwood has a line of products designed by Stewart, sold under the name "Martha Stewart Collection by Wedgwood."[7] Wedgwood and Waterford Products are also promoted on MSLO's website.

William Roskin, a director of MSLO since October 2008 and member of the Special Committee, was previously employed at Viacom until 2008. Viacom and its affiliate carried the Martha Stewart Living syndicated television program until 2004. Arlen Kantarian, a director of MSLO since February 2009 and a member of the Special Committee, previously served as CEO of Professional Tennis for the United States Tennis Association and US Open from 2000 to 2008. It is alleged that Stewart is "a self-avowed tennis enthusiast who has three tennis courts on her various properties [and] who [has] attended the tennis matches and the GalaOpen for the [USTA-sponsored] US Open."[8]

Margaret M. Smyth, a director of MSLO since January 2012 and a member of the Special Committee until November 13, 2014, was previously a partner at Arthur Andersen. It is alleged that MSLO was one of Smyth's "accounts" at Arthur Andersen.[9]

B. *The Company*

Founded in 1996, MSLO was a Delaware corporation headquartered in New York City that conducted a media and merchandising business, creating original how-to content and related products for homemakers and other consumers. MSLO organized its business into three segments: Publishing, Merchandising, and Broadcasting. Its common stock was publicly traded on the NYSE under the ticker symbol "MSO."

Prior to the Merger, MSLO had two classes of common stock: Class A (one vote per share) and Class B (ten votes per share). As of September 18, 2015, MSLO had 32,510,392 shares of Class A common stock outstanding and 24,984,625 shares of Class B common stock outstanding. Stewart owned or controlled 100% of the Class B shares and 2,102,946 Class A shares, which collectively represented 88.8% of the total voting control of MSLO. She shared voting power with her daughter, Alexis Stewart, on behalf of the Martha Stewart Family Limited Partnership (the "Trust") up to the time of the Merger. The Class

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[7] Compl. ¶ 31(c).
[8] Compl. ¶ 31(b).
[9] Compl. ¶ 31(e).

B shares were transferrable only among the triangle of Stewart, the Trust, and Alexis Stewart. In the event of a transfer of Class B shares outside the triangle, the transferred shares would automatically convert into Class A shares.

C. *Stewart's Pre-Merger Contractual Relationships with MSLO*

Prior to the Merger, MSLO maintained three key agreements with Stewart or her affiliates: (1) an employment agreement (the "MSLO Employment Agreement"); (2) an Intellectual Property License and Preservation Agreement (the "IP Agreement"); and (3) an intangible asset license agreement with Lifestyle Research Center, LLC ("LRC"), another Stewart-owned entity (the "License Agreement"). Each are relevant to Plaintiffs' claims here.

Pursuant to the MSLO Employment Agreement, Stewart agreed to serve as MSLO's Chief Creative Officer and primary spokesperson, as the Founding Editorial Director for MSLO's publications and as the executive producer for MSLO's television and radio productions. MSLO, in turn, agreed to pay Stewart annual base compensation of $1.8 million with a right to receive up to $1.5 million per year in bonus compensation and reimbursement for performance expenses of up to $100,000 per year.

Pursuant to the IP Agreement, Stewart granted MSLO "an exclusive, worldwide, perpetual royalty-free license to use her name, likeness, image, voice, and signature for products and services."[10] Under the IP Agreement, MSLO was the owner of the primary trademarks in the business and was granted the right to develop and register further trademarks incorporating the Martha Stewart name, even if Stewart ceased to be MSLO's controlling stockholder. If Stewart was terminated without "cause"—or if Stewart terminated her employment for "good reason"—the IP License would continue only in part, and Stewart would be permitted to use her name in new businesses.

Pursuant to the License Agreement, MSLO paid Stewart, through LRC, an annual fee for the perpetual, exclusive right to use certain Stewart-related intangible assets and to access various Stewart-owned realty through 2017. The annual fee initially was $2 million, but was reduced to $1.7 million in 2013 for an extended term lasting until September 15, 2017. If MSLO terminated Stewart for reasons other than for "cause," or if Stewart terminated her employment for "good reason,"

MSLO would be obligated to pay LRC the licensing fee through the License Agreement's remaining term. Otherwise, the License

[10] Compl. ¶ 30.

Agreement would terminate when Stewart's employment with MSLO terminated.

D. *MSLO Explores a Potential Strategic Transaction With "Company A"*

In the summer of 2014, one of MSLO's peer companies ("Company A") advised Stewart that it wished to explore a potential strategic transaction with MSLO. Stewart subsequently informed MSLO's Board of Directors (the "Board") of Company A's expression of interest. At the time, MSLO's Board was comprised of six members: Stewart, Daniel W. Dienst, MSLO's CEO and a director of MSLO since October 2013, Arlen Kantarian, Pierre deVilleméjane, William Roskin, and Margaret M. Smyth.

After Stewart informed MSLO's Board of Company A's interest, Stewart, Dienst and other members of MSLO management engaged in "a number" of conversations with Company A representatives to explore Company A's overture.[11] On July 29, 2014, MSLO entered into a confidentiality agreement with Company A to facilitate more substantive discussions. On August 26, 2014, MSLO's Board met at the offices of Debevoise & Plimpton LLP, MSLO's outside counsel. At that meeting, Stewart advised the Board that discussions with Company A were at a preliminary stage and that no valuation discussions or due diligence had occurred. The Board, in turn, determined that it was appropriate to form the Special Committee, comprised of independent directors, to evaluate and determine the advisability of the potential transaction with Company A and other alternatives "given Stewart's control position and the uncertainty regarding what her arrangements would be in connection with a potential transaction."[12] The Special Committee was comprised of deVilleméjane, Kantarian, Roskin, and Smyth.[13] The MSLO Board authorized the Special Committee at the outset of its formation to retain legal and financial advisors. The Board also delegated "full and exclusive" authority to the Special Committee to explore, evaluate and negotiate a potential transaction with Company A, to consider an alternative transaction or to decide not to pursue strategic alternatives should it determine that doing nothing was in the Company's best

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[11] Verified Second Am. Class Action Compl. ("Compl.") ¶ 34 (quoting Martha Stewart Living Omnimedia, Inc., Definitive Proxy Statement Form DEFM14A dated Oct. 27, 2015 ("Proxy") at 52).

[12] Compl. ¶ 35 (quoting Proxy at 53).

[13] deVilleméjane eventually became the Chairman of the Special Committee. Compl. ¶ 36. "Smyth resigned from the Committee on November 13, 2014 'due to professional obligations.'" *Id*. (quoting Proxy at 53).

interest.[14]

The Special Committee retained Debevoise as its legal advisor and Moelis & Company as its financial advisor.[15] With its advisers in place, the Special Committee began discussions with Company A regarding a potential transaction. It soon became clear, however, that "Company A was unwilling to expend the time and resources necessary to negotiate a transaction without first ascertaining whether it would be able to reach an understanding in principle with . . . Stewart . . . ."[16] To address this concern, "Company A requested the opportunity to negotiate certain post-closing employment arrangements with Stewart before negotiating the terms of a proposed acquisition."[17] The Special Committee granted Company A's request but "reserv[ed] [the] right to evaluate such arrangements."[18]

E. *Sequential Enters the Picture*

On November 12, 2014, while the Special Committee's negotiations with Company A were ongoing, Dienst had a lunch meeting with Bill Sweedler, the chairman of Sequential's board of directors and the co-founder and managing partner of Tengram Capital Partners ("TCP"), Sequential's largest stockholder. At that meeting, Sweedler

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[14] Compl. ¶ 38 (quoting Proxy at 53). Plaintiffs allege that the Special Committee's broad mandate was not in place until some time after the Board authorized the Special Committee to hire legal and financial advisors, noting that the Proxy states the Board "subsequently delegated full and exclusive authority" to the Committee to consider alternatives. *Id.* A fair reading of the Proxy, however, is that the Board both authorized the Special Committee to hire advisors and empowered the Special Committee to consider alternatives at the August 26 meeting. Proxy at 53 ("The MSLO Board of Directors authorized and empowered the Special Committee to retain independent legal counsel and financial advisors. The MSLO Board of Directors subsequently delegated to the Special Committee full and exclusive authority" to negotiate a transaction with Company A or any alternative transaction.). While this might suggest that the Board did not fix the Special Committee's mandate until some later date, the Proxy goes on to explain that, on the same date, "immediately following the MSLO Board of Directors meeting at which the MSLO Board of Directors established the Special Committee, the Special Committee held a meeting to discuss its mandate and consider the retention of legal counsel and an independent financial advisor to the Special Committee." Proxy at 53. The Proxy further states that "[t]he MSLO Board of Directors resolved not to recommend any potential transaction or any other strategic alternative without the prior favorable recommendation of the Special Committee." Proxy at 53. With all of this said, what ultimately is relevant here is that Plaintiffs do not allege that the Special Committee did not have an appropriate mandate prior to beginning discussions with Sequential nearly three months after the Special Committee was formed.

[15] The Complaint points out that Debevoise had previously represented the Company and "had a prior relationship with Stewart and senior management." Compl. ¶ 39.

[16] Compl. ¶ 42 (quoting Proxy at 55).

[17] Compl. ¶ 42 (quoting Proxy at 55).

[18] Proxy at 55.

indicated to Dienst that TCP was interested in exploring a transaction with MSLO. Later that month, TCP delivered a written preliminary indication of interest to Stewart, who then provided that document to the Special Committee.

TCP's indication of interest described two alternatives. The first was a recapitalization whereby TCP would acquire an unspecified number of shares from Stewart. In return, Stewart would receive the bargained-for consideration for her shares, compensation for the termination of her existing employment arrangements with MSLO and certain profit sharing interests in the shares of MSLO stock acquired by TCP. The second alternative was a merger with Sequential whereby Sequential would offer a combination of cash and stock for 100% of MSLO stock at a price of $4.50 per share (the stock's then-current trading price). After discussing "certain financial considerations" raised by TCP's proposal, the Special Committee elected not to engage with TCP or Sequential at that time.[19]

On March 5, 2015, MSLO announced better-than-expected 2014 financial results and, over the next two weeks, the trading price of MSLO Class A common stock rose from $4.73 per share to $6.45 per share. Prior to March 5, 2015, Company A and Stewart had reached an agreement on Stewart's personal arrangements in the event a MSLO-Company A transaction was ultimately approved. Negotiations had reached a point where MSLO and Company A entered into an exclusivity agreement that would expire on April 3, 2015. Ultimately, however, the Special Committee rejected Company A's best proposal, which had increased to $4.90 per share and had been formulated before the announcement of MSLO's improved financial results. MSLO allowed the exclusivity agreement with Company A to expire as scheduled on April 3, 2015.

On April 9, 2015, the Special Committee and its advisors discussed "next steps" following the cessation of discussions with Company A. The following week, at a meeting on April 15, the Board received reports from the Special Committee and Moelis. The Special Committee advised the Board that discussions with Company A had ceased and Moelis then provided the Board with an overview of alternatives that MSLO could pursue. As it considered next steps, the Board "considered the views of Stewart, who had expressed a preference for a targeted search for a potential buyer rather than a broad public auction."[20] When the Board discussed whether to resume contact with

[19] Proxy at 56.
[20] Compl. ¶ 47 (quoting Proxy at 58).

Sequential, Dienst informed the Board that he had a meeting scheduled the next day with Sweedler, Sequential's chairman, and that he would inquire whether Sequential was still interested.

Dienst met with Sweedler as scheduled. At the conclusion of the meeting, Sweedler confirmed that Sequential was prepared to submit a revised indication of interest to the Special Committee. On April 21, Sequential proposed a transaction at $6.20 per share, payable 50% in cash and 50% in stock. Two days later, MSLO entered into a confidentiality agreement with Sequential. Stewart and other members of MSLO management met with Sequential a week later to discuss "the potential merits of a combination transaction."[21]

F. *The Sequencing of Negotiations Related to the Merger*

At the April 29 meeting of the Special Committee, Debevoise reported on its conversations with Stewart's counsel regarding a potential MSLO-Sequential transaction and the sequencing of negotiations surrounding Stewart's post-closing arrangements. Stewart's advisors represented that "Sequential was willing to base Stewart's post-closing arrangements on the terms of her existing arrangements with MSLO[.]"[22] The Special Committee determined that its negotiations with Sequential for a sale of MSLO should precede Stewart's negotiations with Sequential regarding her post-closing contractual arrangements and resolved to go forward with negotiations on that basis.

On May 11, Sequential submitted a revised proposal to acquire MSLO. The revised proposal set forth two prices for MSLO's stock that depended upon MSLO's success in renegotiating a publishing arrangement with its publishing partner, Meredith Corporation. If MSLO could renegotiate the Meredith contract on favorable terms, Sequential would increase its offer to $6.25 per share. If not, the offer would be $5.75 per share ($0.45 per share lower than the April 21 proposal).[23] This revised proposal was conditioned on approval by a majority of shares of MSLO common stock other than shares owned by Stewart and her affiliates.[24]

The Special Committee met next on May 12, 2015. At that meeting, Debevoise advised the Special Committee that Sequential was seeking to negotiate Stewart's post-closing arrangements and the terms of a MSLO-Sequential transaction simultaneously. Just as Company A

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[21] Proxy at 59.
[22] Compl. ¶ 51 (quoting Proxy at 59).
[23] Proxy at 60.
[24] *Id.*

had insisted during its negotiations with the Special Committee, Sequential did not want to commit substantial resources to merger negotiations without at least simultaneously determining whether they could reach agreements with Stewart—the face of the Company—regarding her post-closing commitments to the acquired entity. And, just as it had approached negotiations with Company A, the Special Committee authorized Stewart to negotiate her post-closing arrangements at the same time the Special Committee negotiated the merger terms with Sequential, subject to the Special Committee's right to review those arrangements before determining whether to recommend the transaction to the full Board. During a Special Committee meeting a week later, the Special Committee decided that its negotiations of merger consideration with Sequential should culminate "near or at the time" all parties were ready to execute definitive agreements.[25]

G. *Sequential Submits a Revised Proposal*

On June 5, 2015, Sequential submitted a revised proposal for the Special Committee's consideration. The revised proposal set forth two alternatives. The first contemplated a purchase price of $6.15 per share with a no-shop provision and a termination fee of 3.75% of the merger consideration. The second alternative contemplated a purchase price of $6.00 per share, a go-shop period, and the same termination fee of 3.75%. Both alternatives included unlimited matching rights for Sequential, information rights and a right to expense reimbursement of $2.5 million in the event MSLO stockholders did not approve the Merger. Neither alternative mentioned the publishing agreement with Meredith. As of the close of trading on June 17, 2015, MSLO's stock was trading at $5.10 per share.[26]

The Special Committee met to consider the revised Sequential proposal on June 19, 2015. At that meeting, the Special Committee was advised that MSLO had received a letter from a third party expressing interest in exploring a possible transaction. The Special Committee determined not to entertain that potential offer and, instead, directed Moelis to request that Sequential increase its bid to $6.65 per share. Moelis made the request but Sequential declined to move from its $6.15 per share offer.

The Special Committee reconvened the next day. At this meeting, the Special Committee was informed for the first time that Stewart had

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[25] Proxy at 60.
[26] Proxy at 4.

negotiated an agreement whereby Sequential would reimburse Stewart for up to $4 million of the fees she incurred in negotiating her post-closing arrangements. The Special Committee was also informed that Stewart was "not prepared to limit or otherwise alter the [agreement to reimburse fees]."[27] At this juncture, the Special Committee abandoned its request for $6.65 per share. Instead, the Special Committee determined to request, and later received, Sequential's agreement to permit MSLO to engage in a thirty-day post-signing go-shop in lieu of a price increase.

The Special Committee met again on June 21, 2015. At that meeting, Moelis provided a fairness opinion with respect to the Merger at $6.15 per share. With the fairness opinion in hand, the Special Committee voted unanimously to recommend the Merger to the Board. The next day, June 22, the full Board approved the Merger. Stewart recused herself from the vote.

H. *The Merger*

MSLO and the Sequential Defendants entered into an "Agreement and Plan of Merger" on June 22, 2015. The Merger Agreement provided for a thirty-day postsigning go-shop period, matching rights for Sequential and a termination fee of $7.8 million during the go-shop period, which would increase to $12.8 million after the go-shop period. The Merger entitled MSLO stockholders to elect to receive either $6.15 per share in cash or a number of shares of Sequential common stock equal to the $6.15 merger price divided by the volume weighted average price of Sequential common stock during the five-day period immediately prior to the Merger's closing.

As had been expressed by Sequential for the first time on May 11 (the day before Stewart began her separate negotiations with Sequential), the Merger Agreement contained a non-waivable condition that the Merger be approved by a vote of at least the majority of the combined voting power of MSLO's outstanding Class A and Class B common stock, as well as a separate vote of at least 50% of the voting power of MSLO's outstanding Class A common stock not owned by Stewart and her affiliates.[28] MSLO's stockholders approved the Merger on December 2, 2015, with an overwhelming majority of the minority stockholders (99%) voting to approve the deal. The Merger closed on December 4, 2015.

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[27] Compl. ¶ 57 (quoting Proxy at 66).
[28] Proxy at A-58.

I. *Stewart's Contractual Relationships with Sequential and MSLO Following the Merger*

On June 22, 2015, the date of the Merger Agreement, Stewart entered into two separate agreements with Sequential. The first was an employment agreement. The second, a registration rights agreement, was between Sequential, Stewart, Alexis Stewart, the Trust and other related Stewart entities (collectively, the "Stewart Entities"). In addition, Stewart bargained for extensions of two other agreements she had in place with MSLO. These agreements collectively have been referred to by the parties as Stewart's "side deals."[29]

The relevant provisions of the employment agreement state that Stewart is to serve as "Chief Creative Officer" of the post-merger company for which she will be paid annual compensation of $1.8 million. She will be entitled to a bonus if bonuses are paid to other senior executives. She also will receive 10% of the annual gross licensing revenue earned from the Stewart brand in excess of $46 million. Beginning in 2026, and terminating upon the later of December 31, 2030 or the date of her death, Stewart will receive 3.5% of annual gross licensing revenues for Martha Stewart branded products. Additionally, she will be reimbursed up to $100,000 each year in performance expenses and expenses incurred in providing promotional services.

The employment agreement continues until 2020 and extends automatically for an additional five years if certain gross licensing revenue targets are achieved. Even if the employment agreement is not automatically extended, meaning that the licensing revenue targets are not met, Stewart will become a part-time brand consultant/ambassador for five years and receive annual payments between $1.5 million and $4.5 million per year. Finally, the employment agreement provides that Sequential will reimburse Stewart up to $4 million in expenses incurred in negotiating her post-merger contractual arrangements.

Pursuant to the registration rights agreement, the Stewart Entities have demand registration rights for all of the shares the Stewart Entities receive in the Merger. Thereafter, the Stewart Entities may include their shares in two offerings of greater than $15 million each and are entitled to certain S-3 registration rights for up to three offerings of greater than $5 million each with piggyback registration rights.

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[29] The theme advanced by Plaintiffs regarding Stewart's side deals with Sequential, of course, is that she had her mind only on her money as revealed by the fact that she bargained for Sequential to pay her more for less work than she had performed for MSLO and, in doing so, diverted consideration away from minority stockholders.

In addition to the new employment and registration rights agreements, the License Agreement was amended and the IP Agreement was amended and restated. The amended License Agreement extends the term of the original License Agreement from 2017 to 2020. Otherwise, the Amended License Agreement tracks the original License Agreement, meaning that Stewart will still receive the same $1.7 million annual payment provided for under the original agreement. The Amended and Restated IP Agreement mostly tracks the original IP Agreement, with one major exception: under the Amended IP Agreement, if Stewart's employment is terminated, she may not use her name in new businesses.

J. *Procedural History*

The initial complaint in this consolidated class action was filed on June 25, 2015, three days after the Merger was announced. That action was consolidated with several related actions pursuant to this Court's consolidation order dated August 18, 2015. Plaintiffs filed an amended class action complaint on January 12, 2016, and then a second amended complaint, the operative "Complaint," on July 18, 2016. The Complaint contains two counts: Count I for breach of fiduciary duty against Stewart as MSLO's controlling stockholder and Count II for aiding and abetting breach of fiduciary duties against the Sequential Defendants.

Stewart and the Sequential Defendants filed motions to dismiss the Complaint pursuant to Court of Chancery Rule 12(b)(6). After initial briefing and oral argument on the motion to dismiss, the Court requested supplemental briefing on June 29, 2017. The supplemental briefing was to address two issues the parties did not fully address in their initial briefing: (1) whether the Court can accept the contents of the Proxy as true at the pleadings stage given the substantial differences between the Complaint and the Proxy with respect to key facts, and (2) whether the framework established by our Supreme Court in *M&F Worldwide* applies to a onesided controller transaction and, if so, at what point in the process would the "dual procedural protections" of an independent, fully empowered special committee and a majority of the minority vote need to be imposed for purposes of determining whether both protections were present "*ab initio*." The parties submitted their supplemental briefing on July 24, 2017.

II. ANALYSIS

"The standards governing a motion to dismiss for failure to state a claim are well settled: (i) all well-pleaded factual allegations are accepted is true; (ii) even vague allegations are "well-pleaded" if they give the

opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the nonmoving party; and (iv) dismissal is inappropriate unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof."[30]

A. *The Standard of Review: Entire Fairness or Business Judgment Rule?*

The Court's consideration of the motions to dismiss must begin with the gating question of what standard of review governs the claims that have been pled against Stewart. Not surprisingly, Stewart urges the Court to determine that business judgment rule deference is appropriate here for either of two reasons.

First, she emphasizes that, although she is indisputably a controlling stockholder, the Merger was an arms-length transaction with a third party. She highlights that she did not negotiate the Merger—that task was undertaken by a well- functioning, fully independent Special Committee. Her alleged side deals with Sequential gave her nothing more than she was already receiving from MSLO. And she received the same consideration for her stock as all other stockholders. According to Stewart, under a long line of precedent, these factors, not countered by the well-pled allegations of the Complaint, justify application of the business judgment rule.[31] In essence, Stewart maintains that, because she did not engage in a conflicted transaction, she should not be held to the onerous entire fairness standard of review.

Second, Stewart argues that even if the Court determines the Complaint adequately pleads that she engaged in a conflicted transaction such that entire fairness would be the default standard of review, the Court nevertheless must review the transaction under the business judgment rule because the transaction was accompanied by procedural protections that protected the minority stockholders—a properly-empowered and independent special committee of the Board and a nonwaivable condition that the Merger be approved by a majority of the minority stockholders. According to Stewart, under well-established case law, these dual procedural protections have the effect of ratcheting down the standard of review from entire fairness to business judgment review

[30] *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002).

[31] Opening Br. in Supp. of Def. Martha Stewart's Mot. to Dismiss Pls.' Second Am. Class Action Compl. ("Stewart's Opening Br.") 29 (citing, by way of example, *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022 (Del. Ch. 2012)).

even in a conflicted transaction involving a controlling stockholder.[32]

Plaintiffs acknowledge that MSLO was acquired by a third-party not affiliated with the controlling stockholder. They also acknowledge that the controller nominally received the same Merger consideration as the minority stockholders. Nevertheless, they contend that entire fairness review is appropriate here since the controller allegedly diverted consideration to herself at the expense of the minority stockholders in the form of side deals dressed up as an employment agreement and various intellectual property-related agreements. This diversion of consideration was made possible, according to Plaintiffs, because the Special Committee, while at first resistant, ultimately allowed Stewart to negotiate her arrangements with Sequential at the same time the Special Committee was negotiating the Merger price with Sequential. These simultaneous negotiations, in turn, allowed Sequential to determine what it was going have to pay Stewart in the side deals to gain her approval of the transaction before it committed to its best and final offer for the Company. Plaintiffs allege that the effect of this sequencing is evident in the fact that Sequential's final offer of $6.15 per share is lower than its initial offer of $6.20 per share.[33]

With these lines drawn, the threshold and dispositive question remains: by what standard of review should Stewart's conduct be measured at this early stage of the litigation? In this case, the question has two parts: (1) whether Plaintiffs have pled facts that allow a

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[32] Stewart's Opening Br. 37 (citing *In re John Q. Hammons Hotels, Inc. S'holder Litig.*, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009); *Se. Pa. Transp. Auth. v. Volgenau*, 2013 WL 4009193 (Del. Ch.), aff'd, 91 A.3d 562 (Del. 2014)).

[33] Defendants argue that Plaintiffs mischaracterize the sequence of events and how Sequential ultimately arrived at the $6.15 per share offer. They acknowledge that Sequential originally proposed $6.20 per share on April 21, 2015. Compl. ¶ 49. They point out, however, that in early May 2015, Sequential submitted a revised proposal that was conditioned upon MSLO's success in renegotiating the publishing arrangement with Meredith. If the Meredith contract was favorably renegotiated, Sequential would increase its offer to $6.25 per share. If not, the offer would stand at $5.75 per share. Proxy at 60. MSLO was not able to meet the Meredith condition set by Sequential. Against this backdrop, Defendants highlight that the eventual $6.15 per share Merger price, substantially higher than the $5.75 offered by Sequential in early May, was extended on June 5, 2015, after Sequential reached agreement in principle with Stewart on her various side deals. Thus, the merger consideration offered by Sequential actually increased after the alleged breaches of fiduciary duty and aiding and abetting had occurred. Given these undisputed facts, Defendants contend that Plaintiffs have not and cannot allege a central element of their claim against Stewart—damages causally related to any wrongdoing by the Defendants. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 773 (Del. 2006) (stating "the fundamental principle governing entitlement to compensatory damages, which is that the damages must be logically and reasonably related to the harm or injury for which compensation is being awarded"). I address this issue below in connection with my determination of whether Plaintiffs have well-pled that the Merger was a conflicted transaction.

reasonable inference that Stewart engaged in a conflicted transaction; and, if so, (2) whether Plaintiffs have pled facts that allow a reasonable inference that the dual procedural protections employed in connection with this transaction fell short of what is required under Delaware law to justify business judgment review of Plaintiffs' breach of fiduciary duty claim at the pleadings stage.

1. Did Stewart Engage in a Conflicted Transaction?

As this court has often reiterated, "entire fairness is not triggered solely because a company has a controlling stockholder."[34] Rather, "the controller also must engage in a conflicted transaction."[35] With that said, "Delaware is more suspicious" when transactions involve controlling stockholders because "[a] controlling stockholder occupies a uniquely advantageous position for extracting differential benefits from the corporation at the expense of minority stockholders."[36] And when a controlling stockholder is involved, there is also "an obvious fear that even putatively independent directors may owe or feel a more-thanwholesome allegiance to the interests of the controller, rather than to the corporation and its public stockholders."[37]

In the controlling stockholder context, a conflicted transaction typically will fit one of two scenarios. In one scenario, the controller stands on both sides of the transaction, such as when a parent acquires its subsidiary.[38] With regard to these transactions, Delaware law is clear that, absent some basis for burden shifting or burden reduction, the controlling stockholder will "bear the burden of proving its entire fairness."[39] As noted, this scenario does not fit here because Stewart stood only on the sell-side of this transaction and was independent of the buyer.

In the other scenario, the controlling stockholder does not stand on both sides of the transaction but exploits its position of leverage on the sell-side to extract "different consideration or derive some unique benefit

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[34] Crimson, 2014 WL 5449419 at *12 (collecting cases); see also, Larkin v. Shah, 2016 WL 4485447, at *8 (Del. Ch. Aug. 25, 2016) ("Importantly, the presence of a controlling stockholder does not per se trigger entire fairness.").

[35] *Larkin*, 2016 WL 4485447, at *8.

[36] *Id*. at *11 (citing Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 678 (2005)).

[37] *Id.*

[38] *See, e.g., Kahn v. M&F Worldwide Corp*., 88 A.3d 635, 644 (Del. 2014).

[39] *Kahn v. Lynch Commc'n Sys., Inc*., 638 A.2d 1110, 1113 (Del. 1994).

from the transaction not shared with the common stockholders."[40] In these circumstances, our courts recognize that even though the controller is not calling the shots on both sides of the negotiating table, it can nonetheless "compete" with the minority by leveraging its controller status to cause the acquiror to divert consideration to the controller that would otherwise be paid into the deal.[41] Under these circumstances, "entire fairness review will apply *ab initio*."[42]

Among the cases that fit within this latter scenario are cases where the controller actually receives more in merger consideration than the other stockholders[43] and cases where the controller diverts merger consideration from other stockholders by masking the payment as consideration for "side deals."[44] Here, Plaintiffs acknowledge that Stewart received the same $6.15 per share Merger consideration that all other MSLO stockholders received. Thus, it is clear that the nature and character of Stewart's side deals, as alleged in the Complaint, will drive the analysis of whether Plaintiffs have pled the existence of a conflicted controlling stockholder transaction.[45]

Plaintiffs allege that the fact that Stewart's side deals diverted consideration from the minority can readily be gleaned from the trajectory of Sequential's offers. Specifically, according to Plaintiffs, Sequential lowered its offer for the Company after it struck its side deals with Stewart.[46] These allegations, however, cannot be squared with the detailed recounting of the negotiations between the Company and

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[40] *Crimson*, 2014 WL 5449419 at *12.

[41] *In re John Q. Hammons Hotels, Inc. S'holder Litig.*, 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009).

[42] *Larkin*, 2016 WL 4485447, at *8.

[43] *See, e.g., In re Tele-Commc'ns, Inc.*, 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).

[44] *See, e.g., In re LNR Prop. Corp. S'holder Litig.*, 896 A.2d 169 (Del. Ch. 2005).

[45] According to Stewart, in resisting her motion to dismiss, Plaintiffs essentially advocate for a *per se* rule that entire fairness review will apply, regardless of the circumstances, anytime a controlling stockholder negotiates "side deals" with the third-party acquiror. She cites to *Golaine v. Edwards* for the proposition that this court has rejected the very sort of per se rule that Plaintiffs purportedly urge the Court to adopt here. Although it is not clear to me that Plaintiffs have advanced the *per se* rule that has been ascribed to them, I agree with Stewart that there is no such *per se* rule recognized in our law. As *Golaine* makes clear, "[t]he analysis of whether [] side transactions tainted the fairness of the transaction to the target stockholders becomes in large measure a judgment about whether it was appropriate or not for those side transactions to occur." *Golaine v. Edwards*, 1999 WL 1271882, at *6 (Del. Ch. Dec. 21, 1999). *See also Houseman v. Sagerman*, 2014 WL 1600724, at *13 (Del. Ch. Apr. 16, 2014) (holding that "[t]o survive a motion for judgment on the pleadings, the plaintiff must plead facts supporting an inference that the side payment represented an *improper* diversion and that, absent the impropriety, the consideration would have gone to the stockholders.") (emphasis in original).

[46] Compl. ¶ 53–54.

Sequential as set forth in the Proxy.[47] Plaintiffs' "truth" is that Sequential made an initial offer of $6.20 for each share of MSLO stock; the Special Committee then allowed Stewart to negotiate with Sequential on a parallel track to the Special Committee's negotiations with Sequential; and then, after negotiations with Stewart were complete, Sequential lowered its offer price to $6.15 per share.[48] Of course, the Complaint not once mentions that Sequential lowered its offer to $5.75 per share after its initial offer of $6.20 per share. The Proxy, upon which Plaintiffs rely, reveals a different truth. There, it is revealed that, in fact, Sequential had already lowered its offer for the Company prior to the Special Committee giving Stewart permission to negotiate her side deals, and then increased its offer after those negotiations were, in essence, concluded.

To review, Sequential's initial expression of interest when it returned to the table in April 2015 was $6.20 per share. After a period of due diligence, on May 11, 2015, Sequential presented the Special Committee with a revised offer comprised of two alternatives—if MSLO successfully renegotiated its publishing agreement with Meredith on more favorable terms, then the offer would be $6.25 per share; if not, then the offer would be $5.75 per share. The Meredith contract was not renegotiated. The next day, May 12, Sequential advised the Special Committee for the first time that Sequential wanted to negotiate with Stewart at the same time it continued negotiations with the Special Committee. After completing separate negotiations with Stewart on the essential terms of her side deals, and even though the contract with Meredith had not been renegotiated on more favorable terms, Sequential increased its offer from $5.75 per share to $6.15 per share. Thus, the facts reveal that after Sequential substantially completed negotiations with Stewart regarding her side deals, its offer for the Company increased by $0.40 per share.

Plaintiffs elected to rest their claim that Stewart engaged in a conflicted transaction on a false narrative—a narrative that strategically omitted, if not outright misstated, a key fact. Sequential did not lower its offer after completing negotiations with Stewart; it increased its offer. With the flaw in their narrative exposed, it is not reasonably conceivable on the pled facts that Stewart caused Sequential to divert consideration from the minority stockholders into its side deals with Stewart.

Putting this dispositive causation issue to the side, Plaintiffs have

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[47] As previously explained, I have accepted the statements within the Proxy for their truth because Plaintiffs relied heavily on the Proxy as the source for merger-related facts in the Complaint and it is, therefore, integral to their claims.

[48] Compl. ¶¶ 49–54.

failed to plead non-conclusory facts that the side deals Sequential offered to Stewart provide her with markedly more lucrative post-merger arrangements than she had in place with MSLO before the Merger. As an initial matter, it cannot be ignored that it was Sequential, not Stewart, who insisted upon and initiated the negotiations with Stewart regarding side deals in order to ensure that Martha Stewart would remain meaningfully involved with the Martha Stewart brand Sequential was acquiring. The Special Committee can hardly be faulted for appreciating that any buyer, including Sequential, would need some level of comfort that Stewart would remain committed after the transaction closed before expending resources negotiating a transaction to acquire the Company that bore her name.

Perhaps more to the point, Plaintiffs have failed to distinguish the "new" side deals from the "old" side deals in any meaningful way that would support the inference that Stewart was extracting consideration from Sequential that otherwise would have gone to the MSLO shareholders. The most Plaintiffs can muster in this regard is that Sequential's commitment to reimburse Stewart for up to $4 million in out-of-pocket fees incurred in connection with her negotiations relating to the Merger "equates to $0.07 per share."[49] This argument, of course, ignores that Stewart herself owns almost half of the outstanding shares and therefore would have received approximately half of that amount even if it had been paid to stockholders. Moreover, Stewart's previous arrangements also contained a similar entitlement to reimbursement.

Plaintiffs' allegations regarding the side deals also ignore the authority of this Court that has declined to sustain a breach of fiduciary duty claim unless the plaintiff can allege facts that support an inference "that the side payment represented an improper diversion" of consideration.[50] I cannot reasonably conceive of a circumstance where Plaintiffs could prevail upon the Court as fact-finder that Stewart's side

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[49] Pls.' Answering Br. in Opp'n to Defs.' Mots. to Dismiss 10.

[50] *See Houseman*, 2014 WL 1600724, at *13 (to sustain a disparate consideration claim against the controller "the plaintiff must plead facts supporting an inference that the side payment represented an i*mproper* diversion and that, absent the impropriety, the consideration would have gone to the stockholders.") (emphasis in original); *Golaine*, 1999 WL 1271882, at *9 ("Put differently, there is nothing in the complaint that supports the notion that KKR took anything off the table that would have otherwise gone to all Duracell stockholders; indeed, by its silence on the matter, the complaint suggests that the Exchange Ratio was set before the KKR fee was set"); *In re First Interstate Consol. S'holder Litig*., 729 A.2d 851, 861–64 (Del. Ch. 1998) (granting a motion to dismiss upon rejecting conclusory allegations that side transactions affected the terms of a merger agreement). *Cf. Parnes v. Bally Entm't Corp*., 722 A.2d 1243, 1245–46 (Del. 1999) (finding that controller had attempted to negotiate disparate merger consideration by attempting to secure side deals where the controller would offer nothing of value); *In re LNR Prop. Corp. S'holders Litig*., 896 A.2d at178 (same).

deals with Sequential, which to reasonable degrees tracked the structure, value and obligations of the side deals she had in place before the Merger, reflect her improper attempt to divert to herself consideration that Sequential would have paid to the stockholders (keeping in mind, of course, that she herself was a stockholder who had by far the largest stake in the Merger consideration).[51] Sequential was acquiring the Martha Stewart brand and, in part, the continued commitment of Martha Stewart's time, energy and talent to keep the brand alive and thriving. It was entirely proper for Sequential to pay, and for Stewart to accept, extra consideration (just as MSLO had paid before the Merger) to secure the immeasurable value of that commitment. Indeed, these fair value side deals ultimately facilitated the Merger and enabled stockholders to realize premium value for their shares.

Giving Plaintiffs the benefit of all reasonable inferences to which they are entitled, they have failed adequately to plead non-conclusory facts that would support a reasonable inference that Stewart secured for herself consideration that otherwise would have been paid to the minority stockholders and that the minority stockholders suffered direct monetary harm as a result.[52] They have failed, therefore, to state a claim that Stewart, as controlling stockholder, engaged in a conflicted transaction. Accordingly, their breach of fiduciary claim against her must be reviewed under the business judgment standard.[53]

Defendants maintain that, even if the Court determined that Stewart's side deals with Sequential justified a pleadings-stage inference that she engaged in a conflicted transaction, the business judgment rule applies nevertheless since the transaction was structured in a manner that allowed impartial decision-makers—both the Special Committee and minority stockholders—to pass on the bona fides of the Merger. Plaintiffs disagree. Because Defendants contend that the dual procedural protections that were put in place here provide a separate basis to invoke the business judgment rule, and to grant their motion to dismiss, it is appropriate to take up this issue notwithstanding my determination that Plaintiffs have failed to plead the presence of a conflicted transaction.

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[51] *Synthes*, 50 A.3d at 1024 ("[t]he controlling stockholder had more incentive than anyone to maximize the sale price of the company"); *Crimson*, 2014 WL 5449419, at *17 ("Stockholders generally are presumed to have an incentive to seek the highest price for their shares. That inference or presumption is even stronger in the case of large stockholders.").

[52] *See Houseman*, 2014 WL 1600724, at *13; *Golaine*, 1999 WL 1271882, at *6.

[53] *Synthes*, 50 A.3d at 1034 (stating "the plaintiffs must plead that [the controller] had a conflicting interest in the Merger in the sense that he derived a personal financial benefit to the exclusion of, and detriment to, the minority stockholders.") (internal citation and quotation marks omitted).

2. Did the Dual Procedural Protections Employed Here Lower the Standard of Review?

Stewart argues that the Merger was structured in a manner that provided the minority stockholders with the dual procedural protections of an independent, disinterested and properly-empowered special committee and a non-waivable, fully- informed and uncoerced vote of a majority of the minority stockholders. According to Stewart, under these circumstances, there is simply no principled basis to conclude that she should be denied the deference of the business judgment rule in connection with this third-party merger when, under the rule stated in *M&F Worldwide*, she would clearly be entitled to business judgment deference if she stood on both sides of the transaction.[54] Indeed, citing *In re John Q. Hammons Hotels Inc. Shareholder Litigation* ("*Hammons*")[55] and *Southeastern Pennsylvania Transportation Authority v. Volgenau* ("*SEPTA*"),[56] she notes this court already has recognized that the standard of review should ratchet down from entire fairness to the business judgment rule when a third-party transaction allegedly involving disparate consideration paid to the controller is coupled with procedural protections that ensure independent decision makers will have the final say.[57]

Neither *Hammons* nor *SEPTA* addressed the question, addressed squarely in *M&F Worldwide*, of whether the parties to the transaction were required to embrace the dual procedural protections as conditions to

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[54] In *M&F Worldwide*, our Supreme Court held that "in controller buyouts, the business judgment rule will be applied *if and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and [approval of] a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively;(iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority." *M&F Worldwide*, 88 A.3d at 645. These protections must be in place "*ab initio*." *Id.* at 644.

[55] 2009 WL 3165613 (Del. Ch. 2009).

[56] 2013 WL 4009193 (Del. Ch.), *aff'd*, 91 A.3d 562 (Del. 2014).

[57] *Hammons*, 2009 WL 3165613, at *12 (holding that business judgment would be the applicable standard of review "if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all minority stockholders."); *SEPTA*, 2013 WL 4009193, at *11 (stating "*Hammons* sets forth the procedural protections necessary for a third-party transaction involving a controlling shareholder to qualify for review under the business judgment rule: (1) the transaction must be recommended by a disinterested and independent special committee, (2) which has "sufficient authority and opportunity to bargain on behalf of minority stockholders," including the "ability to hire independent legal and financial advisors[;]" (3) the transaction must be approved by stockholders in a nonwaivable majority of the minority vote; and (4) the stockholders must be fully informed and free of any coercion.").

consummation *ab initio* in order to justify business judgment review on a motion to dismiss.[58] Their silence on this question, in turn, prompts the question: at what point must the parties to a potentially conflicted third-party transaction involving a controlling stockholder agree to the dual procedural protections in order for the controller to earn pleadings-stage business judgment deference? In this case, the timing issue was confounded by the fact that the parties' initial briefing focused on the chronology as set forth in the Complaint where Plaintiffs alleged that Sequential agreed to a majority of the minority condition after Sequential initiated its negotiations with Stewart on side deals.[59] As noted above, the Proxy contradicts this narrative. Nevertheless, the parties did not address or even acknowledge the contradiction, at least not initially.

In her first pass on this issue, with the chronology as alleged in the Complaint in mind, Stewart took the position that *ab initio* implementation of the dual procedural protections was not required because, contrary to the framework applicable to a two-sided controller transaction, the courts in *Hammons* and *SEPTA* said nothing about the timeframe in which the protections must be implemented. By her lights, the Court should presume from this silence that *Hammons* and *SEPTA* intended to hold that the dual procedural protections would invoke business judgment deference so long as they were deployed as conditions at some point before the transaction closed.[60] *M&F Worldwide* was not reconciled or even addressed in her analysis.

For their part, Plaintiffs argued that *Hammons* and *SEPTA* offer little, if any, guidance since neither case addressed a controlling stockholder's entitlement to pleadings-stage business judgment

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[58] *M&F Worldwide*, 88 A.3d at 644–46 (holding that business judgment review is the standard of review where the merger "is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders" and that "[i]f a plaintiff can plead a reasonably conceivable set of facts showing that any or all of those enumerated conditions did not exist, that complaint would state a claim for relief that would entitle the plaintiff to proceed and conduct discovery.").

[59] Compl. ¶ 60.

[60] In Stewart's original briefing, she made no real attempt to justify why the timing of the implementation of procedural protections would be any less important in the one-sided controller context other than to state summarily, in a footnote, that cases involving alleged disparate consideration are governed by the *Hammons* standard. *See* Stewart's Opening Br. at 37 n.22. ("Plaintiffs challenge that these protections were not present 'at the outset,' but that requirement applies to self-interested transactions between the company and the controller, not to cases involving alleged disparate consideration approved by a special committee of the board."). At oral argument, when asked to elaborate, counsel for Stewart argued that "a two-sided controller transaction is inherently more suspect than a sale to a third party by a controller." Oral Arg. Tr. 24. I address these arguments below.

deference; both were decided on motions for summary judgment with the benefit of full evidentiary records that reflected the efficacy, or lack thereof, of the procedural protections in place with regard to the specific transactions at issue in those cases. While not citing to *M&F Worldwide* (or the opinion in *In re MFW Shareholders Litigation*[61] which it affirmed), Plaintiffs emphasized in their answering brief that timing mattered and that the Complaint adequately pled that the dual procedural protections were deployed too late since Sequential agreed to the majority of the minority condition only after Sequential was well into its negotiations with Stewart over her side deals.

The Court's consideration of the efficacy of the dual procedural protections, including the timing issue, took a turn when it was discovered post-argument that the allegations in the Complaint regarding the timing of Sequential's majority of the minority vote condition did not square with the chronology set forth in the Proxy on which the Complaint so heavily relied. Recall that the Proxy explains that Sequential imposed the majority of the minority condition before it approached the Special Committee about negotiating directly with Stewart.[62] The parties had not addressed the relevance, if any, of the discrepancy between the Complaint and the Proxy with respect to this timing issue in their initial round of briefing or at argument. Nor had the parties addressed in any detail whether the strict requirements set forth in *M&F Worldwide* even applied in these circumstances. So the Court requested supplemental briefing on these issues. Specifically, the Court inquired (a) whether the detailed road map laid out in *M&F Worldwide* applied in the context of a onesided controller transaction involving allegations of disparate consideration; and, if so, (b) whether the sales process leading up to the Merger complied with this detailed road map in all respects, including with respect to the timing of the protective measures implemented "as conditions to the procession of the transaction."[63] With the supplemental briefs in hand, I consider these questions in turn below.[64]

a. The *M&F Worldwide* Framework Applies to One-Sided Controller Transactions

M&F Worldwide was the culmination of decades of Delaware

[61] 67 A.3d 496 (Del. Ch. 2013).
[62] Proxy at 60.
[63] *M&F Worldwide*, 88 A.3d at 645.
[64] I appreciate the parties' helpful supplemental submissions in response to these questions.

jurisprudence that had wrestled with the appropriate standard by which controlling stockholder transactions should be reviewed. There, our Supreme Court affirmed then- Chancellor Strine's decision in *In re MFW*, where he synthesized the evolution of our law regarding controlling stockholder transactions and held for the first time that a transaction involving a controlling stockholder standing on both sides of a transaction, under limited circumstances, could be reviewed under the business judgment rule, prior to trial, including at the pleadings stage.[65] Following *M&F Worldwide*, it is now settled in the context of a controlling stockholder squeeze-out merger that if the transaction is structured to follow the detailed road map laid out there, the transaction will be assailable, even at the pleadings stage, only on the basis of waste, a notoriously exacting standard.

As noted, *M&F Worldwide* was careful to emphasize that business judgment review would be triggered "if and only" the "procession of the transaction" strictly complied with each element of the road map, including the requirement of *ab initio* timing.[66] Stewart offers two reasons why *M&F Worldwide* is not controlling here. First, she continues to maintain that *Hammons* and *SEPTA* govern since those cases addressed the one-sided controller, disparate consideration scenario present here. Second, she argues that "a two-sided controller transaction is inherently more suspect than a sale to a third party by a controller."[67]

Plaintiffs' position is that the strict requirements of *M&F Worldwide* do apply in third-party transactions involving controlling stockholders.[68] They contend, however, that the Complaint and incorporated documents reveal enough at this stage to support a reasonable inference that the dual procedural protections deployed here did not satisfy *M&F Worldwide* and, therefore, were not effective in delivering their intended results—the protection of the minority stockholders. They also argue that Stewart's arguments in support of her effort to escape the strict requirements of *M&F Worldwide* find no support either in the authority on which she relies or in the bases upon which both the Chancery and Supreme Court decisions in *M&F Worldwide* rest.

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[65] 67 A.3d 496 (Del. Ch. 2013).

[66] *M&F Worldwide*, 88 A.3d at 645.

[67] Oral Arg. Tr. 24.

[68] Letter from Carmella P. Keener to the Honorable Joseph R. Slights, III in Response to the Court's Request During June 29, 2017 Teleconference (Trans. ID 60868536) ("Pls.' Supplemental Br.") at 8 (stating that "[t]he *M&F Worldwide* dual procedural protections in the context of a two-sided controller transaction may operate similarly in one-sided controller transactions.").

In *Hammons* and *SEPTA*, the court determined that the business judgment rule applies where the transaction: "(1) is recommended by a disinterested and independent special committee; (2) which has 'sufficient authority and opportunity to bargain on behalf of minority stockholders,' including the 'ability to hire independent legal and financial advisors'; (3) [is] approved by stockholders in a nonwaivable majority of the minority vote; and (4) the stockholders [are] fully informed and free of any coercion."[69] Lest there be any doubt as to whether *Hammons* and *SEPTA* reflect "good law," the Supreme Court removed that doubt when it affirmed *SEPTA* by summary Order.[70]

Stewart is correct that both *Hammons* and *SEPTA* involved mergers with third-parties where the target's stockholders alleged that a controlling stockholder was conflicted after negotiating and ultimately securing disparate merger consideration. She is also correct that in neither case did the court appear to dwell on the timing of the target company's implementation of the dual procedural protections. Indeed, in both cases, the protections were deployed after negotiations with the third party began but prior to the close of the mergers and yet, in both cases, the courts were satisfied that if the measures were effective, then a shift from entire fairness to business judgment review was justified.[71] Critically, however, neither case addressed the question that Stewart has called here—whether pleadings-stage business judgment deference is appropriate when minority stockholders allege that a controlling stockholder competed with them for merger consideration. Both cases were decided on motions for summary judgment. And both were decided without the guidance of *M&F Worldwide*, where the emphasis on strict compliance, including *ab initio* timing, was first set forth and explained.

This strict or "formalistic"[72] approach to pleadings-stage transactional standard of review determinations in *In re MFW* and *M&F Worldwide* was not at all surprising. Because the court was addressing whether the minority stockholders' claim should be dismissed before discovery, both this court and the Supreme Court took pains to provide a detailed road map of the points of protection the controller must visit to

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[69] 2013 WL 4009193, at *11 (citing *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *10–11).

[70] *Se. Pa. Transp. Auth. v. Volgenau*, 91 A.3d 562 (Del. 2014) (TABLE).

[71] *Id.* at *2. *SEPTA*, 2013 WL 4009193, at *1.

[72] *In re Sauer-Danfoss, Inc. S'holder Litig.*, C.A. No. 8396-VCL (Del. Ch. Oct. 23, 2013) (TRANSCRIPT) at 79 ("[W]hen the question is what's the standard of review, we have been far more formalistic in our requirements . . . . [W]e've talked about specific, readily ascertainable transactional situations or voting scenarios so that people know where they are.").

earn business judgment deference on a motion to dismiss.[73] In this light, *Hammons* and *SEPTA* are properly viewed as two of several waypoints on the long road leading to *M&F Worldwide*, not as controlling authority for the determination of when one-sided controlling stockholder transactions involving allegations of disparate consideration will be reviewed at the pleadings stage under the business judgment rule.

I also disagree with Stewart that the risks and incentives differ significantly as between two-sided controller transactions and one-sided controller transactions where the controller is alleged to have competed with the minority for consideration. The risks are obvious; our law is clear that a controller's interests do not align with those of other stockholders when the controller competes with the minority for deal consideration.[74] The conflicts inherent in the disparate consideration scenario are no more or less present or worrisome than in the scenario where the controller stands on both sides of the transaction. Both scenarios justify our corporate law's highest level of scrutiny, entire fairness.[75]

The need to incentivize fiduciaries to act in the best interests of minority stockholders, likewise, is equally important in one-sided and two-sided conflicted controller transactions. In both instances, the key is to ensure that all involved in the transaction, on both sides, appreciate from the outset that the terms of the deal will be negotiated and approved by a special committee free of the controller's influence and that a majority of the minority stockholders will have the final say on whether the deal will go forward. Regardless of which side of the transaction a conflicted controller stands, it is critical that the process is designed from the outset to incentivize the special committee and the controller to take positions at every turn of the negotiations, including during the negotiation of side deals, which will later score the approval of the majority of other stockholders. Only then is it appropriate to reward the controller with pleadings-stage business judgment rule deference.[76]

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[73] *M&F Worldwide*, 88 A.3d at 645. *See also Books-A-Million*, 2016 WL 5874974, at *8 n.2 (describing this dynamic and noting that to achieve business judgment deference defendants must "have described their adherence to the elements identified in M&F Worldwide in a public way suitable for judicial notice").

[74] *Crimson*, 2014 WL 5449419, at *12–13 (collecting cases).

[75] *Id*. In fact, entire fairness applies to allegedly conflicted transactions where the controller is on only one side of the transaction precisely to "assuage the risk that a controller who stands to earn 'different consideration or some unique benefit' will flex his control to secure that self-interested deal to the detriment of minority stockholders." *Larkin*, 2016 WL 4485447 at * 9 (citing *Synthes*, 50 A.3d at 1033).

[76] I note that the discussion in *In re MFW* regarding the costs and benefits of providing controlling stockholders with a point-by-point road map to achieve dismissal is equally apt

Given the looming conflict created by potentially disparate consideration, I can see no principled basis to conclude that it would be somehow less important that Stewart and Sequential be incentivized from the outset of their negotiations to take positions and to reach side deals that will be acceptable to the other stockholders than it would be if Stewart was negotiating to acquire the Company. The potential for conflict is omnipresent in both scenarios. Thus, to the extent any doubt remained following *In re MFW* and *M&F Worldwide*, I am satisfied that strict compliance with the transactional road map laid out in those seminal decisions is required for the controlling stockholder to earn pleadings-stage business judgment deference when it is well-pled that the controller, as seller, engaged in a conflicted transaction by wrongfully diverting to herself merger consideration that otherwise would have been paid to all stockholders.

While Stewart has questioned whether strict compliance with the *M&F Worldwide* road map was required with respect to the Merger, she has not shied away from those requirements when addressing the Court's inquiry as to whether the "procession of the transaction" followed the road map.[77] In particular, with respect to the timing issue, she argues that the dual procedural protections must be in place "before any actual agreement on terms involving separate contracts with the controller have taken place . . ."[78] Alternatively, she argues that the earliest the Court should measure whether the *M&F Worldwide* requirements are in place is at the time the conflict potentially surfaces—in this case, at the time

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here. *In re MFW*, 67 A.3d at 534–35 (observing that an obvious cost of creating the map is that, if followed, controlling stockholders will avoid judicial review of the substantive fairness of the transactions in which they engaged to the alleged detriment of the minority, while the benefit of offering pleading-stage business judgment deference is that the controller and the target board will be incentivized at the outset of the sales process to implement both procedural protections and to ensure that they remain effective throughout the process). Assuming strict, ab initio compliance with the road map, the benefits of avoiding litigation risk and agency costs and, more importantly, the benefits of incentivizing the sell-side constituencies involved in a controlling stockholder transaction to manage conflicts properly at the outset of the process for the protection of the other stockholders will outweigh the risk that minority stockholders will be deprived of judicial review of the transaction. As this court has recognized, adopting the majority of the minority vote requirement up front has an important effect on the special committee because "most directors will want to procure a deal that their minority stockholders think is a favorable one, and virtually all will not want to suffer the reputational embarrassment of repudiation at the ballot box." *Id*. at 529. In other words, "because a special committee knows from the get-go that its work will be subject to disapproval by the minority stockholders, the special committee has a strong incentive to get a deal that will gain their approval." *Id*. at 530.

[77] *M&F Worldwide*, 88 A.3d at 645.

[78] Letter to the Honorable Joseph R. Slights, III from Kevin R. Shannon, Regarding Questions Raised During June 29, 2017 Teleconference (Trans. ID 60886825) at 2; Stewart's Reply Br. 37 n.22.

she began her negotiations with Sequential over side deals. Plaintiffs, on the other hand, argue that the dual procedural protections must be in place "at the moment either the controller or the buyer communicates any effort or intention to seek to negotiate or propose separate consideration and arrangements for the controller in the transaction."[79]

In a transaction where the controller is on both sides, such as a squeeze-out merger, the controller has the ability publicly to announce that it is conditioning any transaction on the *M&F Worldwide* procedural protections in its initial offer to the board of the target. Because the controlling stockholder decides when to begin negotiations regarding a transaction and on what terms, the "outset" of the transaction is clear. In the one-sided controlling stockholder context, however, where an unaffiliated third party initiates the process with its offer, the controller obviously has no control over the conditions the third party will impose on the process or approval of the transaction. But the controller can ensure that the third party and the target have agreed to both procedural protections before she begins to negotiate separately with the third party for disparate or non-ratable consideration. That is when the potential conflict with the minority surfaces.

Plaintiffs urge the Court to adopt a rule that would require the procedural protections to be implemented at the outset of discussions between the target and the third party even if the controller and third party have not even hinted that they might engage in separate negotiations. Such a rule would make no sense for the simple reason that the *M&F Worldwide* protections serve no purpose at the outset of discussions between a target and third party when the only proposal from the putative buyer is that all shareholders receive the same price for their shares. No conflict or potential for conflict (assuming status quo) exists at this point; the interests of the controlling stockholder and the minority stockholders are aligned.[80]

In my view, the correct time at which to determine if the *M&F Worldwide ab initio* requirement has been met is the point where the controlling stockholder actually sits down with an acquiror to negotiate for additional consideration. If the procedural protections are

[79] Pls.' Supplemental Br. at 13.

[80] *See Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721–22 (Del. 1971) (holding that when the controller "receive[s] nothing [in a transaction]. . . to the exclusion of [the] minority stockholders," the business judgment rule is the proper standard by which to evaluate the board's decision to approve the transaction); *Synthes*, 50 A.3d at 1034 (stating "the plaintiffs must plead that [the controller] had a conflicting interest in the Merger in the sense that he derived a personal financial benefit to the exclusion of, and detriment to, the minority stockholders.") (internal citation and quotation marks omitted).

implemented before that time, then all actors, and most importantly the controlling stockholder, enter those negotiations aware that both the Special Committee and the majority of the minority stockholders will have the final say on whether the deal, with the controller's extra consideration, will be approved. In the parlance of *In re MFW*, the "get-go" of the process in the disparate consideration case is the moment the controller and third party begin to negotiate the controller's side deals.[81]

The question remains whether the process implemented by the Special Committee and Sequential in this case satisfied the *M&F Worldwide* framework. According to Stewart, it is clear from the Complaint that the dual procedural protections were solidified in the transactional structure prior to any alleged conflict surfacing between her and the minority stockholders, i.e., before she commenced discussions with Sequential regarding her side deals. Moreover, according to Stewart, the Complaint has failed to plead any facts that support a reasonable inference that the dual procedural protections were not effective and did not yield their intended results. Specifically, the Complaint and the incorporated Proxy acknowledge that the Merger was negotiated and approved by the properly-constituted Special Committee and was conditioned on the affirmative vote of the majority of the minority stockholders who, when called to vote, overwhelmingly approved the transaction.[82]

Plaintiffs disagree. They argue that the Complaint adequately alleges that the Special Committee was conflicted and otherwise ineffective.[83] As for the majority of the minority condition, they allege this condition was imposed too late in the process and, therefore, did not comply with the requirement in *M&F Worldwide* that the dual procedural protections exist *ab initio*.[84]

I address the efficacy of the Special Committee first. I then consider whether the majority of the minority condition was imposed *ab initio* and whether it was effective in its implementation.

b. The Independence and Effectiveness of the Special Committee

Even though they voluntarily dropped all claims against members of the Board, including the Special Committee, Plaintiffs allege that the

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[81] *In re MFW*, 67 A.3d at 530.

[82] Reply Br. in Supp. of Def. Martha Stewart's Mot. to Dismiss Pls.' Verified Second Am. Class Action Compl. ("Stewart's Reply Br.") 38.

[83] The Special Committee was formed well before Sequential arrived on the scene. Plaintiffs do not, therefore, challenge the timing of the implementation of this condition under *M&F Worldwide*.

[84] *Id.* at 644.

Special Committee was comprised of directors loyal to Stewart and therefore was not fully independent as required by *M&F Worldwide*.[85] To plead that a director was "interested" in a transaction, a plaintiff "must allege facts supporting a reasonably conceivable inference that the director received 'a personal financial benefit from a transaction that is not equally shared by the stockholders.'"[86] To plead that a director "lacked independence," a plaintiff "must allege facts supporting a reasonable inference that a director is sufficiently loyal to, beholden to, or otherwise influenced by an interested party so as to undermine the director's ability to judge the matter on its merits."[87] In the controlling stockholder context, a plaintiff "must demonstrate that the director is beholden to the controlling party or so under [the controller's] influence that [the director's] discretion would be sterilized."[88] "Bare allegations that directors are friendly with, travel in the same social circles as, or have past business relationships with the proponent of a transaction . . . are not enough to rebut the presumption of independence."[89]

Plaintiffs do not allege that the members of the Special Committee were interested in the Merger. They do, however, attempt to state a basis to infer that the Special Committee was not independent because each of its members was somehow beholden to Stewart. I address these allegations in turn.

As to Pierre deVilleméjane, the Chairman of the Special Committee, Plaintiffs allege that he is also the CEO of WWRD, a company that makes products under various brand names, including Wedgwood and Waterford. Wedgwood, in turn, carries a line of products

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[85] *M&F Worldwide*, 88 A.3d at 646 (holding that "the special committee must 'function in a manner which indicates that the controlling stockholder did not dictate the terms of the transaction and that the committee exercised real bargaining power at an arms-length'") (citations omitted).

[86] *In re Books-A-Million, Inc. S'holders Litig*., 2016 WL 5874974, at *9 (Del. Ch. Oct. 10, 2016 (citing *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993)).

[87] *Id*. (citing *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984) (stating that one way to allege successfully that an individual director is under the control of another is by pleading "such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person")), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). Aw

(stating that one way to allege successfully that an individual director is under the control of another is by pleading "such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person")).

[88] *M&F Worldwide*, 88 A.3d at 648–49 (internal quotation marks and citations omitted).

[89] *Id*. at 649 (citing *Beam ex rel. Martha Stewart Living Omnimedia v. Stewart*, 845 A.2d 1040, 1051–52 (Del. 2004)).

designed by Stewart and sold under the name "Martha Stewart Collection by Wedgwood."[90] Wedgwood and Waterford Products are promoted on MSLO's website. Nothing about this connection even remotely suggests that deVillemėjane lacked independence.

In order to show that a presumptively independent director is nonetheless beholden to a controller, a plaintiff "must satisfy a materiality standard."[91] As our Supreme Court has explained, "[t]he court must conclude that the director in question had ties to the person whose proposal or actions he or she is evaluating that are sufficiently substantial that he or she could not objectively discharge his or her fiduciary duties."[92] Therefore, "the existence of some financial ties between the interested party and the director, without more, is not disqualifying."[93] Plaintiffs have not even attempted to plead the materiality to deVillemėjane of the relationship between WWRD and Stewart. Consequently, the Court has no grounds to question his independence based on this relationship. For William Roskin, who was previously employed at Viacom until 2008, Plaintiffs highlight that Viacom and its affiliate carried the Martha Stewart Living syndicated television program until 2004. This bare allegation of a prior business relationship from over a decade ago between Stewart and the company for which Roskin used to work is precisely the type of conclusory allegation concerning a prior business relationship that does not come close to overcoming the presumption of independence.[94]

As for Arlen Kantarian, Plaintiffs allege that he previously served as CEO of Professional Tennis for the USTA and US Open from 2000 to 2008. To create a connection to Stewart that would cast doubt on Kantarian's independence, the only allegation Plaintiffs serve up is that Stewart shares Kantarian's interest in tennis. In this regard, Plaintiffs allege that Stewart has three tennis courts on her various properties and has previously attended US Open events. To characterize this attempt to undermine Kantarian's independence as a "double fault," while perhaps befitting, would not do justice to the frailty of the argument. Our courts have been crystal clear that such bare allegations of a shared interest, or

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[90] Compl. ¶ 31(c).

[91] *Id.*

[92] *Id.* (citing *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995) ("[A] shareholder plaintiff [must] show the materiality of a director's self-interest to the . . .director's independence. . .")).

[93] *Id.*

[94] *Beam*, 845 A.2d at 1051–52 (stating that "allegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' even when coupled with Stewart's 94% voting power, are insufficient, without more, to rebut the presumption of independence.").

even that the controller and the director travel in the same social circles, are insufficient to rebut the presumption of independence.[95]

Finally, as for Margaret M. Smyth, Plaintiffs allege that she was previously a partner at Arthur Andersen and that, while there, MSLO was one of her "accounts."[96] Here again, this is nothing more than a bare allegation of a past business relationship that does nothing to call into question Smyth's independence.[97]

In addition to the specific allegations of conflict directed at each member of the Special Committee, Plaintiffs also make a blanket allegation that the Special Committee was beholden to Stewart because her voting control empowered her to elect each member of the board of directors, including the Special Committee members. Our Supreme Court has made clear, however, that "proof of majority ownership does not strip the [other] directors of the presumptions of independence."[98] In considering whether demand on the board was excused in the derivative suit context, this court has held that the controller's ability to remove or replace directors does not, by itself, demonstrate a capacity to control them absent "allegations that remaining on [the] board is material to the outside directors…"[99] Materiality, in this context, is measured by whether the plaintiff has alleged specific facts that support a reasonable inference the board members "would be incapable of" acting independently on a particular proposal because the controller's ability to remove them had "an inappropriate effect on their decision making process."[100]

With this materiality standard in mind, I have no hesitation in concluding that Plaintiffs have failed adequately to plead that the members of the Special Committee lacked independence due to a material interest in remaining on the board of MSLO, or that Stewart's control of MSLO affected their decision-making process in any way. Indeed, any suggestion that the Special Committee members had a material interest in remaining on the MSLO board—a fact Plaintiffs do not even summarily allege—is belied by the fact that none of them made any effort to remain affiliated with Sequential or TopCo at any time

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[95] *Id.*; see also M&F Worldwide, 88 A.3d at 648–49 (same); *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 369 (Del. Ch. 2008) (same).

[96] Compl. ¶ 31(e).

[97] Additionally, I note that any alleged conflict that might call into question Smyth's independence would be wholly irrelevant because Smyth left the Special Committee on November 13, 2014, which was prior to the time negotiations with Sequential began.

[98] *Aronson*, 473 A.2d at 815.

[99] *Beam ex rel. Martha Stewart Living Omnimedia*, 833 A.2d at 978.

[100] *Id.*

during the negotiations of the Merger or after.

Plaintiffs also attempt to challenge the Special Committee's effectiveness. As an initial matter, they challenge the mandate of the Special Committee. In this regard, they contend that the Special Committee was initially only authorized to hire legal and financial advisors and therefore did not have the broad mandate required under Delaware law until sometime later in the process.[101] Once again, however, Plaintiffs' allegations in the Complaint do not match up to an objective reading of the Proxy.[102] More to the point, Plaintiffs cannot point to anything that would imply that the Special Committee's broad mandate to negotiate a transaction, and say "no" if it chose, was not well in place by the time it began its discussions with Sequential. This is all that matters when assessing whether the Special Committee's mandate met Delaware standards when it negotiated the Merger at issue here.[103]

Plaintiffs' other attempts to undercut the effectiveness of the Special Committee fare no better. In their brief, Plaintiffs adopt a laundry list of allegations they believe demonstrate that the Special Committee did not adequately protect the interests of the minority stockholders.[104]

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[101] *See, e.g., Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1221–22 (Del. 2012) (describing a special committee with a narrow, and therefore ineffective, mandate as one that could only "evaluate a transaction suggested by a majority stockholder" and "authorized the Special Committee to retain legal and financial advisors" but did not have "express power to negotiate, nor . . . to explore other strategic alternatives").

[102] Proxy at 53 (discussing how the Special Committee received its broad mandate from the Board on the day it was formed).

[103] *See In re Books-A-Million*, 2016 WL 5874974, at *3–4. In *Books-A-Million*, Vice Chancellor Laster, in granting a motion to dismiss under the *M&F Worldwide* framework, noted that the board formed a special committee, authorized the committee to retain legal and financial advisors, and expected the members of the committee to hire their own legal counsel, who would help craft the committee's mandate that would then be approved by the full Board. *Id.* The committee was formed and authorized to hire advisors on January 30, 2015, but did not have its mandate approved by the full board until February 24, 2015. *Id.* This was before negotiations between the controller and the committee had begun. *Id.* The clear lesson from these facts is that the Board need not grant the special committee the authority to hire advisors and establish the committee's broad mandate at the same time in order to brand the committee "effective" under *M&F Worldwide*.

[104] Plaintiffs argue that the Complaint alleges the Special Committee retained legal and financial advisors who were conflicted and who, in fact, controlled the negotiations, permitted Stewart to dictate a "targeted search" for a buyer rather than an auction, permitted Stewart to meet initially with Sequential to discuss the merits of a deal before commencing negotiations on its own, permitted Stewart to negotiate her agreements with Sequential while deferring any discussion of price for the Company, declined even to entertain a third party offer for MSLO after Stewart had completed negotiations on her arrangements with Sequential and, upon finally learning of Stewart's costly arrangements at the eleventh hour, deferred to Stewart's position that she was not going to alter such arrangements. Of these, the allegation Plaintiffs have pressed hardest is that the Special Committee allowed a conflicted financial advisor, Moelis, to negotiate on behalf of the Company. Compl. ¶¶ 41–42. The two conflicts alleged by Plaintiffs are: (1) that a MSLO director and its CEO, a loyal friend of Stewart's, worked

Under the *M&F Worldwide* framework, a special committee must "meet its duty of care in negotiating a fair price."[105] To do so, the directors must "inform themselves, prior to making a business decision, of all material information reasonably available to them."[106] As this court recently explained, "[f]or purposes of applying the *M&F Worldwide* framework on a motion to dismiss, the standard of review for measuring compliance with the duty of care is whether the complaint has alleged facts supporting a reasonably conceivable inference that the directors were grossly negligent."[107]

Plaintiffs' vague criticisms of the Special Committee's process and decision-making land far wide of the mark set by *M&F Worldwide*.[108] As former Chancellor Chandler explained in *In re Walt Disney Co*. Derivative Litigation, "[i]n the duty of care context with respect to corporate fiduciaries, gross negligence has been defined as a reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason."[109]

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alongside a managing director of Moelis, Mark Henkels, at CIBC World Markets and (2) that Moelis has performed services for The Carlyle Group LP, Sequential's second largest stockholder. These alleged conflicts are not material conflicts as a matter of law. As to the first alleged conflict, a relationship between a financial advisor and a member of the Board of the company it is advising would generally raise no concerns of conflict. Plaintiffs attempt to create the conflict by arguing that this specific director was not just any member of the Board, but was a Stewart loyalist. Even if this daisy chain of inferences could possibly be enough to plead a material conflict of interest, Plaintiffs ignore that Moelis was hired to advise the Special Committee, not the full Board of MSLO. Dienst, the director and CEO who was allegedly loyal to Stewart, was not a member of the Special Committee and the Complaint makes no allegation that Dienst somehow interfered with the Special Committee's work. As to the second alleged conflict, this court has previously held, in a variety of circumstances, that a financial advisor's prior dealings with a counterparty to a transaction, standing alone, will not be adequate to plead a conflict of interest. *See, e.g., In re Inergy LP*, 2010 WL 4273197, at *14 (Del. Ch. Oct. 29, 2010) (holding that financial advisor's "prior dealings" with counterparty to the proposed transaction "d[id] not show that [the transaction committee's] decision to retain [that advisor] . . . was unreasonable"). In this instance, Plaintiffs are not even alleging that Moelis did work for Sequential directly, but only for a Sequential-related affiliate that is the second largest stockholder of Sequential. This remote relationship, fully disclosed to MSLO stockholders, does not call into question Moelis' independence or the decision of the Special Committee to retain Moelis. *See* Proxy at 123 (disclosing that "Moelis had acted as financial advisor . . . [to] an affiliate of the Carlyle Group LP, a stockholder of Sequential, in a matter unrelated to the merger agreement . . . and Moelis received customary compensation.").

[105] *M&F Worldwide*, 88 A.3d at 645.

[106] *Aronson*, 473 A.2d at 812.

[107] *Books-A-Million*, 2016 WL 5874974, at *17.

[108] *M&F Worldwide*, 88 A.3d at 644 (noting that pleadings-stage business judgment deference not available if complaint raises a reasonable inference that the special committee did "fulfill its duty of care").

[109] 907 A.2d 693, 750 (Del. Ch. 2005) (internal citation and quotation marks omitted); see also *Guttman v. Huang*, 823 A.2d 492, 507 n.39 (Del Ch. 2003) (stating that the plaintiff

Plaintiffs' conclusory allegations do not come close to meeting this high standard. Instead, the Complaint does nothing more than question the business judgment of the independent committee members, an avenue of attack this court has repeatedly rejected.[110]

The Proxy explains in some detail that the Special Committee met frequently over a period of several months. It rejected a proposal from Company A when MSLO's financial condition improved and Company A was unwilling to raise its offer price, a rejection that led directly to the negotiations with Sequential. It allowed Stewart to negotiate with Sequential concurrently only after Sequential committed that the deal would be subject to a majority of the minority vote. It negotiated vigorously with Sequential on price and ultimately secured a postclosing go-shop period despite Sequential's initial reluctance to agree to this deal term. And, importantly, it was able to get Sequential to better its final offer even though the troublesome (from Sequential's perspective) publishing agreement with Meredith was never renegotiated and even after Sequential had reached an agreement with Stewart on her post-closing contractual arrangements. These facts do not support a reasonable inference that the Special Committee was grossly negligent in performing its duties.

c. The Effectiveness of the Majority of the Minority Vote Condition

As discussed above, Plaintiffs' showcase challenge with respect to the majority of the minority condition is that Sequential agreed to the condition too late in the process. Once the discrepancy between the Complaint and the Proxy is resolved, however, and it is understood that Sequential did not approach the Special Committee about negotiating separately with Stewart until *after* the non-waivable majority of the minority condition was in place, Plaintiffs' challenge regarding the timing of the majority of the minority condition crashes on the shoals of reality. The Proxy makes clear that Sequential locked this condition into the deal process the day before any potential conflict between Stewart

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needs to articulate "facts that suggest a wide disparity between the process the directors used . . . and that which would have been rational.") (emphasis in original).

[110] *In re MFW*, 67 A.3d at 516 ("[T]he plaintiffs make a number of arguments in which they question the business judgment of the special committee, in terms of issues such as whether the special committee could have extracted another higher bid from MacAndrews & Forbes if it had said no to the $25 per share offer, and whether the special committee was too conservative in valuing MFW's future prospects. These are the sorts of questions that can be asked about any business negotiation, and that are, of course, the core of an appraisal proceeding and relevant when a court has to make a determination itself about the financial fairness of a merger transaction under the entire fairness standard.").

and the minority surfaced. Accordingly, the majority of the minority condition was in place *ab initio*.[111]

Plaintiffs next allege that the vote of the minority stockholders was uninformed. Specifically, they allege that the stockholders were not informed of Moelis' alleged conflict.[112] I disagree for two reasons. First, as I have already determined, the alleged Moelis conflict was no conflict at all.[113] Moreover, even if a conflict existed, Plaintiffs, yet again, have ignored the Proxy, which clearly disclosed the relationship between Moelis and the Sequential stockholder that Plaintiffs allege gives rise to the conflict.[114]

Finally, Plaintiffs complain that the majority of the minority vote was not a robust procedural protection in this instance because non-minority shares affiliated with Stewart were counted in the vote.

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[111] For the first time in their supplemental briefing, Plaintiffs raise the argument that the majority of the minority vote condition was ineffective because it was "not non-waivable.'" Remarkably, they have yet again ignored the Proxy which makes clear that Sequential told the Special Committee that the transaction was "conditioned. . . on the approval" of a majority of the minority stockholders. Proxy at 29. *See also* Proxy at 9, 107 (disclosing that the Merger "required" the affirmative vote of the majority of the minority). The Proxy then refers stockholders to the Merger Agreement. Proxy at 74. In turn, the Merger Agreement, appended to the Proxy, clearly states that the majority of the minority vote was non-waivable. Specifically, Article VII of the Merger Agreement, entitled Conditions Precedent, states "[t]he respective obligations of the parties to effect the Mergers shall be subject to the satisfaction, or waiver (*except with respect to Section 7.1(a), which shall not be waivable*) by each of the parties, at or prior to the Closing of the following conditions . . .) (emphasis added). Section 7.1(a), which states the explicitly non-waivable obligations of the parties, imposes the following condition: "[t]he MSLO Stockholder Approval shall have been obtained." Proxy at A-58. The term MSLO Stockholder Approval is defined to include the majority of the minority vote. As this court has said before, "[i]f the defendants have described their adherence to the elements identified in *M&F Worldwide* in a public way suitable for judicial notice . . . then the court will apply the business judgment rule at the motion to dismiss stage unless the plaintiff has pled facts sufficient to call into question the existence of those elements." *Books-A-Million*, 2016 WL 5874974, at *8 (internal citation and quotation marks omitted). Based on the description of the condition in the Proxy and the clear and unequivocal statement in the Merger Agreement that the majority of the minority vote "shall not be waivable," the defendants have described their adherence to this element of *M&F Worldwide* in a public way suitable for judicial notice. The Complaint pleads nothing to call that fact into question or to question the timing of the non-waivable condition. *M&F Worldwide*, 88 A.3d at 645 (noting that it is the plaintiff's burden to "plead a reasonably conceivable set of facts showing that any or all of those enumerated conditions did not exist, [which] would [then] state a claim for relief that would entitle the plaintiff to proceed and conduct discovery.").

[112] Compl ¶ 41.

[113] Standing alone, the allegations of the financial advisor's prior dealings with the second largest stockholder of the counterparty to the transaction is not adequate to plead a conflict of interest. *See, e.g., In re Inergy LP*, 2010 WL 4273197, at *14 (holding that financial advisor's "prior dealings" with counterparty to the proposed transaction "d[id] not show that [the transaction committee's] decision to retain [that advisor] . . . was unreasonable").

[114] See Proxy at 123.

Specifically, they allege that "the 'minority' shares included shares owned by various MSLO insiders, including Stewart's friend Deinst, Stewart's sister-in-law Margaret Christiansen (employed as a Senior Vice President of MSLO), and all other directors, officers, and employees of the Company."[115] This allegation misfires for lack of specificity. First, Plaintiffs have not attempted to quantify what effect counting the purportedly non-minority shares had on the final vote count. They have not alleged, for instance, that the vote would have failed to achieve 51% approval from the minority had the shares they challenge been excluded. They also have not sufficiently alleged that the shares they wish to exclude are, in fact, "non-minority" shares. The Complaint contains no allegations that support a reasonable inference that the vote of any of the shares Plaintiffs seek to exclude was somehow compromised by Stewart's influence.[116] In the absence of these allegations, it is not reasonably conceivable that Plaintiffs could prove that the majority of the minority vote failed to act as a robust procedural protection due to a failure to exclude non-minority shares.[117]

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Plaintiffs have failed to plead facts "sufficient to call into question the existence of th[e] elements" required by *M&F Worldwide*.[118] Accordingly, business judgment review is appropriate and the transaction

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[115] Compl. ¶ 60.

[116] Also, I note that Plaintiffs have failed to allege any coercion of the minority. Lack of coercion of the minority is the required sixth element under M&F Worldwide. *M&F Worldwide*, 88 A.3d 639.

[117] As an aside, I note that Plaintiffs might have attempted to challenge the effectiveness of the vote on the ground that a reasonable inference could be drawn that the stockholders did not "bless" Stewart's side deals when they voted to approve the Merger. In the typical two-sided controller transaction, where a majority of the minority is asked to vote in favor of the deal, the choice for the stockholders is simply whether to accept a specific price. In the disparate consideration case, however, the minority stockholders are asked to approve both the merger consideration and, implicitly, a variety of potentially complex contractual arrangements between the controlling stockholder and the third-party, the value of which may be difficult to determine. In other contexts, this court has questioned how much aboard can permissibly pack into a stockholder vote when seeking to proffer the vote as reflecting "an independent decision maker's" informed blessing of a transaction. *See, e.g.,Sciabacucchi v. Liberty Broadband Corp*., 2017 WL 2352152, at *23 (Del. Ch. May 31, 2017) (in the context of *Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015), holding that it was reasonably conceivable that a stockholder vote favoring the challenged transactions did not reflect stockholder approval of the merits of the transactions because the stockholders "were confronted with accepting an allegedly tainted transaction in order to obtain two larger beneficial transactions"). Plaintiffs did not make this argument, however, and I have not considered it.

[118] *Swomley v. Schlecht*, 2014 WL 4470947, at *20 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT), *aff'd*, 128 A.3d 992 (Del. 2015) (TABLE).

can only be challenged on the basis of waste. Plaintiffs have not made a waste claim and, in any case, I cannot reasonably conceive of a scenario where they could meet that high standard given the factual allegations they have pled.

B. Aiding and Abetting

To state a claim for aiding and abetting a breach of fiduciary duty, Plaintiffs must plead "(1) the existence of a fiduciary relationship, (2) a breach of fiduciary duty, (3) knowing participation in that breach by the defendants, and (4) damages proximately caused by the breach."[119] Plaintiffs have failed to state a claim for aiding and abetting because they have failed to plead an underlying breach of fiduciary duty by Stewart.

III. CONCLUSION

For the foregoing reasons, the motions to dismiss brought by Stewart and the Sequential Defendants must be GRANTED.

IT IS SO ORDERED.

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[119] *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001).

CARL ZEISS VISION, INC.
v.
REFAC HOLDINGS, INC. AND U.S. VISION, INC.

In the Court of Chancery of the State of Delaware

C.A. No. 11513-VCS

MEMORANDUM OPINION

Date Submitted: June 14, 2017
Date Decided: August 24, 2017

Gregory E. Stuhlman of GREENBERG TRAURIG, LLP, Wilmington, Delaware and Jeff E. Scott and Valerie W. Ho of GREENBERG TRAURIG, LLP, Los Angeles, California, *Attorneys for Plaintiff and Counterclaim Defendant*.

William R. Denney, Brian C. Ralston, Andrew H. Sauder, and Jordan A. Braunsberg of POTTER ANDERSON & CORROON LLP and Jon M. Talotta of HOGAN LOVELLS US LLP, McLean, Virginia, *Attorneys for Defendants and Counterclaim Plaintiffs*.

SLIGHTS, *Vice Chancellor*.

Delaware courts do not take lightly applications to vacate arbitration awards. Indeed, the standard of judicial review with respect to such applications is among "the narrowest . . . in all of American jurisprudence."[1] Acknowledging the nearly vertical mountain it must climb, Defendants/Counterclaim Plaintiffs, REFAC Holdings, Inc. and U.S. Vision, Inc. (collectively "USV"), nevertheless move the Court to vacate an arbitration award that construed a supply agreement between USV and Plaintiff/Counterclaim Defendant, Carl Zeiss Vision, Inc. ("Zeiss"), in a manner that supported Zeiss' claim that USV had wrongfully terminated the agreement. According to USV, the arbitration panel "eviscerate[d] the essential term" of the agreement *sua sponte* and then "permit[ted] the agreement to remain in effect after gutting that term."[2] This grave error, according to USV, was the product of an arbitration panel that "abdicated its duties" and thereby "acted outside

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[1] *SPX Corp. v. Garda USA, Inc.*, 94 A.3d 745, 750 (Del. 2014).

[2] Opening Br. in Supp. of Defs. and Countercl. Pls.' Mot. to Vacate Arbitral Award ("Opening Br.") 1.

the scope of its authority."[3]

USV's motion would have the court turn the applicable standard of review on its head. Indeed, although it has not expressly advocated for *de novo* review, the tone of its motion suggests that the Court should construe the terms of the operative contract anew without any regard for the fact that a carefully selected, experienced arbitration panel has already undertaken that exercise. In two words, USV seeks a "do over." That relief is rarely justified. It is not justified here. The motion to vacate is DENIED.

I. BACKGROUND

The parties have submitted rather extensive exhibits from the arbitration proceeding, including sworn testimony. I have drawn the facts from that record to the extent necessary to determine whether the arbitration award "can be rationally derived" from the contract the arbitrators were asked to construe and otherwise from the evidence.[4]

A. *The Parties*

Zeiss manufacturers ophthalmic lenses used in eyeglasses. USV operates as a retailer of ophthalmic products in the United States. Zeiss has supplied ophthalmic lenses to USV for the past 16 years.

B. *The 2011 Supply Agreement*

The contract at the heart of the parties' dispute is the Amended and Restated Supply Agreement dated December 28, 2011 (the "Agreement"). Pursuant to the Agreement, USV committed to purchase

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[3] *Id.*

[4] *Brennan v. CIGNA Corp.*, F. App'x 132, 136–37 (3d Cir. 2008) (If "an arbitration award rationally can be derived from either the agreement of the parties or the parties' submission to the arbitrator, it will be enforced."). I note that the procedural posture of the motion sub judice is not entirely clear. The motion is styled as a "Motion to Vacate Arbitral Award." It does not purport to invoke any of this Court's rules of procedure as the means by which USV seeks this case dispositive relief. *Cf. Beebe Med. Ctr., Inc. v. InSight Health Servs. Corp.*, 751 A.2d 426, 431 (Del. Ch. 1999) (observing that the filing of cross motions for summary judgment is the "common [method] for this court to determine whether to vacate or confirm an arbitration award."). As noted, the parties have submitted extensive record evidence. If I had determined that material factual disputes were revealed in that record, the murky procedural context might confound the analysis here. Since I have found that no such material disputes of fact exist, I am satisfied that I may finally adjudicate this motion as styled rather than kick the can down the road in search of more procedural clarity.

95% of its lenses from Zeiss, subject to certain identified conditions. In exchange, Zeiss committed to supply the lenses ordered by USV and to extend $20 million of unsecured financing to USV at below market interest. The term of the Agreement is ten years. It is governed by Delaware law and requires the parties to submit disputes relating to the Agreement to binding arbitration.

The conditions to USV's purchase obligation are set forth in Paragraph 3.2(a) of the Agreement. Specifically, USV need only purchase 95% of its lenses from Zeiss if: (1) Zeiss makes the products required by USV in the quantities USV requires; (2) Zeiss's products comply with industry quality standards; and (3) "CZV [Zeiss] offers USV competitive pricing with respect to the CZV Lenses."[5] Paragraph 3.5 confirms that the purchase prices of Zeiss lenses are set forth on an exhibit attached to the Agreement and that "the purchase price to be charged USVRefac for the various CZV Lenses. . . shall be no higher than the prices charged by CZV to any other customer making an equivalent volume of purchases of CZV Lenses."[6] The parties have referred to this as a "most favored nation" or "MFN" provision.

The present dispute arises under the "competitive pricing" provision in Section 3.2(a)(ii). USV maintains that it may avoid the 95% purchase requirement in the Agreement if it is able to obtain more competitive (*i.e.*, better) pricing from another lens supplier. Zeiss interprets the competitive pricing provision as allowing USV to purchase its lenses elsewhere only if Zeiss does not provide pricing to USV that is competitive with what it offers other similarly situated customers, as further addressed in the Agreement's MFN provision.

C. *The Arbitration*

USV filed a Demand for Arbitration with the American Arbitration Association on August 28, 2015 (the "Demand").[7] The Demand sought a declaration that the Agreement (specifically Paragraph 3.2(a)(ii)) authorized USV to engage in price checks of the market to determine if Zeiss was offering competitive prices and, if not, to purchase some or all of its lenses from the suppliers offering the best price. USV identified in its Demand that one of Zeiss's biggest

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[5] Transmittal Aff. of Gregory E. Stuhlman in Supp. of Pl. and Countercl. Def. Carl Zeiss Vision, Inc.'s Opp'n to Defs. and Countercl. Pls.' Mot. to Vacate Arbitral Award Ex. 55 ("Agreement") ¶ 3.2(a). Zeiss is referred to in the Agreement as CZV.

[6] Agreement ¶ 3.5.

[7] Transmittal Aff. of Andrew H. Sauder in Supp. of Opening Br. in Supp. of Defs. And Countercl. Pls.' Mot. to Vacate Arbitral Award ("Sauder Transmittal Aff.") Ex. F.

competitors, Essilor Laboratories of America ("Essilor"), was, in fact, able to offer more competitive pricing than Zeiss and it alleged that it was therefore entitled to purchase lenses from Essilor under the Agreement.[8]

A panel of three arbitrators (the "Panel") was selected as called for in the Agreement. As the parties moved closer to the arbitration hearing, the Panel asked USV to state definitively the relief it would be seeking at the hearing. USV responded by expanding, or refining, the relief it was seeking to include declarations that: (1) when it compared Zeiss's pricing with that of other manufacturers it could do so on a "portfolio" or "product line" basis; (2) if USV buys lenses from another supplier offering lower prices, USV would have ten days to notify Zeiss when that supplier's prices increase; (3) if Zeiss offers to lower its pricing after USV moves to another supplier in order to return to "competitive pricing," then USV will have three months to transition its purchasing back to Zeiss; (4) the pricing for Essilor's product portfolio is more competitive than the pricing for Zeiss's product portfolio; (5) the pricing of certain Essilor products is more competitive than the pricing of certain Zeiss products; and (6) USV could purchase any amount of lenses from Essilor until Zeiss matches Essilor's pricing. Importantly, USV did not seek rescission of the Agreement or damages for breach of contract.

The hearing lasted seven days. As one would expect after a seven-day hearing, the evidentiary record was extensive. The parties offered closing arguments at the conclusion of the hearing and, in doing so, addressed the specific questions posed to them by the Panel. By agreement, the parties then submitted post-hearing briefs. It was in this submission that USV argued for the first time that the Agreement should be rescinded if the Panel concluded that the competitive pricing provision was ambiguous.[9] Zeiss objected. Among other grounds, it stressed that the Agreement could not be rescinded because USV had already taken and spent most the $20 million that it had loaned to USV as consideration for the Agreement. USV responded to Zeiss's objection and the issue was joined for decision by the Panel along with USV's other claims for relief.

The Panel issued its unanimous decision denying all of USV's

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[8] After filing its Demand, USV began to purchase lenses from Essilor. This prompted Zeiss to initiate an action in this Court for, *inter alia*, injunctive relief. The parties ultimately agreed to stay the litigation in this Court in favor of arbitration.

[9] USV's request for rescission at the close of the arbitration hearing is curious given the extensive extrinsic evidence that both parties developed and then presented to the panel during the hearing to assist in the construction of the Agreement should the panel find the Agreement was ambiguous.

requested relief on July 14, 2016. With respect to USV's request for a declaration relating to its interpretation of the competitive pricing provision, the Panel found that while "USV intended that the provisions set forth market check language," "the evidence is undisputed that Labeeuw [a USV negotiator of the Agreement] never intended, or understood, that the new language was market check language, and there is no evidence (other than by implication from the execution of the [Agreement] by Zeiss) that anyone employed by Zeiss, or representing Zeiss, intended or understood before the [Agreement] was executed that the [competitive pricing] provisions set forth market check language."[10] The Panel also determined that "even if one were to conclude Zeiss accepted USV's proposed language, that does not indicate any agreement by Zeiss or, for that matter, USV, to any mechanism for implementation of any market check right. This is only illustrative of the absence of terms supporting the forms of relief requested by USV."[11]

After completing its construction of the relevant language in the Agreement, the Panel concluded that USV was not authorized by the Agreement to engage in a market check to determine if Zeiss was offering competitive pricing. It further concluded, under the Uniform Commercial Code ("UCC") and Delaware case law, that it had no reasonably certain basis to fashion an appropriate remedy if it were to agree that USV's construction was reasonable since the Agreement was silent as to how a market check would work under the MFN clause.[12] It expressly declined to "rewrite" the parties' Agreement.[13]

The Panel then addressed USV's belated request for rescission. After acknowledging USV's argument that it "would not have entered into the [Agreement] 'unless it could exclude lenses that were not competitively priced," the Panel determined that USV had failed to cite any evidence in support of this statement and noted that the Panel's own assessment of the evidence found no support for this position either.14[14]

D. *Procedural Posture*

This matter first came to the Court on Zeiss's Verified Complaint for Specific Performance, filed on September 16, 2015, in which Zeiss sought an order declaring that the Agreement precluded USV from purchasing lenses from Zeiss competitors, including Essilor. Zeiss sought

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[10] Sauder Transmittal Aff. Ex. M ("Award") 6.
[11] *Id.*
[12] *Id.* at 7.
[13] *Id.* at 6-7.
[14] *Id.* at 8.

a temporary restraining order to that same effect. On October 26, 2016, the parties stipulated that this action should be stayed in favor of arbitration that would address the "merits of their dispute relating to the [] Agreement."[15] The arbitration hearing was held May 18–26, 2016. The Panel issued its award on July 14, 2016. USV filed its Motion to Vacate Arbitral Award on October 12, 2016.

USV argues that the Panel "abdicated its duties and ignored basic tenets of UCC law by declaring the Competitive Pricing Exceptions [in the Agreement] unenforceable and then compounded the problems it created by refusing to terminate the contract as the UCC requires."[16] According to USV, the Panel "refused to interpret" the Agreement as requested by the parties and, instead, resolved issues that it raised *sua sponte* at the conclusion of the arbitration hearing.[17] By proceeding in this manner, the Panel "acted outside the scope of its authority, [] issued an award that did not resolve the disputes submitted to arbitration, [] manifestly disregarded governing law, [] gutted USV's bargained-for contractual protections, and []ultimately decided the parties' disputes based on the Panel members' own idiosyncratic views of justice."[18]

Zeiss, of course, emphasizes the extraordinarily narrow standard of review within which the Court must operate—a standard that USV has not come close to meeting here. It also challenges USV's characterization of the Panel's award. According to Zeiss, USV asked the Panel to declare that the Agreement allowed USV to seek out competitively priced lenses in the marketplace and to acquire such lenses if Zeiss did not match the pricing. The Panel considered USV's proffered construction of the Agreement in this regard and rejected it. Accordingly, dissatisfied with the Panel's award, USV cannot now be heard to argue that the Panel somehow acted outside of the scope of its authority when it decided precisely what USV asked it to decide.

II. ANALYSIS

Although the parties have cited to both Delaware and federal authority with respect to the standard of review, they appear to agree that the Federal Arbitration Act ("FAA") applies here.[19] This consensus regarding the standard of review is well placed given that the Agreement

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[15] Stipulation (DI 36).
[16] Opening Br. 2.
[17] *Id.*
[18] *Id.* at 2–3.
[19] 9 U.S.C. §§ 1–16.

does not expressly reference the Delaware Uniform Arbitration Act ("DUAA") or otherwise reflect the parties' "desire to have [the DUAA] apply to their agreement."[20] With regard to the appropriate deference to which an arbitrator's award is entitled, however, the decision to apply the FAA over the DUAA (or vice versa) is of limited moment since precedential decisions applying both statutes require reviewing courts to give practically the highest degree of deference, short of "untouchable,"[21] recognized in the law to an arbitrator's award.[22] Indeed, to overturn an award, the court must be satisfied that "there [is] absolutely no support at all in the record justifying the arbitrator's determinations."[23]

When considering "whether the arbitrator exceeded its authority," the court must "resolve all doubts in favor of the arbitrator."[24] "Even if the arbitrator did not state the grounds for a grant or denial of relief, the grant or denial of relief will be deemed to be within the scope of the arbitrator's authority [i]f grounds for the award can be inferred from the facts of the case."[25] This court will not "pass an independent judgment on the evidence or applicable law," and "[i]f *any grounds* for the award can be inferred from the facts on the record, the Court *must* presume that the arbitrator did not exceed his authority and the award must be upheld."[26]

A. *The Award does not Disregard Controlling Law*

USV contends that the Panel disregarded controlling law when it

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[20] 10 Del. C. §§ 5702(a)(c) (unless the parties expressly agree that the DUAA shall apply to their agreement any motions to vacate or enforce an arbitrator's award shall be decided "in conformity with the [FAA]").

[21] As any trial judge will attest, the "untouchable" standard of review does not exist.

[22] Compare *SPX Corp. v. Garda USA, Inc.*, 94 A.3d 745, 750 (Del. 2014) (noting the DUAA "tracks" the FAA with regard to standard of review and further observing that the "review of an arbitration award is one of the narrowest standards of judicial review in all of American jurisprudence"); *Brentwood Med. Assocs. v. United Mine Workers of Am.*, 396 F.3d 237, 241 (3d Cir. 2005) ("There is a strong preference under the [FAA] in favor of enforcing arbitration awards."); *Hamilton Park Health Care Ctr. Ltd. v. 1199 SEIU United Healthcare Workers*, 817 F.3d 857, 861 (3d Cir. 2016) (noting that arbitration awards must be reviewed under an "extremely deferential standard, the application of which is generally to affirm easily the arbitration award").

[23] *United Transp. Union Local 1589 v. Suburban Transit Corp.*, 51 F.3d 376, 379 (3d Cir. 1995).

[24] *TD Ameritrade, Inc. v. McLaughlin, Piven, Vogel Sec., Inc.*, 953 A.2d 726, 732 (Del. Ch. 2008).

[25] *World-Win Mktg., Inc. v. Ganley Mgmt. Co.*, 2009 WL 2534874 (Del. Ch. Aug. 18, 2009) (internal quotation marks omitted).

[26] *TD Ameritrade*, 953 A.2d at 733 (citation omitted) (emphasis added). *See also Neuronetics, Inc. v. Fuzzi*, 552 F. App'x 134, 135 (3d Cir. 2014) ("We will vacate an award only under the exceedingly narrow circumstances listed in 9 U.S.C. § 10(a) or to correct a manifest disregard of the law.") (citations omitted)

determined that the Supply Agreement was enforceable even after it struck, or at least refused to enforce, an essential term of the contract (the competitive pricing provision). To demonstrate that an arbitral award was rendered in disregard of the law such that the award should be vacated, the party seeking to vacate the award must demonstrate that "the arbitrator (1) knew of the relevant legal principle, (2) appreciated that this principle controlled the outcome of the disputed issue, and (3) nonetheless willfully flouted the governing law by refusing to apply it."[27] This showing must be "something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law."[28] USV has not come close to meeting this burden.

The Panel concluded that the competitive pricing language in the Agreement could not reasonably be construed on its face to allow USV to stop buying lenses from Zeiss if it found better pricing elsewhere.[29] In reviewing the plain language of the Agreement, the Panel reasonably found that the phrase "competitive pricing with respect to the CZV Lenses" in Paragraph 3.2(a)(ii) could be a reference to the MFN pricing structure described in Paragraph 3.5 (pricing competitive with Zeiss's other customers), as Zeiss argued, or the phrase could mean competitive pricing as compared to other lens manufacturers, as USV argued.[30] Because the parties elected to leave the phrase "competitive pricing" undefined, the Panel did its best to construe the term first by reference to

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[27] *Paul Green Sch. Of Rock Music Franchising, LLC v. Smith*, 389 F. App'x 172, 177 (3d Cir. 2010).

[28] *TD Ameritrade*, 953 A.2d at 732–33. *See also RBC Capital Mkts. Corp. v. Thomas Weisel P'rs, LLC*, 2010 WL 681669, at *8 (Del. Ch. Feb. 25, 2010) ("as long as [an honest] arbitrator is even arguably construing or applying the contract and acting within the scope of his authority,' the fact that 'a court is convinced he committed serious error does not suffice to overturn his decision." (alteration in original)).

[29] Award 5, Ex. A ("taking into consideration the MFN provisions of section 3.5, the Panel finds the CP provisions ambiguous, and susceptible of different meanings, regarding whether these provisions set forth market check language.").

[30] Specifically, the Panel determined:

> As previously set forth, the language of the CP [competitive pricing] provisions was never negotiated between the parties. Other than its appearance in the final draft of the SA [supply agreement], there is no evidence the language was addressed between the parties before execution of the SA, either in any conversation, or in any writing. The course of dealing between the parties after execution of the SA also provides no guidance, as the CP provisions were never acted on or invoked until years later when the Essilor offer was presented to Zeiss. Other than the language of the CP provisions, and that Zeiss rejected the previous language that would permit US to continually shop Zeiss prices for any Zeiss lenses, there is no evidence that provides guidance as to the meaning, or intent, or operation of the CP provisions.

Award, at 6–7.

the language within the four corners of the Agreement, and then, when that analysis did not yield a clear construction, by reference to extrinsic evidence.[31] This hardly reveals that the Panel "flouted the governing law"; indeed, the analysis was entirely consistent with settled Delaware law in the area of contract construction.[32] As the party seeking declaratory relief, USV had the burden to prove that Section 3.2(a)(ii) meant what USV claims it meant.[33] USV did not meet its burden. Consequently, the Panel did not adopt USV's proposed interpretation.

Having determined that USV's proffered construction of the Agreement was not reasonable, the Panel was under no obligation to declare the entire agreement unenforceable. According to USV, the Panel's refusal to accept USV's proffered construction of the competitive pricing language left the Supply Agreement without an essential "quantity" term. I note that USV raised this argument to the Panel for the first time *after* the hearing had concluded. Notwithstanding that the argument is of post-hearing vintage, and therefore arguably not properly joined in the arbitration proceedings, USV's attempt to assail the Panel's treatment of this argument fails in any event because it misconstrues the Panel's decision and applicable Delaware law.[34]

In essence, what USV asked the Panel to do after the hearing was

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[31] As the Panel observed, Paragraph 3.2(a)(ii) of the Agreement states "competitive pricing *with respect to the CZV Lenses*"; it does not state "competitive pricing with respect to the lens market" or "competitive pricing *with respect to other lens manufacturers*," all language that actually appeared in prior drafts of the Agreement that Zeiss rejected. Agreement ¶ 3.2(a)(ii). When the parties referred to competitive pricing elsewhere in the Agreement, they always took care to identify precisely what prices will be compared. *See id.* at ¶ 5.2(a) (. . . to timely accommodate USV's customer orders at prices competitive with other available wholesale optical laboratories."); ¶ 5.2(b) (". . . to timely accommodate USV's customer orders at prices that are relatively competitive with (but not necessarily the lowest price available) other available wholesale optical laboratories."). In this regard, the term "competitive pricing" in Paragraph 3.2(a)(ii) stands alone in its failure to provide context and for that reason alone, as the Panel determined, the term is ambiguous.

[32] *Paul Green Sch. Of Rock Music Franchising*, 389 F. App'x at 177. *See also GMG Capital Invs., LLC v. Athenian Venture P'rs I, L.P.*, 36 A.3d 776, 783 (Del. 2012) ("[W]here reasonable minds could differ as to the contract's meaning, a factual dispute results and the fact-finder must consider admissible extrinsic evidence.")

[33] *Zimmerman v. Crothall*, 62 A.3d 676, 691 (Del. Ch. 2013); *Lillis v. AT&T Corp.*, 2008 WL 2811153, at *4 (Del. Ch. July 21, 2008).

[34] USV's demand for rescission was likely received with some surprise given that USV had already received and likely spent the $20 million loan that Zeiss had extended to it (on highly favorable terms) in connection with, and as partial consideration for, the Agreement. *See Stenta v. Gen. Motors Corp.*, 2009 WL 1509299, at *10 (Del. Super. May 29, 2009), *aff'd*, 7 A.3d 485 (Del. 2010) (rejecting rescission claim where the circumstances present at the time the claim was adjudicated made it "impossible for the Court to 'unscramble the eggs'").

to rescind the Agreement.[35] Yet it can hardly be said that the Panel "flouted the applicable law" when it concluded that USV did not meet its burden of demonstrating that the "extreme remedy" of rescission was appropriate here.[36] Specifically, as the Panel observed, USV "cite[d] no evidence" to support its claim that the competitive pricing term was material to its decision to enter into the Agreement and "*the Panel finds the evidence does not so prove*."[37] Indeed, looking beyond the competitive pricing language, the Panel was reasonable in its perception that Paragraph 3.2(a) still adequately addresses pricing in that it contains a definite quantity term that provides a formula for determining USV's purchase obligations: Paragraph 3.2(a) provides that Zeiss "shall be the preferred supplier of ophthalmic lenses"; "USV-Refac shall order from [Zeiss] substantially all of the ophthalmic lenses required by USV" to the extent that Zeiss makes the lenses and they comply with industry quality standards; and "substantially all of the ophthalmic lenses required by USC-Refac shall mean at least 95% of the aggregate number of all ophthalmic lenses sold by USV-Refac in connection with its sale of ophthalmic eyeglasses through the USV Stores during any consecutive 3-month period of the Term."[38] Under these circumstances, there is no basis to conclude that the Panel manifestly disregarded the applicable law when it declined USV's eleventh-hour invitation to rescind the Agreement.[39]

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[35] Opening Br. 14 ("The Panel was clearly aware of the relevant principals at issue under the UCC, but improperly refused to apply them to invalidate the whole agreement when it invalidated an essential element of the quantity term, the Competitive Pricing Exceptions.").

[36] *Liberto v. Bensinger*, 1999 WL 1313662, at *5 (Del. Ch. Dec. 28, 1999) (noting that the court must have a "high degree of confidence" in the propriety of imposing the "extreme remedy" of rescission). *See also Neuronetics, Inc.*, 552 F. App'x at 135 ("We will vacate an award only under the exceedingly narrow circumstances listed in 9 U.S.C. § 10(a) or to correct a manifest disregard of the law.").

[37] Award, at 8 (emphasis added). *See Home Ins. Co. v. Honaker*, 1983 WL 102619, at *1 (Del. Ch. Nov. 2, 1983) (holding that a party's unilateral mistake as to the meaning of a term of the contract will justify rescission only when the term is material); *Asten, Inc. v. Wangner Sys. Corp.*, 1999 WL 803965, at *4 (Del. Ch. Sept. 23, 1999) (same). *See also Hildreth v. Castle Dental Ctrs., Inc.*, 939 A.2d 1281, 1283–84 (Del. 2007) (stating that under Delaware law, "[a]n invalid term of an otherwise valid contract, if severable, will not defeat the contract"); *Tracey v. Franklin*, 67 A.2d 56, 61 (Del. 1949) (stating that under Delaware law, "[w]hether or not the terms of a contract are severable is purely a question of the intent of the parties").

[38] Agreement, at ¶ 3.2(a); Award at 8.

[39] Contrary to USV's position here, the UCC does not dictate a different result. As USV points out, "UCC Section 2-204 'reflects the common law principle that a meeting of the minds on all essential contract terms is critical for contractual formation.'" Opening Br. 14 (citing *Hardwire, LLC v. Zero Int'l, Inc.*, 2014 WL 5144610, at *9 (D. Del. Oct. 14, 2014)). And, to be sure, "quantity" is an essential term. See 2 E. Farnsworth, *Farnsworth on Contracts* § 6.7, at 141 (2d ed. 1990) (noting that the UCC "significantly relaxes the requirement that the

B. *The Award was not Irrational*

An arbitrator "subjects his award to judicial vacatur under [FAA] § 10(a)(4) when he decides an issue not submitted to him, grants relief in a form that cannot be rationally derived from the parties' agreements and submissions, or issues an award that is so completely irrational that it lacks support altogether. . . . [W]hen the arbitrator 'strays from interpretation and application of the agreement' and effectively 'dispenses his own brand of industrial justice' he exceeds his powers and his award will be unenforceable.'"[40] USV argues that the Panel abdicated its responsibility to interpret the Agreement and instead "dispensed [its] own brand of industrial justice" by finding that the competitive pricing provision was unenforceable and, more importantly, by improperly refusing to find that the entire Agreement was unenforceable based on the failure of the competitive pricing provision. This argument is simply a recycling of the argument that the Panel ignored controlling law. As before, I reject it as an unfounded characterization of the Panel's decision and an unsupported interpretation of Delaware law.

C. *The Panel Addressed All Issues it was Asked to Decide*

USV maintains that "[t]he Panel's decision that 'the [competitive pricing] provisions lack[ed] sufficient definiteness, specificity, and mechanisms to be enforceable by declaratory relief' (Award, p. 7) resulted in an imperfect execution of the Panel's powers such that 'a mutual, final, and definite award upon the subject was not made.'"[41] According to USV, the Panel neglected to determine whether the competitive pricing provision could be enforceable by an action for damages (as opposed to the claim for declaratory relief that USV actually brought) and "whether the Competitive Pricing Exceptions related to the prices of comparable ophthalmic lenses offered by other lens suppliers

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memorandum state all the essential terms by insisting only that it state the quantity of goods"). But, as noted, the Panel did not commit manifest error in determining that, even without the competitive pricing provision, the Agreement still more than adequately addressed the quantity of lenses USV was to purchase. There was no essential term missing here even after the Panel declined to construe the competitive pricing provision according to USV's construction of that term.

[40] *Sutter v. Oxford Health Plans LLC*, 675 F.3d 215, 219–20 (3d Cir. 2012), as amended (Apr. 4, 2012), *aff'd*, 133 S. Ct. 2064 (2013).

[41] Opening Br. 25 (citing 9 U.S.C. § 10(a)(1)(4), *Certain Underwriters at Lloyd's London et al. v. BCS Ins. Co.*, 239 F. Supp.2d 812, 816 (N.D. Ill. 2003)). Title 9 of the U.S. Code, Section 10(a)(1)(4) provides that an arbitration award may be vacated "where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."

(as USV argued), or whether they were simply a re-iteration of the MFN clause of Section 3.5 (as [Zeiss] argued)."[42] A review of the Award reveals that the Panel decided every issue that was submitted by USV and denied USV's requests for declaratory relief.

As an initial matter, it cannot be ignored that neither party submitted a breach of contract claim to the Panel. The claims were plainly limited to prayers for declaratory relief. Moreover, the fact that a breach of contract claim will not lie with USV's proffered construction of the Agreement is implicit in the Panel's Award. The Panel determined that the competitive pricing provision was not enforceable as drafted. Any breach of contract claim that USV might pursue based on an alleged breach of the competitive pricing provision, therefore, would not be viable.

The same analysis applies to USV's argument that the Panel did not decide whether the competitive pricing provision referred to the MFN pricing provision in Section 3.5 of the Agreement. USV did not seek a decision from the Panel on that issue. Its argument that the Panel should now be faulted for not deciding the issue, therefore, is, at best, impertinent.

The Panel's Award was "mutual" and "final" in that it "resolved the entire dispute (to the extent arbitrable) that had been submitted to them."43 USV's argument to the contrary is unfounded.

III. CONCLUSION

USV has failed to state any grounds that justify the extraordinary relief of vacating an arbitration award. Its Motion to Vacate Arbitral Award, therefore, must be DENIED. The parties shall confer and submit a proposed final order addressing the Motion to Vacate and the final disposition of this case within ten (10) days.

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[42] Opening Br. 26.

ADT HOLDINGS, INC., IN ITS INDIVIDUAL CAPACTIY AND AS ATTORNEY-IN-FACT FOR ZONOFF, INC., ANDADT LLC,
v.
MICHAEL HARRIS AND RING INC.,

In the Court of Chancery of the State of Delaware

C.A. No. 2017-0328-JTL

MEMORANDUM OPINION

Date Submitted: September 19, 2017
Date Decided: September 28, 2017

Steven L. Caponi, K&L GATES LLP, Wilmington, Delaware; *Attorney for Plaintiffs*.

Megan Ward Cascio, Lauren Neal Bennett, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; Mark C. Scarsi, Ashlee N. Lin, Katherine R. Pierucci, J. Samuel Payne, MILBANK, TWEED, HADLEY & McCLOY LLP, Los Angeles, California; Attorneys for Defendants.

Jeremy D. Anderson, FISH & RICHARDSON P.C., Wilmington, Delaware; *Attorney for Nonparty Legrand Home Systems, Inc*.

LASTER, *Vice Chancellor*.

On the eve of trial, nonparty Legrand Home Systems, Inc. ("Legrand") moved to seal certain trial exhibits so that they would not become part of the public trial record. Legrand also sought to close the courtroom for any testimony or attorney argument regarding the exhibits. Legrand claimed this relief was necessary because the exhibits contained sensitive, confidential information and that Legrand would suffer irreparable harm if the information was made public. The parties to the case did not oppose Legrand's motion. The court, however, bears an independent obligation to balance the harm Legrand claims it will suffer against the public right of access, which is at its height during a trial. Legrand's motion is denied.

"The public's right of access to judicial records has been characterized as fundamental to a democratic state."[1] The right of access

[1] *In re Cont'l Ill. Sec. Litig*., 732 F.2d 1302, 1308 (7th Cir. 1984).

enables the public to "judge the product of the courts in a given case."[2] This, in turn, "helps ensure 'quality, honesty and respect for our legal system.'"[3] Consequently, "all court proceedings are presumptively open to the public."[4]

Court of Chancery Rule 5.1 "reflects the Court of Chancery's commitment to these principles."[5] It states that, "[e]xcept as otherwise provided" in Rule 5.1, "proceedings in a civil action are a matter of public record."[6] This language "makes clear that most information presented to the Court should be made available to the public."[7]

Rule 5.1(b)(3) provides that a "party or person seeking to obtain or maintain Confidential Treatment always bears the burden of establishing good cause for Confidential Treatment." Rule 5.1(b)(2) defines "good cause" as follows:

> For purposes of this Rule, "good cause" for Confidential Treatment shall exist only if the public interest in access to Court proceedings is outweighed by the harm that public disclosure of sensitive, non-public information would cause. Examples of categories of information that may qualify as Confidential Information include trade secrets; sensitive proprietary information; sensitive financial, business, or personnel information; sensitive personal information such as medical records; and personally identifying information such as social security numbers, financial account numbers, and the names of minor children.[8]

In determining whether good cause has been established, the court must "balanc[e] . . . the public interest against the harm that public disclosure might entail with respect to sensitive nonpublic information."[9] The court will not order confidential treatment "merely because disclosure has the

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[2] *Va. Dep't of State Police v. Wash. Post*, 386 F.3d 567, 575 (4th Cir. 2004).

[3] *Horres v. Chick-fil-A, Inc.*, 2013 WL 1223605, at *1 (Del. Ch. Mar. 27, 2013) (quoting *Cont'l Ill.*, 732 F.2d at 1308).

[4] *In re Nat'l City Corp. S'holders Litig.*, 2009 WL 1653536, at *1 (Del. Ch. Jun 5, 2009) (citing *Richmond Newspapers, Inc. v. Virginia*, 448 U.S. 555, 579 n.17 (1980)).

[5] *Horres*, 2013 WL 1223605, at *2.

[6] Ct. Ch. R. 5.1(a).

[7] *Sequoia Presidential Yacht Gp. LLC. v. FE P'rs LLC*, 2013 WL 3724946, at *2 (Del. Ch. July 15, 2013).

[8] Ct. Ch. R. 5.1(b)(2).

[9] *Reid v. Siniscalchi*, 2014 WL 6486589, at *1 (Del. Ch. Nov. 20, 2014).

potential for collateral economic consequences."[10] Instead, the harm must be "particularized."[11]

The fact that Legrand's motion is unopposed does not change these standards. Although the parties to the case have not opposed it, the motion seeks to overcome the public interest in open trials. The real opposition is from the public. Indeed, when considering such a motion, the court "serves not only the litigants before it; it has a public function as well."[12] It is therefore necessary for the court to examine Legrand's motion to determine whether it has carried its burden, notwithstanding the lack of a formal opposition to the motion.

Legrand also argued that, as a nonparty, it should benefit from a lighter burden when seeking to obtain confidential treatment. It is true that, when refusing to grant a party's motion to seal exhibits, the court has reasoned, in part, that "[t]hose who decide the litigate in a public forum (rather than pursue a private dispute-resolution procedure) must do so in a manner consistent with the right of the public to follow and monitor the proceedings and result of their dispute."[13] But that principle does not alter the necessary showing to overcome the public's right of access. An everyday reality of doing business is the possibility that a business partner may end up in litigation in a public court. For information to be sealed from public view, the person seeking confidential treatment must make the showing required by Rule 5.1(b)(3), which applies equally to any "party *or* person" who wishes to keep a matter secret."[14]

Legrand's motion is cursory and conclusory. Legrand claims that the exhibits contain "confidential, proprietary, and commercially-sensitive business information."'[15] Legrand asserts that disclosure of the information

> would subject Legrand to significant injury. Namely, Legrand's confidential, proprietary, and commercially-sensitive business information would be known to those within its industry, including competitors and those with which Legrand negotiates services. Competitors would have Legrand's pricing structure and understand the nature of its outsourced services, and vendors with whom Legrand

[10] *Al Jazeera Ant, LLC v. AT & T Servs., Inc*., 2013 WL 5614284, at *5 (Del. Ch. Oct. 14, 2013).

[11] *Sequoia*, 2013 WL 3724946, at *2.

[12] *Al Jazeera*, 2013 WL 5614284, at *1.

[13] *Al Jazeera*, 2013 WL 5614284, at *7.

[14] Ct. Ch. R. 5.1(b)(3) (emphasis added).

[15] Mot. ¶ 13.

> negotiates would be privy to the terms to which Legrand has previously agreed. Such disclosure would cause Legrand economic harm because the availability of that information would disadvantage Legrand when competing for customers and negotiating with vendors.[16]

During argument, Legrand reiterated these conclusory assertions. Legrand also contended that mere disclosure of the existence of a relationship between Legrand and Zonoff, Inc., a defunct entity whose fate lies at the heart of this action, would cause Legrand competitive harm.

The contents of the exhibits do not support Legrand's characterizations. Legrand first asked to seal in its entirety a Joint Development Agreement between Legrand and Zonoff dated June 15, 2013. As the date evidences, the agreement's terms are more than four years old, a vintage which exceeds by more than a year the default three-year period for the expiration of confidentiality designations under Rule 5.1(g). The contents of the Joint Development Agreement are unremarkable. It is simply a common form master services agreement that sets forth general terms on which the parties will do business together. It contains customary recitals acknowledging a business relationship between the parties, several pages of "General Provisions," a section on indemnification, and routine provisions addressing confidentiality. It also contains provisions relating to intellectual property and licenses, which Legrand emphasized, but they too are standard and unremarkable. For example, they provide that each party retains title to the intellectual property that it brings to the dea1.[17] Legrand has not carried its burden to show that the Joint Development Agreement, or any portion of it, warrants confidential treatment.

Legrand also sought to seal the appendices to the Joint Development Agreement, which included Statements of Work. The Statements of Work contain descriptions of the tasks to be addressed, but they too are relatively general. They resemble generic descriptions of the coding process, far removed from lines of code or innovative product features. By analogy to the tasks that litigators perform, the descriptions

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[16] *Id.* ¶ 14.

[17] *See, e.g., Lucent Techs., Inc. v. Gateway, Inc.*, 543 F.3d 710, 714 (Fed. Cir. 2008) (discussing joint development agreement distinguishing "existing technology" and "new work" along similar lines); see also 2 Raymond T. Nimmer, *Law of Computer Technology* § 4:26 (4th ed. 2017) (discussing joint development arrangements and suggesting agreements "might provide that sole ownership of the intellectual property vests in the original author").

resemble items such as "draft complaint" or "depose key witnesses," rather than more particularized items that might warrant concern.

Legrand also focused in the Statements of Work on language specifying payment terms and per unit licensing fees. Legrand claimed that the disclosure of this information from 2013 might disadvantage Legrand in future negotiations. The conclusory assertion that a company faces an unsubstantiated risk of "economic disadvantage with respect to competitors and others within the industry" is not sufficient to overcome the principle of public access."[18] In this case, the pricing terms are from four years ago and concern services in the dynamic technology industry. Legrand has not provided any reason to think that the pricing remains current. There is nothing about the terms that implies they were specifically negotiated, as opposed to representing standard rates. Legrand has not carried its burden to show that the appendices warrant confidential treatment.

Legrand also sought to seal in its entirety an escrow agreement between Legrand and Iron Mountain Intellectual Property Management, LLC. This document is a standard form industry-standard software escrow between the parties.[19] The escrow agreement itself does not contain any technical information. Legrand has not carried its burden to show that the escrow agreement warrants confidential treatment.

Moving beyond these documents, Legrand claimed that its relationship with Zonoff was itself commercially sensitive and should not be revealed. Having evaluated Legrand's arguments, I find that there is no credible reason to believe that a standard, arms'-length relationship between Legrand and a software developer from over four years ago remains highly sensitive such that its disclosure would cause competitive harm. Moreover, the existence of the relationship and its terms are important facts for the case, because they are relevant to determining whether Zonoff entered into a contested transaction at the heart of the case in the ordinary course of business. A high-level understanding of the Legrand-Zonoff relationship is necessary for the court to decide the matter and for the public to understand the case.

Legrand has failed to show that any of the exhibits are highly sensitive such that Legrand would suffer serious harm sufficient to warrant keeping the exhibits out of the public record. Relatedly, Legrand has failed to show that the courtroom should be sealed for testimony regarding the commercial relationship between Legrand and Zonoff.

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[18] *Al Jazeera*, 2013 WL 5614284, at *4.

[19] *See* Nimmer, *supra* note 17, § 7:136 ("So-called escrow agreements are often used to" facilitate "a third party arrangement in which source code is deposited, allowing for future access by the licensee if the licensor breached a stated condition or is unavailable.").

Legrand's motion for confidential treatment is therefore denied.