which are barred by the exculpatory provision of UniHolding's certificate of incorporation.

I. Factual Background

A. The Plaintiffs

Plaintiffs Grace Brothers and Banc of America control, respectively, 457,187 and 232,494 shares of nominal defendant UniHolding Corporation.

B. The Corporate Defendants

Nominal defendant UniHolding Corporation is a Delaware corporation.

Defendant UGL is a BVI corporation that was formerly a wholly-owned subsidiary of UniHolding.

Defendant Unilabs is Panamanian corporation that was the largest stockholder of UniHolding and is now the largest stockholder of UGL. Panama Holdings is wholly-owned by Swiss Holdings, a Swiss Corporation. For simplicity's sake, I generally refer to both Swiss Holdings and Unilabs as "Unilabs" in this opinion.

C. The Ownership Structure Of UniHolding Before The Challenged Transactions

Resolution of this motion requires an understanding of the profound difference between UniHolding's status as of the time the plaintiffs became stockholders in January 1997 and its status after the transactions challenged in the complaint (the "Challenged Transactions").

In January 1997, the plaintiffs and certain other institutional investors became common stockholders of UniHolding. At that time, UniHolding stock traded on the NASDAQ Small Cap Market. UniHolding's business consisted of providing clinical laboratory testing services to physicians, managed care organizations, hospitals, and other health care providers. UniHolding itself had no operations but conducted all of its business through subsidiaries. Its clinical laboratory business was operated by ULSA, a Swiss corporation that had laboratories throughout continental Europe.

UniHolding controlled ULSA through its ownership of 54% of ULSA's stock. The rest of ULSA's stock was publicly traded. Although UniHolding's interest in ULSA was its most important asset, UniHolding
also owned a wholly-owned subsidiary, Global Unilabs Clinical Trials, Ltd. ("GUCT"), which performed testing for the pharmaceutical industry.

In the beginning of 1997, UniHolding was, for all practical purposes, controlled by Unilabs and stockholders who had affiliations with it. Before the Challenged Transactions were undertaken, Unilabs owned 41.6% of UniHolding's outstanding shares, and the Chairman of the board of Unilabs, defendant Edgar Zwirn, was also Chairman of UniHolding's board of directors. When the UniHolding shares Zwirn controlled through Unilabs are aggregated with those of the other defendant-directors, the UniHolding directors controlled over 50% of the company's issued and outstanding voting common stock.

D. The UniHolding Board Of Directors

The plaintiffs contend that a majority of the UniHolding board of directors is bound together by their ties to the company's Chairman, defendant Zwirn. Those ties, plaintiffs say, contributed to what the plaintiffs argue was a course of conduct designed to benefit Zwirn personally to the detriment of the Minority Stockholders of UniHolding.

The alleged ties depend to a large extent on Zwirn's own multiple roles at corporations affiliated with UniHolding. At all relevant times, Zwirn served as the Chairman of the Board of Unilabs and of its parent, Swiss Holdings. Through Unilabs, Swiss Holdings owned 41.6% of UniHolding's voting stock. Zwirn and his family own 23.3% of Swiss Holdings.

Zwirn's managerial authority extended down to all of UniHolding's subsidiaries. Thus he was the Chairman of the boards of UGL, GUCT, and ULSA as well as of other direct or indirect UniHolding subsidiaries. Defendant Enrico Gherardi was director and secretary of UniHolding. He owned nearly 250,000 UniHolding shares, or approximately 4.6% of the company's stock. In addition, Gherardi served as a director of ULSA, and the plaintiffs believe that he (and/or defendant van Gemerden) also served on the UGL board. The complaint also alleges that a company affiliated with Gherardi received over $1.6 million in unspecified consulting fees from ULSA during the years 1997 to 1999 and that GUCT also paid a Gherardi-affiliated company $300,000 in fees annually during that period.

Defendant Alessandra van Gemerden was a director of UniHolding and GUCT as well as of two other UniHolding subsidiaries. She owned over 490,000 UniHolding shares, or approximately 8.2% of the company's stock. Van Gemerden is defendant Gherardi's niece and is affiliated with
the same businesses that received over $2.5 million in unspecified consulting fees from ULSA and GUCT during years 1997 to 1999.2

Defendant Tobias Fenster was at all relevant times a director of UniHolding and GUCT as well as of two other UniHolding subsidiaries. Most important for present purposes is the fact that Fenster is Zwirn's brother-in-law and serves as the Chief Executive Officer of United Laboratories Espana, SA ("ULSP"), ULSA's Spanish subsidiary.

Finally, defendants Daniel Regolatti and Pierre-Alain Blum were at all relevant times directors of UniHolding and ULSA. According to the plaintiffs, none of the defendant-directors would have held their directorships and offices or received other related benefits but for the beneficence of Zwirn. Thus the plaintiffs argue that none of the defendant-directors was capable of exercising a business judgment adverse to Zwirn's personal interests and that all of them lacked independence as a consequence.

E. ULSA Is Listed On The Swiss Stock Exchange

In April 1997, ULSA's stock became listed on the Swiss Exchange. According to the plaintiffs, this event is important because it led the defendant-directors, particularly Zwirn, to question UniHolding's continued utility to them. As a Swiss corporation, Swiss Holdings may have seen little need to continue to hold its Unilabs control block in ULSA through a publicly traded U.S. corporation, UniHolding, when ULSA shares were now freely tradable on a European exchange.

F. UniHolding Announces Its Intent To Merge Into UGL

In August of 1997, UniHolding announced that its board of directors had approved the concept of merging the company into its UGL subsidiary. The stated purpose of the merger was to streamline the corporate structure of UniHolding and its subsidiaries.

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2I infer this from the fact that the amounts, timing, and sources of the payments are identical.
G. The UniHolding Board Abandons The Merger And Sits By While Its Wholly-Owned Subsidiary Turns Itself Into UniHolding's Parent Corporation

The plaintiffs allege that the defendant directors in effect decided to implement a strategy that would provide Unilabs with the benefits of the proposed merger but relieve it from shouldering the burden of fair treatment of the Minority Stockholders that would be demanded in a merger. That alleged strategy had several components, which I now describe.

1. **GUCT Is Spun-Off To The UniHolding Stockholders**

   In January 1998, UniHolding's board approved a spin-off of GUCT to UniHolding's stockholders (the "Spin-Off"). In the Spin-Off, UniHolding shareholders received a pro rata share of 7.9 million shares of GUCT common stock. But UniHolding retained non-voting GUCT preferred stock valued at $20 million on a historical cost basis, which it then transferred to its wholly-owned UGL subsidiary. UniHolding recorded a net loss of $2.8 million on the transaction.

   Because GUCT stock had not been traded publicly prior to the Spin-Off, the UniHolding board assured its stockholders that GUCT would file a registration statement with the Securities and Exchange Commission after the Spin-Off and thereafter issue public disclosures in accordance with federal law. To date, GUCT has not done so, and its stock is not listed or traded on any public exchange.

2. **The Child Takes Over The Parent: UGL Assumes Control Of UniHolding**

   The most important transaction the plaintiffs attack was the culmination of a year's worth of effort. In April of 1998, UniHolding announced that its 100% child had — supposedly without the involvement of UniHolding's board — become UniHolding's 60% percent parent:

   On April 24, 1998 the Registrant's subsidiary, Unilabs Group Limited ("UGL") issued 3,156,700 new shares of its common stock in exchange for the same number of shares of common stock of the Registrant [UniHolding]. The newly-issued UGL shares were issued to Unilabs Holdings SA and its affiliates and certain European institutional investors in exchange for
shares of Registrant on a one-for-one basis. As a result of these transactions, UGL now directly holds approximately 3.9 million shares (60%) of the Registrant.³

In another disclosure, UGL described the purpose for the stock swap (the Initial Swap") the following way:

[Unilabs] Holdings and its affiliates and certain European institutional investors transferred their shares of the Issuer for the same number of UGL Shares because they preferred holding their investments through a British Virgin Islands entity (such as UGL) rather than a Delaware corporation (such as the Issuer). While the undersigned reporting persons have not solicited nor made any offer for additional transfers, they at present do not intend to oppose any effort by other shareholders of the Issuer to transfer their shares in consideration for UGL Shares of the same one-for-one basis.

UGL also plans to investigate the quoting or listing of the UGL Shares on various markets. Depending upon the progress with respect to such markets, there could be further developments and transactions involving UGL and the Issuer.⁴

Defendants Zwirn, Gherardi, and van Gemerden exchanged the UniHolding shares they controlled for UGL shares in the Initial Swap. The Initial Swap left UniHolding's remaining stockholders as the owners of a publicly traded Delaware subsidiary of a non-publicly traded BVI corporation, the majority owner of which was Unilabs.

This situation did not persist, however, because the Initial Swap was rescinded. Then, on October 29, 1998, UniHolding once again announced its ongoing evaluation of a possible merger with UGL:

On August 8, 1997, the Company announced its intention to merge UniHolding into its wholly-owned subsidiary, UGL, with a view toward streamlining the corporate structure. The

³Second Amended Complaint ¶ 43, at 8 (hereinafter "Complaint") (quoting Form 8-K dated April 24, 1998) (brackets in original; emphasis added).
proposed merger was and is subject to shareholder and regulatory approvals. In the fourth quarter of fiscal 1998, a major shareholder, Unilabs Holdings SA, a Panama corporation ("Holdings," reported the contribution to UGL of approximately 3.1 million shares of UniHolding common stock in exchange for the same number of shares of UGL common stock. However, this was rescinded. Accordingly, at present UGL remains a wholly-owned subsidiary of UniHolding. The Company is now continuing to examine the feasibility of the proposed merger with UGL.1

Yet approximately five months later, UniHolding announced that, rather than merging with its wholly-owned subsidiary UGL, UniHolding had once again been acquired by its corporate child. Specifically, UniHolding announced that Unilabs and certain other members of a "controlling group" had swapped their UniHolding shares to UGL in exchange for UGL shares (the "Swap"). The disclosure issued by UniHolding warrants careful consideration in view of its emphasis on the fact that the Swap was performed to benefit "a controlling group" and the fact that UniHolding — UGL's parent corporation — was supposedly informed of the Swap after it had already occurred:

Unilabs' European founders had until recently held their controlling stake through a holding company, Unilabs Group Limited, itself owned by UniHolding Corporation, a US, Nasdaq-listed, corporation. With a view to simplify the group's shareholding structure and avoid any subsequent confusion with this US corporation's activities, the founders of Swiss-based [ULSA] now hold their majority stake directly through Unilabs Group Limited.

As summarized in the above [ULSA] press release, the Board of Directors of UniHolding was informed by its subsidiary Unilabs Group Limited (a British Virgin Islands corporation, "UGL"), that UGL has reached a definitive agreement with Unilabs Holdings SA (a Panama corporation, "Holdings") on [Unilabs'] own behalf and on behalf of affiliates of [Unilabs]. Under such agreement, UGL has agreed to issue to [Unilabs] approximately 2.8 million newly-issued shares of UGL

1Compl. ¶ 50, at 10.
common stock for a consideration consisting of approximately 2.8 million shares of UniHolding common stock. Prior to the transaction, [Unilabs] was the single largest shareholder of UniHolding. According to UGL, the purpose of the transaction was to enable the controlling group, which includes the group founders, to simplify the structure of their holdings without necessarily proceeding with a more massive restructuring entailing for example the liquidation of UniHolding; a restructuring which might not have been in the best interest of the companies and all their shareholders, while, according to UGL the described transaction was made with a view to preserve the interests of the minority shareholders.6

UniHolding's public disclosures further explained:

On February 25, 1999, the Registrant's subsidiary, Unilabs Group Limited ("UGL") issued approximately 2.8 million new shares of its common stock in exchange for the same number of shares of common stock of the Registrant. The newly-issued UGL shares were issued to Unilabs Holdings SA and its affiliates in exchange for shares of the Registrant on a one-for-one basis. As a result of these transactions, UGL now directly holds approximately 4.7 million shares (60%) of the Registrant. The Registrant continues to hold 2.5 million shares of UGL, the initial amount of UGL shares issued and outstanding when the Registrant owned 100% of UGL.7

Thus as a result of the Swap, UniHolding became a subsidiary of UGL — which now controlled 73.4% of UniHolding's stock — but retained a 43% interest in UGL. In turn, Unilabs — whose Chairman Zwirn was Chairman of both UniHolding and UGL — became UGL's majority stockholder. Gherardi and van Gemerden also participated in the Swap, and it is plausible to infer for purposes of this motion that they were an integral part of the "controlling group" of "Unilabs and its affiliates" referred to in UniHolding's public disclosures. Therefore, I hereinafter refer to Unilabs, Zwirn, Gherardi, and van Gemerden collectively as the "Controlling Group."

7Compl. ¦ 54, at 11 (quoting Form 8-K dated March 12, 1999) (emphasis added).
Given their participation as part of the Controlling Group in the Initial Swap and the ultimate Swap, the plaintiffs allege that Zwirn, Gherardi, and van Gemerden (and the other members of the UniHolding board) were deeply involved in planning and implementing the Swap. Despite the involvement of UniHolding's board, the plaintiffs aver, UniHolding never disclosed any information that the Swap was being considered until after the Swap had already transpired. Moreover, the plaintiffs contend that the defendant-directors, as the board members of UGL's 100% owner, clearly had the authority to stop the Swap from occurring but did not do so.

3. UniHolding Exchanges A Block Of Its UGL Shares For UniHolding Shares Held By UGL

After the Swap was announced, UniHolding received complaints about the Swap from several of the Minority Stockholders, who included the plaintiffs and the Mutual European Fund (through its agent, Franklin Mutual Advisers, Inc.), as well as accompanying demands for books and records pursuant to 8 Del. C. § 220. Before its complaint could be resolved, Mutual European Fund sold its UniHolding shares for $2.00 each. The plaintiffs suspect that members of the Controlling Group or their affiliates purchased the Mutual European shares but cannot verify this suspicion because the buyer did not file the required Schedule 13-D after acquiring the shares.

After the demands were received, the UniHolding board convened a June 16, 1999 board meeting. The minutes of the meeting, which are attached to the complaint, have a surreal quality. They indicate that Zwirn explained to his fellow UniHolding directors (two others of whom had participated directly in the Swap) why the UGL board had engaged in a transaction whereby UGL became its owner's parent. In particular, Zwirn referred the board to a June 7, 1999 UGL memorandum (the "UGL Memo"), described in greater detail below, which discusses the Swap and the reasons behind it. Although redacted in large part, the minutes reflect the board's awareness of the Minority Stockholders unhappiness with the Swap.

In September of 1999, the UniHolding board approved a proposal made in the UGL Memo. The UGL Memo indicated that the UGL and UniHolding boards had reached an "agreement in principle" about this proposal before the June 16, 1999 board meeting. The proposal was

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8 Compl. Ex. C at U0045
designed to dampen the ire of UniHolding's Minority Stockholders through an exchange of shares that would eliminate UGL as a stockholder of UniHolding (the "Exchange"). In exchange for 430,000 shares of UGL stock, UniHolding was to receive all of the over 5.85 million UniHolding shares owned by UGL. After the Exchange, UniHolding was expected to cancel the shares rather than keep them as treasury stock.

The defendants allege that the purpose of the Exchange was to protect UniHolding's remaining stockholders from having their attributed interest in ULSA diluted as a result of the Swap. The Exchange did so by reducing UGL's ownership in UniHolding from 73.4% to zero, thus restoring the indirect proportionate interest of UniHolding's remaining stockholders in ULSA approximately to the level that existed before the Swap. The Exchange also had the effect of slightly reducing UniHolding's position in UGL from 43% to 37%. In the end, the plaintiffs, along with another Minority Stockholder, Morgan Stanley, became the owners of over 52% of UniHolding.9

4. The UGL Memo Explaining the "Restructuring"

The plaintiffs attached to the complaint a copy of the June 1999 UGL Memo regarding the Swap and the Exchange. According to the UGL Memo, the Swap was inspired by the European UniHolding stockholders' desire to get rid of the undue cost associated with holding their indirect investment in ULSA through a publicly listed and traded American corporation. More specifically, the UGL Memo indicates that UniHolding had failed to develop a good market for its stock, despite the company's efforts to obtain get analysts to follow the stock and appreciate the strong performance of the ULSA subsidiary. Indeed, the UGL Memo asserts that analysts themselves had complained about UniHolding's unwieldy structure, blaming this corporate structure for the failure of UniHolding's stock price to thrive.

Thus Unilabs "and certain other non-US stockholders of UniHolding" decided "to hold their shares at the UGL rather than UniHolding, level."10 The UGL Memo asserts that these stockholders

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9 According to defendants, this means that demand should be required because plaintiffs, if they act concertedy with Morgan Stanley, can elect a new board. But the UniHolding certificate provides for a classified board so that such a change can only occur over a two year period; moreover, I decline to adopt the innovation that stockholders who wish to bring a derivative suit must take steps to unseat the board as opposed to simply satisfying the traditional tests that measure demand futility.

10 Id. at U0008.
offered the plaintiffs and other American institutional holders the opportunity to do the same but that those stockholders had declined to do so. Nevertheless, the UGL Memo stated, UniHolding was "free to maintain" its status as a publicly listed and traded corporation "at its own expenses [sic] if its board and shareholders determine that it is in their best interests."\(^{11}\)

**H. UniHolding Is Delisted For Failure To Comply With Its Securities Law Responsibilities And Is Forced To Hock Its Assets To UGL**

During 1998 and 1999, the UniHolding board repeatedly ignored SEC filing deadlines. As a final consequence of these failures, the SEC delisted UniHolding on September 17, 1999.

The delisting was accompanied by UniHolding's inability to fund its limited operations. After the Spin-Off and the Swap, UniHolding's only assets were its stock in UGL and certain non-trading assets that UniHolding later sold to UGL for $10,000. The sale of the non-trading assets in June of 1999 was based on a five-year-old book value.

Consistent with the UGL Memo, UniHolding board minutes from June 1999 reflect Zwirn's view that UniHolding would have to meet all of its obligations itself. Even though UGL was at that time UniHolding's majority stockholder, Zwirn told his fellow UniHolding directors at the June 16, 1999 board meeting that "[i]n view of the new relationship between UGL and [UniHolding], he felt that, contrary to what happened previously, UGL would no longer make financial resources available to [UniHolding], and it was necessary to arrange for bridge financing . . . ."\(^{12}\)

As a result, the UniHolding board entered into a loan agreement with its former wholly-owned subsidiary, whereby UniHolding would pledge 320,000 of its 430,000 UGL shares in exchange for a $500,000 loan. This loan was procured in part to help UniHolding defend against the § 220 actions brought by the plaintiffs.

**I. The Stock Price Of UniHolding Plummets**

From the time the plaintiffs acquired their UniHolding shares in January 1997 until its shares were delisted in September 1999, UniHolding's stock price fell from $12 per share to $2.00 per share. During

\(^{11}\)Id.

\(^{12}\)Id. at U0004.
the time the plaintiffs have been stockholders, UniHolding has never paid
a dividend. UniHolding stock currently has no market price and does not,
for all practical purposes, trade.

By contrast, ULSA has apparently done extremely well during the
same period and has paid substantial dividends to its stockholders. Yet,
according to the complaint, none of these dividends have been upstreamed
to UniHolding's stockholders through that company by way of UGL.

II. Legal Analysis

The defendants argue that the complaint must be dismissed for
several reasons. I turn to the defendants' first two arguments now, applying
the familiar standards that must be used under Court of Chancery Rules
23.1 and 12(b)(6).

A. Must The Complaint Be Dismissed For Failure To Plead Facts
Excusing Demand On The UniHolding Board?

The defendants contend that the claims raised by the plaintiffs are
solely derivative in nature. As a result, defendants assert, the complaint
must be dismissed unless the plaintiffs have satisfied the Aronson v. Lewis
test for demand excusal. That test requires a derivative plaintiff to plead
particularized facts that create a reasonable doubt as to whether: (1) a
majority of the UniHolding directors are disinterested and independent; or
(2) the Challenged Transactions were valid exercises of business judgment
by the UniHolding board of directors. The defendants argue that the
complaint fails to satisfy either prong of Aronson and therefore must be
dismissed. I now turn to the first prong of Aronson.

The defendants assert that the UniHolding board is comprised of
wholly disinterested and independent directors. According to the defen-
dants, none of the UniHolding directors had a financial interest in effecting
a reorganization of UniHolding that would prefer the interests of the

\[13\]In considering the defendants' motion to dismiss under Rule 23.1, the well-pleaded
allegations of the derivative complaint must be accepted as true, but conclusory allegations will

\[14\]On a motion to dismiss, the well-pleaded allegations of the complaint will be
accepted as true, but mere conclusory allegations will not be. E.g., In re Tri-Star Pictures Litig.,
Inc., Del. Supr., 634 A.2d 319, 326 (1993). If, after doing so and drawing all reasonable
inferences in favor of the plaintiffs, the court is convinced that there is no basis for a recovery
by the plaintiffs, the court must grant the motion to dismiss. Id.


\[16\]Id., 473 A.2d at 814-15.
Controlling Group affiliates over the interests of the Minority Stockholders. Nor, defendants assert, does the complaint plead facts from which one can infer that any of the other UniHolding directors could not exercise their business judgment independently of defendant Zwirn. By contrast, the plaintiffs argue that every member of the UniHolding board either was interested in the challenged transactions or was so beholden to Zwirn as to lack independence.

After carefully examining the allegations of the complaint, I conclude that the plaintiffs have pled particularized facts that create a reasonable doubt about the impartiality of four of the six UniHolding directors: Zwirn, Gherardi, van Gemerden, and Fenster. As a result, demand is excused.

As to defendant Zwirn, the complaint alleges facts that support the inference that Zwirn is the dominant player in Unilabs, which controlled 41.6% of UniHolding's stock at the inception of the Challenged Transactions.17 In view of Zwirn's position as Chairman of UniHolding, UGL, and ULSA, it is also reasonable to infer that Unilabs had effectively used its position in UniHolding to ensure that its leader, Zwirn, would be the key executive at all the downstream businesses. Moreover, the attachments to the complaint support this and suggest that Unilabs was the driving force behind the creation and operation of ULSA from the beginning. Moreover, Unilabs appears to have only relinquished equity to the extent necessary to raise capital and to have taken great care to ensure that it would not give up effective control over ULSA.

The complaint also alleges that Zwirn orchestrated the Challenged Transactions and directed the other UniHolding board members to assent.18 These allegations are buttressed by pled facts and documents incorporated into the complaint indicating Zwirn's central role in the Challenged Transactions.19

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18 Compl. ¶ 56 ("Defendant Zwirn orchestrated the February 25, 1999 Stock Swap and, upon information and belief, other members of the UniHolding Board of Directors were intimately Involved in the formulation and implementation of the 'two-step' restructuring of UniHolding and its formerly wholly-owned subsidiary, UGL"); id. ¶ 127 ("Defendant Zwirn directed the Director Defendants to endorse the February 25, 1999 Stock Swap, to consent to the September 3, 1999 stock exchange as the final step to the restructuring of UniHolding and UGL, and to engage in the related Corporate Transactions at issue.").

Taken together, these facts create a reasonable doubt about Zwirn's disinterest. Underlying this doubt is the fact that UniHolding had the option of restructuring through a merger in which it would have had to ensure that the Minority Stockholders received fair consideration or through a distribution of its controlling interest in ULSA directly to its stockholders on a pro rata basis. Instead, UniHolding chose to effect a transaction that enabled the Controlling Group to continue to use the Minority Stockholders' equity to help them exercise firm majority control over ULSA while decreasing the Minority Shareholders' liquidity and informational rights. It is thus implausible that Zwirn — who indirectly owns over 23% of Unilabs had no financial interest in the Challenged Transactions. As a result, the plaintiffs have established a reasonable doubt as to his ability to give impartial consideration to a demand.

The complaint also pleads particularized facts that create reasonable doubt about the ability of defendants Gherardi and van Gemerden to impartially consider a demand. Gherardi is van Gemerden's uncle. Between the two of them, they owned nearly 13% of UniHolding before the Challenged Transactions. They subsequently converted their UniHolding shares into UGL stock in the Swap. In addition, Gherardi serves on the ULSA board, and van Gemerden served on the boards of two other UniHolding subsidiaries.\footnote{The complaint suggests that one or both also served on the UGL board, but whether that is true or not would not change the outcome of this motion.} According to the documents quoted above that were attached to the complaint, the Swap was effected at the instance of the "controlling group" of Unilabs "and its affiliates." As stated previously, it is reasonable to infer at this pleading stage that Gherardi and van Gemerden were part of this "controlling group" of "affiliates" of Unilabs.

The basis for this inference is strengthened by the fact that, according to UniHolding public disclosures, a company affiliated with Gherardi and van Gemerden received "unspecifed consulting fees" from GUCT and ULSA of over $2.5 million during the period 1997 to 1999.\footnote{Compl. ¶ 81, 86.} Although the defendants fault the plaintiffs for not detailing the nature of these fees or Gherardi's and van Gemerden's precise affiliations with the company receiving these fees, it seems to me reasonable to infer that UniHolding (whose approach to disclosure compliance is allegedly otherwise less than exemplary) would not have disclosed these substantial
fees if Gherardi's and van Gemerden's affiliation to the recipient company was immaterial to them. Thus I conclude that Gherardi and van Gemerden were "interested" in the Challenged Transactions.

The fact that Gherardi's and van Gemerden's involvement in the Unilabs' family of companies was so extensive and apparently lucrative also creates a reasonable doubt about their ability to act adversely to Zwirn's interests. Zwirn is clearly positioned to exert substantial influence over decisions regarding Gherardi's and van Gemerden's roles at and remuneration from Unilabs-affiliated companies.

Likewise, the complaint also raises a reasonable doubt about the ability of defendant Fenster to impartially consider a demand adverse to Zwirn's interest. Fenster is Zwirn's brother-in-law. Any suggestion that Fenster's family bond to Zwirn is strained would seem to be contradicted by Fenster's service as CEO of ULSA's Spanish subsidiary, ULSP, and as a director of UniHolding and other Unilabs-related companies. It is reasonable to infer that Fenster does not serve as CEO of ULSP as a matter of charity rather than for material compensation. In view of Fenster's

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22) Rales v. Blasband, Del. Supr., 634 A.2d 927, 937 (1993) (where controlling stockholder-directors were positioned to exert substantial influence over a director's continued employment, that director could not objectively consider a demand adverse to their interests); Friedman v. Beninson, 1995 Del. Ch. LEXIS 154, at *15 (where 36% stockholder/director/CEO could exercise influence over director's receipt of $48,000 a year in consulting fees, that director's ability to consider a demand detrimental to the CEO was sufficiently doubtful as to excuse demand); Mizel v. Connelly, C.A. No. 16638, mem. op., 1999 Del. Ch. LEXIS 157, at *8 n.1, Strine, V.C. (July 22, 1999, corr. Aug. 2, 1999) (where chairman and CEO held 32.7% of the company's stock, "the pragmatic, realist approach dictated by Rales require[d] the court to accord great weight to the practical power wielded by a stockholder controlling such a block and to the impression of power likely to be harbored by the stockholder's fellow directors").

23) Harbor Finance Partners v. Huizenga, Del. Ch., 75 1 A.2d 879, 886-89 (1999) (director who was brother-in-law of CEO and who was involved in various businesses with the CEO could not impartially consider a demand adverse to the CEO's interest); see also Grimes v. Donald, Del. Supr., 673 A.2d 1207, 1217 (1996) (a "material financial or familial interest" can disable a director from considering a demand); Mizel v. Connelly, 1999 Del. Ch. LEXIS 157, at *11-12 (grandson could not objectively consider demand adverse to interests of his grandfather); cf. Chaffin v. GNI Group, Inc., Del. Ch., C.A. No. 16211, mem. op., 1999 Del. Ch. LEXIS 182, at *17-20, Jacobs, V.C. (Sept. 3, 1999) (where a transaction benefited his son financially, the father was "interested" in transaction for purposes of the business judgment rule).

24) Huizenga, 751 A.2d at 889.

25) Cf. Kahn v. Tremont Co., Del. Ch., C.A. No. 12339, mem. op., 1994 Del. Ch. LEXIS 41, at *8-*9, Allen, C. (Apr. 21, 1994, rev. Apr. 22, 1994) (where directors might jeopardize their employment as executives by granting a demand contrary to interests of the director who indirectly controlled the corporation, a reasonable doubt existed as to their impartiality); Mizel v. Connelly, 1999 Del. Ch. LEXIS 157, at *8-*9 (where director-officers would have to consider a demand harmful to the interests of a director who was their management superior, reasonable doubt as their independence was created); Steiner v. Meyerson, Del. Ch., C.A. No. 13139, mem. op., 1995 Del. Ch. LEXIS 95, at *27-*30, Allen, C. (July 18, 1995) (a director who was the
close familial and business relationships with Zwirn and Zwirn's influence over Fenster's employment at ULSP, Fenster's ability to consider a demand impartially is doubtful.

Because four of the six UniHolding directors cannot impartially consider a demand, I need not examine the impartiality of defendants Regolatti and Blum. Similarly, having found that the plaintiffs' complaint meets the first prong of Aronson, I will not consider the second prong of that test. Nor will I engage in the metaphysical exercise of determining whether the plaintiffs have stated individual — as opposed to exclusively derivative — claims. Such an analysis can be undertaken later in the litigation, if necessary to determine a remedy or address other issues.

B. Does The Complaint State A Claim Against The Director-Defendants For Breach Of The Fiduciary Duty Of Loyalty?

Because the complaint seeks relief in the form of monetary damages and because the UniHolding certificate of incorporation contains an exculpatory charter provision pursuant to 8 Del. C. § 102(b)(7), the plaintiffs may survive this motion to dismiss only if the complaint states a cognizable claim for breach of fiduciary duty not immunized by the exculpatory charter provision.26 Put simply, the complaint must state a claim for the breach of the duty of loyalty.27

In arguing that the complaint does not do so, the defendants advance two somewhat contradictory arguments. Relying on the plaintiffs' claim that the defendants unlawfully divested the Minority Stockholders of appraisal rights by accomplishing their reorganization of UniHolding and UGL through the Swap, the defendants first argue that they are protected by the doctrine of independent legal significance.28 The defendants next contend that the complaint fails to state a claim against them in relation to

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26In re General Motors Class H Shareholders Litig., Del. Ch., 734 A.2d 611, 619 n.7 (1999).

27McMillan v. Intercargo Corp., Del. Ch., C.A. No. 16963, mem. op., 2000 Del. Ch. LEXIS 70, at *25-*26 & *25 n.41, Strine, V.C. (Apr. 20, 2000). The pertinent exceptions in § 102(b)(7) relating to unlawful actions and actions taken in bad faith are quite obvious examples of disloyal acts. Arguably, the improper personal benefits provision of § 102(b)(7)(iv) could be seen as preventing a director from benefiting from his own gross negligence in the context of a self-dealing transaction, but this, too, can properly be seen as raising loyalty concerns, given that it involves a fiduciary who has personally benefited from his own lack of care at the expense of the beneficiaries of his service.

28Defs.' Br. at 29 (citing Orzeck v. Englehardt, Del. Supr., 195 A.2d 375 (1963)).
the Swap, because the Swap was effected without the involvement of the UniHolding board. As a consequence, the defendants claim, the Uni-Holding directors are not proper defendants to an action challenging that transaction.

For the following reasons, however, I reject the defendants' arguments and find that the complaint states a claim for breach of the fiduciary duty of loyalty.

Read as a whole, the complaint alleges that Zwirn, Gherardi, and van Gemerden, with the active support of their fellow directors, effected a scheme whereby the Controlling Group was able to gain the benefits of a squeeze-out merger without having to ensure that the merger was fair to UniHolding's Minority Stockholders. The members of the Controlling Group made clear their desire to rid themselves of the expense of being stockholders in a publicly listed and regulated corporation that provides its minority stockholders with important benefits such as regular financial disclosures, access to books and records, and a liquid market for their securities. These benefits were critical to the Minority Stockholders but not nearly as important to the Controlling Group. After all, the Controlling Group could obtain liquidity whenever it desired by selling UniHolding's control block in ULSA, could most likely dictate dividend flow to themselves through their control of the UGL and ULSA boards, and would have day-to-day access to corporate information through their multiple corporate offices.

The defendants initially announced to the market that they were considering a merger that would have streamlined UniHolding's structure but that would have required the defendants to take steps to guarantee the fairness of the consideration received in the merger.29 After making this announcement, the Controlling Group consummated the Initial Swap at the UGL level, which had the effect of placing UniHolding's wholly-owned subsidiary in control of UniHolding. Defendant Zwirn was UGL's Chairman and the facts in the complaint amply support the inference that he instigated the Initial Swap. Defendants van Gemerden and Gherardi each participated in that swap. And by the time the Initial Swap was rescinded, it is clear that the entire UniHolding board knew that UGL's board was prepared to engage in a transaction that would place UGL in

29That is, the defendants would have had to show, in the absence of procedural protections such as an effective special committee with real clout, that the straight exchange of liquid shares in a publicly listed and SEC-regulated company for identical securities in a non-listed, non-SEC-regulated corporation was a fair transaction.
control of UniHolding and leave UniHolding's Minority Stockholders in a potentially compromised position.

Furthermore, it is reasonable to infer that the entire UniHolding board was aware of the Initial Swap at the planning stages. Because UniHolding had already announced the possibility of a merger so as to streamline the UniHolding/UGL/ULSA holding structure and because several of the defendants were involved in the Initial Swap, the plaintiffs are entitled to the inference that the UniHolding board considered that swap as an alternative means of accomplishing the streamlining that would advantage the Controlling Group. This inference is made even stronger by the fact that the Initial Swap was rescinded and that the UniHolding board then announced that a merger was still a real possibility. And by the time the final Swap took place, it seems implausible that the UniHolding board was uninvolved in determining which option to pursue. At the very least, the complaint pleads facts that, if true, make clear that the UniHolding board was not only fully aware of the possibility of the final Swap before it occurred but stood by and did nothing to stop it.

In this same regard, it is counterintuitive that those directors of UGL who were not affiliated with UniHolding decided independently that it was important for UGL to take action to respond to the desires of the Controlling Group of UniHolding stockholders — who were not UGL stockholders — without consulting with the UniHolding board. While events may in fact have transpired in this rather unusual manner, on a dismissal motion the plaintiffs are entitled to the inference that the Controlling Group also dominated UGL and impelled UGL to do what it did. After all, Zwirn was UGL's Chairman.

In this context, the UniHolding board's supine reaction supports a claim for breach of the duty of loyalty. It is by no means a novel concept of corporate law that a wholly-owned subsidiary functions to benefit its parent. To the extent that members of the parent board are on the subsidiary board or have knowledge of proposed action at the subsidiary level that is detrimental to the parent, they have a fiduciary duty, as part of their management responsibilities, to act in the best interests of the parent and its stockholders.

Here the pled facts support the inference that certain members of the UniHolding board — Zwirn, van Gemerden, and Gherardi — actively initiated and participated in the Swap at the UGL level to the benefit of

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30This group's identity is not revealed in the record.

their personal interests and at the expense of UniHolding and its Minority Stockholders. The other members of the board permitted them to do so. Although the defendants-directors would have me find that they were powerless to control the actions of UniHolding's wholly-owned subsidiary, they have not supported that implausible assertion with legal authority, and I hesitate to adopt an "uncontrollable child" theory of parent-subsidiary relations. More reasonable is the inference that the UniHolding directors decided that the best way to accomplish the goals desired by the Controlling Group was to effect a transaction at the UGL level and to allow that transaction to take place, even though UniHolding had the practical power to stop it.

There is no safe harbor in our corporate law for fiduciaries who purposely permit a wholly-owned subsidiary to effect a transaction that is unfair to the parent company on whose board they serve. Nor do I find convincing the defendants' attempt to compartmentalize Zwirn's role in the Swap. In their papers and at oral argument, the defendants would have me pretend that the Zwirn who served as Chairman of UniHolding had no responsibility to control or know about the actions of the Zwirn who served as Chairman of UGL, even though "they" were in fact one person.

This argument rests on the premise that the members of a parent board who also serve on the board of a subsidiary board may take action at the subsidiary level that is disloyal to the parent without bearing any fiduciary responsibility to the parent to help it exercise its power to stop the disloyal action.32 Put more simply, the plaintiffs argue that a director of a parent board such as Zwirn has no duty to stop himself from injuring the parent while wearing his subsidiary hat.33 The policy implications of accepting this premise are, to put it mildly, unappealing. I decline to

32See Hoover Industries, Inc. v. Chase, Del. Ch., C.A. No. 9276, mem. op., 1988 Del. Ch. LEXIS 98, at *4-*8, Allen, C. (July 13, 1998) (rejecting defendant's argument that because he performed his challenged actions solely as an officer, he was not susceptible to substituted service under 10 Del. C. § 3114, strongly implying that such an approach would reduce the protective function of the duty of loyalty, and noting that it would also "encourage a jurisprudence of distinctions of metaphysical subtlety"); cf. Manchester v. Narragansett Capital, Inc., Del. Ch., C.A. No. 10822, mem. op., 1989 Del. Ch. LEXIS 141, at *23-*24, Chandler, V.C. (Oct. 18, 1989) ("given the fact that the individual defendants are all employees, shareholders, officers, and directors of the corporation, it would be artificial to distinguish their actions as having been taken in different guises when, as directors, they control the corporation").

endorse an approach that so obviously invites abuse and that would gut the
duty of loyalty owed by Delaware directors to their stockholders.

This conclusion fiends strong support in Vice Chancellor Jacobs's
post-trial decision in the analogous case of Technicorp International II, Inc.
v. Johnson ("TCI II v. Johnston"). In that case, the defendants argued that
they were not subject to service of process in Delaware under 10 Del. C.
§ 3114 for their actions in pillaging the wholly-owned California subsidiary
of a Delaware corporation on whose board they served, even though that
subsidiary was the parent's "only operating asset and source of income." Like UniHolding, the parent in that case held all of its key operations at the
subsidiary level, making oversight of subsidiaries a crucial aspect of the
parent board's function.

Vice Chancellor Jacobs rejected the directors' suggestion they could
escape responsibility at the parent level, stating:

In Hoover Industries, Inc. v. Chase, a director and officer of
a corporation and its subsidiary was charged with wrongfully
diverting assets of both the parent and the subsidiary. The
director claimed jurisdiction under §3114 was unavailable
because the challenged transactions were performed in his
capacity as an "officer" rather than as a director. Rejecting
that contention, former Chancellor Allen stated that "[t]he
duty of loyalty of a director is . . . a special obligation upon a
director in any of his relationships with the corporation." The
Chancellor also observed that it well may be that "a director
qua director owes a duty to the corporation to so conduct
himself in all of his capacities so as not to inflict an
intentional, wrongful injury upon the corporation," but the
Court found it unnecessary to explore the soundness of that
proposition in that particular case. In this case, I conclude
that that proposition is axiomatic and subsumed within the
director's broader duty of loyalty. Thus, Johnston and
Spillane had a duty as directors "in any of their relationships"
with [the parent corporation] not to injure that corporation or
its assets, including its wholly-owned subsidiary . . . . This
Court, therefore, has personal jurisdiction over the defendants

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34Technicorp Int'l II, Inc. v. Johnston ("TCI II v. Johnston"), Del. Ch., C.A. No. 15084,
35Id., mem. op. at 11.
under § 3114 with respect to [the parent corporation's] claim for wrongfully diverting assets of [the subsidiary].

Equally ineffective is the defendants' reliance on the doctrine of independent legal significance. It was long ago settled that inequitable action is not insulated from review simply because that action was accomplished in compliance with the statutory and contractual provisions governing the corporation. The defendants are on firmer ground in arguing that the transactions complained of by the plaintiffs did not give rise to rights under 8 Del. C. § 262. Nonetheless, if the plaintiffs later prove that the defendants took inequitable action designed to have the same effect on the plaintiffs as a squeeze-out merger, an award of quasi-appraisal damages would be within the realm of possibilities as a remedy.

Finally, the fact that the defendants belatedly undertook the Exchange cannot save them at this stage of the litigation. Although the Exchange reduced the dilutive effect of the Swap, UniHolding's Minority Stockholders were still left as the owners of stock in a delisted corporation, the only valuable asset of which was a non-revenue-generating minority block of an unlisted BVI corporation dominated by the Controlling Group. At this stage, therefore, one cannot rule out the possibility that this

36 TCI II v. Johnston, mem. op at 11-12 (quoting Hoover Industries, mem. op. at 4-5) (emphasis added in TCI II v. Johnston). Pauley Petroleum Inc. v. Continental Oil Co. does not hold to the contrary. Del. Supr., 239 A.2d 629 (1968). In that case, the Supreme Court affirmed the Chancellor's decision not to order an American parent company to take whatever action it could to force its Mexican subsidiary to terminate litigation against one of the plaintiff's subsidiaries. The case did not involve an allegation by a stockholder of the parent that the parent board was breaching its fiduciary duties to oversee the company's operations, even at the subsidiary level. Rather, it involved allegations by a business whose interests were adverse to the aligned interests of the parent and its subsidiary. Thus the Supreme Court upheld the application of the traditional veil piercing analysis but expressly noted that the separate identities of a parent and subsidiary may be disregarded "in the interest of justice, when such matters as fraud . . . are involved" or "where equitable consideration[s] among members of the corporation require it . . . ." Id., 239 A.2d at 633 (citations omitted). See also Carlton Investments 1996 Del. Ch. LEXIS 130, at *13-*14 (if separate subsidiaries are used to divert assets to an interested director, the court will ignore the separate existences of a parent and subsidiary because to do otherwise "would simply advance a wrong").


38 Indeed, the proposed merger most likely could have been accomplished without triggering statutory appraisal rights. See, e.g., 8 Del. C. §§ 253, 262(b)(2)(a).

39 Because the Exchange took place after the Minority Stockholders complained about the Swap, it is inerferable that the Exchange was ginned up to make the Swap look fair. It is also conceivable that the Exchange was performed later so as to allow the UniHolding board to argue that it was uninvolved in the Swap, a claim that would have been even less plausible had the Swap and Exchange been effected contemporaneously.
transformation caused the Minority Stockholders real harm. Nor can one rule out the possibility that the defendants knew that the Swap would be likely to induce some or all of the Minority Stockholders to cash out for a pittance, much as Franklin had done, thereby enabling the Controlling Group to absorb the minority's stake at an unfair price.

In this respect, it is again noteworthy that the defendants apparently never considered the option of distributing ULSA shares to the Minority Stockholders proportionate to their interests in UniHolding. That option would have given the Minority Stockholders stock in a listed corporation and therefore much more liquidity and value, although it also would have cut into the Controlling Group's voting power at ULSA. Furthermore, the defendants' failure to consider this option contributes to the inference at this point that they wanted to retain as much control of ULSA as possible for themselves and put as much pressure as possible on the Minority Stockholders to sell out their stakes cheaply.

That inference is not undercut for the purposes of this motion by the fact that the Controlling Group allegedly gave the Minority Stockholders the opportunity to trade their Nasdaq-listed shares in UniHolding for illiquid securities in an unlisted BVI corporation. It may turn out that evidence introduced later in the litigation will bear out the defendants' assertion that the Swap and Exchange were in fact a fair way to balance the divergent interests of the Controlling Group and the Minority Stockholders. But for now, it is impossible to conclude that the defendants did not realize that the chance to hold a minority block in a corporation such as ULG was an offer that institutional investors who want liquidity and reliable corporate disclosures would undoubtedly refuse (in part because of their own fiduciary obligations).

In sum, the complaint pleads facts that, if true, state a claim that the defendants breached their duty of loyalty.

C. Are The Defendant-Directors Subject To Personal Jurisdiction Under 10 Del. C. § 3114?

The defendants also argue that they are not subject to this court's jurisdiction because the Swap did not involve actions they took as directors of UniHolding. As the reader might anticipate from the discussion above, I believe this argument lacks merit.

The complaint pleads that the UniHolding board actively participated in a scheme to benefit the Controlling Group to the detriment of UniHolding as an entity and its Minority Stockholders. To that end, the complaint alleges, members of the UniHolding board instigated action at
the UGL level, and other members of the UniHolding board permitted that action, even though UniHolding was UGL's 100% owner and can be presumed to have had the power to prevent UGL, UniHolding's own creation, from turning on its parent.

Thus the complaint states a claim for breach of fiduciary duty against the UniHolding board members in their capacity as UniHolding directors. This suffices to invoke this court's jurisdiction over them.40

D. Whether The Complaint Must Be Dismissed
Because Indispensable Parties Are Allegedly Not Before The Court

The defendant-directors also contend that dismissal is warranted because the plaintiffs will most likely be unable to obtain jurisdiction over UGL and Unilabs. Because the Swap is the central transaction challenged and because UGL and Unilabs were the major parties to that transaction, the defendant-directors assert that those companies are indispensable parties and that a proper balancing analysis under by Court of Chancery Rule 19(b) dictates dismissal in their absence.41

For purposes of this motion, I will assume that the plaintiffs will have difficulty obtaining personal jurisdiction over UGL and Unilabs in Delaware. Although the plaintiffs are in the process of effecting service on these foreign corporation pursuant to the relevant international treaties, the complaint fails to allege acts that transpired in Delaware. Thus, even if it can be shown that any of the defendant-directors acted as agents for UGL and/or Unilabs, jurisdiction over UGL and Unilabs is doubtful.42

40TCI II v. Johnston, mem. op at 11-12 (discussed supra); Hoover Industries, 1988 LEXIS 98, at *5-*7 (discussed supra); Carlton 1996 Del. Ch. LEXIS at *12 (if plaintiff makes a prima facie showing that a director of a Delaware corporation knew that the corporation's French subsidiary was being used to effect self-dealing transaction to the detriment of its corporate parent and "took no action as director to correct the alleged abuses," jurisdiction under 10 Del. C. § 3114 could be asserted).

41See Ct. Ch. R. 19(b) ("If [an indispensable party] cannot be made a party, the Court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent party being thus regarded as indispensable. The factors to be considered by the Court include: First, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder).

42HMG/Courtland Properties, Inc. v. Gray, Del. Ch., 729 A.2d 300, 305 (1999) (jurisdiction over a co-conspirator in a breach of fiduciary duty action cannot be predicated on 10 Del. C. § 3114 but must be based instead on an application of § 3104, which, according to the alter ego theory of personal jurisdiction, turns in part on "the existence of acts in Delaware which
Nonetheless, I conclude that this action should proceed even if UGL and Unilabs cannot be required to participate as defendants. To use the words of Rule 19(b), it would ill serve "equity and good conscience" to permit defendants who have allegedly committed breaches of fiduciary duty against stockholders of Delaware corporations to escape jurisdiction here merely because the breaches they allegedly committed to benefit non-Delaware holding entities took place outside Delaware. If this were the rule, controlling stockholders would have an incentive to create non-Delaware holding entities simply to thwart the ability of minority stockholders to obtain a reliable forum to redress fiduciary breaches.

Similarly, dismissing this case because UGL is a British Virgin Islands corporation could incentivize Delaware boards of directors to set up or use non-Delaware subsidiaries as vehicles for self-dealing transactions on the hope that Delaware's lack of jurisdiction over the subsidiaries will allow the parent board to escape accountability here. Perhaps in view of the obvious concerns raised by a contrary approach, it is not uncommon for this court to hear claims that directors of Delaware corporations have committed breaches of fiduciary duty at the behest of a majority or controlling stockholder who is not before the court. Proceeding in such a manner has never been thought unduly prejudicial, and I perceive no case-specific prejudice here.

Here, if this case gets to that point, the court can fashion an award of monetary damages that holds the defendant-directors accountable for any and only the harm that their breaches of fiduciary duty may have caused the plaintiffs. If the defendant-directors believe that Unilabs or UGL should shoulder a portion of their liability, the defendant-directors may file separate actions for contribution or indemnification against UGL and Unilabs in the domiciles of those entities. Moreover, given that director Zwirn has a considerable amount of influence over Unilabs and that Unilabs controls UGL, Zwirn has more than a slight say in whether those entities choose to participate in this action.

Nor will the defendant-directors face evidentiary prejudice because, Unilabs and UGL might be absent. Zwirn was the primary mover on behalf of these entities participating in the Swap and that he therefore possesses sufficient knowledge to ensure that there is no evidentiary unfairness to the defendant-directors in proceeding without Unilabs and UGL. Furthermore, Zwirn likely possesses the practical authority to ensure that UGL and Unilabs provide him and the other defendant-directors with any additional

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evidence they need to defend this suit, and this court can aid the defendant-directors (through the issuance of appropriate process to their domicile nations under international conventions) if he is unable to convince those corporations to do so.

The absence of prejudice to the defendant-directors is compounded by the quandary in which dismissal would put the plaintiffs. In Delaware, the plaintiffs can obtain jurisdiction over the entire UniHolding board. It is unclear whether jurisdiction over the whole board can be had elsewhere, and even if it could be had in, for example, the British Virgin Islands, there is no just reason why the plaintiffs should be forced to litigate against the directors of a Delaware corporation in another forum.43

For all these reasons, I conclude that the relevant interests at stake weigh in favor of denying the defendant-directors' motion to dismiss pursuant to Court of Chancery Rule 19.

III. Conclusion

Based on the foregoing, the motion to dismiss is DENIED, except that the plaintiffs' claim for monetary relief against the defendant-directors other than Zwirn, Gherardi, and van Gemerden based on their breaches of duty of care is HEREBY DISMISSED. IT IS SO ORDERED.

43Sternberg v. O'Neill, 550 A.2d at 1123 ("Delaware has an interest in holding accountable those responsible for the operation of a Delaware corporation"); Carlton Investments, 1996 Del. Ch. LEXIS 130, at *17 ("As has been noted in the past, actions involving claims that a director has breached his fiduciary duties to a Delaware corporation are of special concern to this Court. Section 3114 recognizes the strong interest that this Court has in assuring the effective administration of the law governing corporations organized in Delaware and, therefore, in hearing cases regarding internal corporate governance issues.") (internal citation omitted).
LAMB, Vice Chancellor

I. INTRODUCTION

In October 1997, the largest holder of Kenetech Corporation common stock advised Kenetech's President and CEO, Mark D. Lerdal, who was also a director, that it was "shopping" its 12.8 million share block (over 30% of the common outstanding) and meant to sell those shares by year-end. The other directors also learned of these facts and considered purchasing the shares jointly. They and Lerdal also knew that the block could be acquired at a nominal price. Without formally meeting to analyze Kenetech's options, the directors failed to cause Kenetech to take advantage of the opportunity to buy those shares. Rather, in December 1997, Lerdal purchased the shares for a mere $1,000.

Plaintiffs Robert L. and Louise A. Kohls, who are Kenetech stockholders, filed this derivative action on February 3, 2000, seeking to enforce the company's right to purchase those shares. The Kohls assert that the 12.8 million Kenetech shares were worth far more than $1,000 when purchased from Hillman and are now valued at over $8.2 million. The Kohls allege that the opportunity to buy the shares belonged to Kenetech and that Lerdal breached his duty of loyalty by appropriating it for himself. They also claim that the other directors breached their fiduciary duties to Kenetech by their acquiescence in Lerdal's action and their failure properly to pursue and protect Kenetech's interests in exploiting the opportunity presented.
By the time the Kohls filed this action, two of the directors had resigned from the Kenetech board and been replaced with new outside directors. A third, Charles A. Christenson, remained on the Kenetech board.

The defendants in this action filed a motion to dismiss for failure to state a claim and failure to comply with the demand requirement of Rule 23.1. For the reasons set forth below, I deny defendants' motions.

II. FACTUAL BACKGROUND

A. Parties

Plaintiffs Robert L. and Louise A. Kohls have purportedly been Kenetech stockholders at all times relevant to this action.

Nominal Defendant Kenetech is a Delaware corporation with its principal office in San Francisco, California. As of October 30, 1999, Kenetech had 41,919,218 outstanding shares of common stock. The Hillman Company, which is not a party to this action, held about 30% of those shares at the time of the events described herein.

Defendant Mark D. Lerdal has been a Kenetech director and its President and CEO, since 1996. In 1997, Lerdal received a substantial cash severance payment from Kenetech. He was not, however, terminated.

Defendant Charles A. Christenson is now and has since 1980 been a Kenetech director. Defendants Angus M. Duthie and Gerald R. Alderson were the other two board members at the time of the matters alleged, but terminated their directorial roles as of August 18, 1999. Duthie and Alderson were replaced on the Kenetech board by two outside, independent directors.

B. The Hillman Offer

Kenetech historically operated in the electric utility market. Beginning in 1995, Kenetech's business deteriorated significantly. Over time, Kenetech sold off most of its assets and ceased most of its operations.

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2As I noted during oral argument, such arrangements are not unheard of and, if properly approved, are presumably valid.
In June 1996, Kenetech defaulted on $99 million worth of its Senior Notes. Thus, Kenetech faced the threat of an involuntary bankruptcy.

In October 1997, a Hillman representative contacted Lerdal, stating that it was prepared to sell its approximately 13 million Kenetech shares for a nominal price. Lerdal expressed his personal interest in such a transaction. Another Hillman representative contacted one or more of the other directors who then discussed the possibility of all four Kenetech directors jointly purchasing the shares. Lerdal discouraged these discussions.3

In December, Hillman again contacted Lerdal and told him that Hillman had not found a buyer. Lerdal agreed to buy the shares for $1,000 and the transaction closed before year-end.4 Plaintiffs allege that at the then-trading price of $0.065, those shares were valued at over $800,000. It is alleged that the board never met to consider whether Kenetech could or should take the opportunity to purchase the shares itself. It is alleged, however, that Lerdal told the other directors, outside the context of a board meeting, that Kenetech could not purchase the shares for a variety of reasons, all relating to its poor financial condition. These reasons included: the prohibition found in §160(a)(l) of the Delaware General Corporation Law against a corporation repurchasing shares at a time when its capital is impaired, restrictive covenants found in Kenetech's Senior Notes, and certain protective provisions of Kenetech's charter relating to a series of preferred stock denominated as PRIDES.5 The complaint alleges that since The board never met to consider the question of repurchasing the block of shares, it never obtained independent legal, financial or accounting advice on the subject. Plaintiffs also allege that the reasons identified by Lerdal did not, in fact, prevent Kenetech from purchasing the shares.

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3Vice Chancellor Steele found that when the other directors wanted to participate in the opportunity, "Lerdal resisted on the grounds that director Alderson and Hillman Co.'s representatives were on bad terms." Quadrangle at 14.

4Vice Chancellor Steele quoted Lerdal's surprisingly blunt testimony about how he closed the stock purchase with Hillman in December 1997:

'I got a call from Mark Laskow [Hillman's representative], who said, 'We haven't been able to dump these things.'
I said, 'Well, I would be interested in buying them.'
He said, 'Okay.'
And I said, 'What do you want me to pay?'
He said, 'A thousand bucks, $5,000. It's sort of irrelevant.'
I said, 'I'll pay a thousand.'
And that is how the negotiation went."
Quadrangle at 15 (emphasis in original).

5"PRIDES" is an acronym referring to Kenetech's Preferred Redeemable Increased Dividend Equity Securities.
C. The Eco-Electrica Sale

By the time of Hillman's offer, Kenetech had sold-off a large part of its assets but retained its one-half interest in an electric plant project called Eco-Electrica.\(^6\) In December 1997, just prior to the challenged stock purchase, Kenetech obtained construction financing for the project, thus increasing its value significantly. In December 1998, Kenetech closed a sale of its Eco-Electrica interest, realizing $2.52 million in the transaction. Kenetech's market value has risen accordingly. Thus, Lerdal's shares purchased from Hillman for $1,000 are now worth well over $8 million.

III. THE PARTIES' CONTENTIONS

The defendants moved to dismiss the complaint on the ground that the demand upon the board required by Court of Chancery Rule 23.1 was neither made nor excused. Defendants concede Lerdal's interest in a demand but argue that the other 3 members of the 4-man board of directors are disinterested and independent and, therefore, demand was required. Defendants point out that half of the Kenetech board at the time of Lerdal's stock purchase has been replaced and argue that plaintiffs fail to show that Christenson is either interested in that transaction or controlled by Lerdal.

Defendants also moved to dismiss the complaint for failure to state a valid corporate opportunity claim, relying on the Delaware Supreme Court's opinion in *Braz v. Cellular Information Systems, Inc.*\(^7\) First, they say, Kenetech's capital was impaired, so it could not statutorily repurchase its own shares.\(^8\) Second, the provisions of its debt instruments prevented a repurchase. Third, the PRIDES Certificate of Designations prevented Kenetech from repurchasing any of its common shares at a time the PRIDES dividends were in arrears. Finally, defendants argue, Kenetech had no expectancy in the opportunity. For each of those reasons, Lerdal could purchase the shares without concern for Kenetech's interest therein.

Plaintiffs counter by arguing that Lerdal's usurpation of the extraordinary opportunity for Kenetech to repurchase one-third of its shares for nominal consideration (and the other directors' complicity in the same) evidences faithless conduct. Plaintiffs argue that Kenetech's capital was

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6Though not directly pertinent to this Opinion, the Notes holders agreed not to force Kenetech into bankruptcy because of their understanding that by allowing Kenetech to obtain certain financing and regulatory approval for this project, the amount Kenetech could realize in any sale would increase substantially, thus making more likely a full satisfaction of the debt.


8See 8 Del. C. § 160.
impaired only because it carried its Eco-Electrica investment at a mere $19.5 million book value. The directors knew that Eco-Electrica's fair value was at least $200 million and that a revaluation would produce over $48 million in surplus.

Plaintiffs also claim that no properly motivated director would believe that either the preferred stockholders or the Senior Notes holders would have prevented Kenetech from making a $1,000 purchase of one-third of its stock. First, the PRIDES holders had an interest in seeing the purchase made because they were imminently confronting a mandatory conversion into common.9 Second, since the board had already obtained the Senior Notes holders' consent to over $1 million in bonus payments to Kenetech's officers, it stood to reason that they would allow a mere $1,000 payment to buy the stock. In any event, since Kenetech was already in default, plaintiffs' contend that those holders could attain no additional rights by virtue of an unauthorized $11,000 share repurchase. Further, plaintiffs argue, even if the PRIDES holders' and Senior Notes holders' respective cooperation could not be presumed, the opportunity to buy one-third of the company for $1,000 provided such a great benefit to Kenetech's stockholders that the board was required to efficiently breach those contracts.

Plaintiffs then argue that demand was excused at the time they filed their complaint because there was not a disinterested and independent majority of directors on whom to make such a demand. Lerdal is concededly conflicted because he actually bought the stock. Christenson is also conflicted, plaintiffs argue, because of his knowledge of the operative facts and his failure (and that of defendants Duthie and Alderson) to take steps to protect the interests of Kenetech in making the purchase.

IV. ANALYSIS

A. Standards

In order to survive a motion to dismiss under Court of Chancery Rule 12(b)(6), the complaint must allege facts that, if true, establish every element of a claim upon which relief can be granted.10 For Rule 12(b)(6)

9As discussed in greater detail in the Companion Opinion and in Quadrangle, the PRIDES holders faced a mandatory conversion of their preferred shares to common stock on May 14, 1998. Thus, their interest was consonant with the common stockholders' interest in consolidating their pro rata ownership of the corporation.

purposes, a complaint need only provide "a short and plain statement" of the facts supporting relief.\(^1\)

Plaintiffs sue derivatively but did not make a pre-suit demand on the board. Rule 23.1 requires that the complaint allege "with particularity," the justification for not making a demand.\(^2\) This heightened pleading standard exists because "the derivative suit impinges on the managerial freedom of directors."\(^3\) In order to assert a claim on behalf of the corporation, a plaintiff stockholder must show that "the directors are under an influence which sterilizes their discretion"\(^4\) or "are incapable of making an impartial decision regarding such litigation."\(^5\)

In *Aronson v. Lewis*, the Delaware Supreme Court articulated a two-part test for demand excusal: as a general rule, demand is excused where the complaint alleges, with particularity, facts that establish a reasonable doubt that either (a) the directors are disinterested and independent, or (b) the challenged transaction is otherwise the product of a valid exercise of the directors' business judgment.\(^6\)

Central to this analysis is the operation of the business judgment rule. This is self-evident as to the second prong. But it is equally true of the first. "As to the [first prong] inquiry, directorial independence and disinterestedness, the court reviews the factual allegations to decide whether they raise a reasonable doubt, as a threshold matter, that the protections of the business judgment rule are available to the board."\(^7\) Relatedly, the *Aronson* court also pronounced that the mere fact that directors would be asked to sue themselves is not a basis for excusing demand.\(^8\) Nor is it sufficient to allege that the directors had voted to approve the transaction at issue.\(^9\) Rather, the complaint must allege "specific facts establishing that 'the potential for liability is not 'a mere threat' but instead may rise to 'a substantial likelihood.'"\(^10\) These general statements may be seen as flowing from the premise that, where business judgment protection is available, a mere threat of personal liability

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\(^{1}\) Ct. Ch. R. 8(a).
\(^{4}\) Id. at 814.
\(^{6}\) *Aronson*, 473 A.2d at 814.
\(^{7}\) Id.
\(^{8}\) Id at 815; see also *Brehm*, 746 A.2d at 257 n. 34.
\(^{9}\) *Aronson*, 473 A.2d at 817.
resulting from one's participation as a director in approving a transaction should not suffice to sterilize a director's discretion. The *Aronson* court ruled as follows:

In sum the entire review is factual in nature. The Court of Chancery in the exercise of its sound discretion must be satisfied that a plaintiff has alleged facts with particularity which, taken as true, support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment. Only in that context is demand excused.

While *Aronson*'s focus on the business judgment rule serves well in most cases, the Delaware Supreme Court has recognized, most notably in *Rales v. Blasband*, the existence of situations in which the *Aronson* analysis cannot apply. This is so, for example, "where the absence of any action or decision on the part of the board to which the demand would be addressed makes it impossible to perform the essential inquiry contemplated by *Aronson*" — whether the presumption of the business judgment rule applies to the challenged transaction. Pertinently, the *Rales* court concluded that the *Aronson* test should not be applied "where the subject of the derivative suit is not a business decision of the board."

Of course, recognizing that the *Aronson* test cannot be applied in a given situation does not lead the conclusion that demand is excused. Rather, as the Supreme Court said in *Rales*:

Instead, it is appropriate in these situations to examine whether the board that would be addressing the demand can impartially consider its merits without being influenced by

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21In *Brehm*, the Supreme Court overruled this aspect of *Aronson* and its progeny, holding that *de novo* review applies to a Rule 23.1 analysis. *Brehm*, 746 A.2d at ( ).
25Id. at 934. *Rales* also recognized that the *Aronson* test cannot be applied "where a business decision was made by the board of a company, but a majority of the directors making that decision have been replaced" by the time the complaint is filed. *Id.* at 934. Here, only 2 of the 4 directors had been replaced in the interim period. Thus, all other things being equal, the *Aronson* test could still be applied in this case to assess whether the remaining directors — Lerdal and Christenson — are "conflicted" for purposes of considering a demand. Finally, *Rales* recognized that the *Aronson* test should not apply where "the decision being challenged was made by the board of directors of a different corporation." *Id.*
improper considerations. Thus, a court must determine whether or not 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 a demand. If the derivative plaintiff satisfies this burden, then demand will be excused as futile.26

It has been observed that this "simple and straightforward inquiry would seem to be the very issue that Aronson, in its more mechanical and roundabout way, was intended to resolve."27 Moreover, because this formulation is one of general application (and can as easily be applied in the business judgment rule context addressed in Aronson), "it is arguable that the current state of the law is conceptually inverted and that it would be both simpler and more direct to regard the original Aronson analysis as a subpart of the more generally applicable and flexible principle set forth in Rales."28

For present purposes, I need not wrestle with this last observation because I am persuaded by my review of the amended complaint and the parties' arguments that the Kenetech board of directors did not make a business decision in 1997 regarding the purchase of the Hillman block of shares by either Kenetech or Lerdal. Thus, the Aronson test is irrelevant and I will analyze the demand issue under the standard articulated in Rales — whether the board can consider a demand "without being influenced by improper considerations."29

B. Can a Majority of the Kenetech Board Consider a Demand?

It is uncontested that half of the present board is presumed capable of impartially considering a demand. It is equally clear that Lerdal is conflicted from doing so. The question of demand futility thus turns on Christenson.30

26 Id. at 934 (emphasis added).
28 Id.
29 Rales, 634 A.2d at 934.
30 See Beneville v. York, Del. Ch., C.A. No. 17638, Strine, V.C. (Jul. 10, 2000) (holding that where half the board is conflicted, demand is excused).
1. Is Christenson Beholden to Lerdal?

Plaintiffs acknowledge that Christenson was not financially interested in Lerdal's stock purchase. Nevertheless, arguing by analogy to the first prong of *Aronson*, plaintiffs say that Christenson is "beholden" to Lerdal and, thus, not independent. "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." Thus, plaintiffs must show facts tending to suggest that Christenson is so dependent on Lerdal (ordinarily by virtue of financial, familial or other relationships) as to "sterilize" his ability to consider a demand in this case.

Plaintiffs present two reasons that allegedly prove Lerdal's domination of Christenson. First, they point to Christenson's vote in favor of Lerdal's generous severance agreement that was paid to Lerdal despite the fact that he did not leave or change his job with the company, and that provided for Kenetech to pay his taxes with respect to that benefit. I cannot conclude that Christenson's vote on this matter shows his domination by Lerdal. First, agreements of this nature are not entirely uncommon and there is nothing inherently improper about them. More importantly, Christenson, an outside director, was simply one of a unanimous board (other than Lerdal) to approve the transaction. Finally, Christenson's ability to control or influence control over Lerdal's compensation would ordinarily be more suggestive of his domination and control over Lerdal, not the opposite inference suggested by plaintiffs here.

Plaintiff's second argument is that Christenson's conduct with respect to the challenged transaction is so inexplicable that it supports an inference that Lerdal controls him. I agree that the unusual nature of the corporate opportunity described in the complaint is properly considered in weighing whether or not Christenson is "conflicted" for purposes of considering a demand. However, this argument will be considered as part of the second part of my *Rules* inquiry, discussed below.

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31*Rales*, 634 A.2d at 936.
32*Aronson*, 473 A.2d at 816.
35*See Rules*, 634 A.2d at 937 (holding that director whose substantial compensation from his position with a different corporation may be controlled by an interested defendant is considered beholden, and conflicted from considering a demand).
2. Is Christenson "Interested" in the Demand Itself?

Although Christenson is neither interested in the challenged transaction nor beholden to Lerdal, the demand futility analysis is not complete. Is Christenson, by virtue of a "substantial threat" of personal liability, interested in the decision to bring the litigation, so as to leave him conflicted from impartially evaluating a demand?\(^\text{36}\) On the basis of the matters properly alleged in the complaint, I conclude that he is.

This case presents a highly unusual set of facts that color my decision on this motion. The complaint does not allege merely the opportunity to repurchase shares of stock at market price. Rather, the complaint alleges the forfeiture or usurpation of an opportunity for the corporation to realize a substantial windfall for the benefit of its stockholders.

- The company's CEO learned that its 30% shareholder was anxious to sell its position and was willing to do so for next to nothing. The CEO wanted to buy the shares \textit{himself}. The other members of the board of directors also learned of this opportunity and jointly considered purchasing it, \textit{in their personal capacities}.

- The CEO consulted with counsel and gave the other directors a series of reasons why the company could not buy the shares. The complaint alleges (in a conclusory fashion) that these reasons were false on their face and could not have been believed by the others, including Christenson.\(^\text{37}\) Moreover, it is alleged that Christenson (and, I infer, the board as a whole) "failed to obtain competent legal, financial or accounting advice." The CEO then convinced the

\(^{36}\)In a way, this inquiry is related to the second prong of the \textit{Aronson} test. Under \textit{Aronson}, the court determines whether the defendant will enjoy the protection from liability that exists when the business judgment rule stands unrebutted. If those protections will not apply, the court will infer that the director will be unable to consider impartially the corporation's interest in bringing the litigation because of his own interest in avoiding that litigation. Relatedly, when there is no challenge to a business \textit{judgment}, as is the case here, the question becomes whether the director faces a substantial threat of personal liability \textit{due to his alleged conduct or lack thereof}.

\(^{37}\)The fact that the complaint is not particularly pleaded in this regard does not require dismissal. Rather, I consider only the particularly pleaded facts in the complaint, and analyze whether, as a matter of law, the hurdles identified by Lerdal are valid.
others to let him take the deal alone. *Those shares were allegedly worth many times the price paid for them, and are now worth over 8,000 times their cost to the CEO.*

Plaintiffs argue that Christenson faces a substantial threat of personal liability because his "inexplicable indifference to the interests of the Company in this matter... implicate[s] his duty of loyalty to Kenetech and... amounts to bad faith..." Plaintiffs also argue that a "director's duty of loyalty may also be implicated where directors who do not benefit from a transaction nevertheless act with 'indifference to their duty to protect the interests of the corporation and its minority shareholders.'" 38 Put simply, plaintiffs assert that no properly motivated director could have perceived this corporate opportunity and not thoroughly inquired into the company's ability to exploit it.

Later in this opinion, I deny defendants' motion to dismiss the complaint for failure to state a claim for usurpation of a corporate opportunity. Suffice it to say for now that I am satisfied that the complaint does state a claim against all of the defendants relating to Lerdal's alleged usurpation of a corporate opportunity. Even applying Rule 23.1's heightened pleading standard, I conclude that the allegations of the complaint, if true, would establish that Christenson faces a "substantial likelihood" 39 of personal liability for breach of fiduciary duty and aiding and abetting Lerdal's breach of duty. 40

In *Broz v. Cellular Information Systems, Inc.*, the Supreme Court made clear that the failure to *formally* present an opportunity to the corporate board cannot be the sole basis for imposing liability. 41 I take this to mean that, by analogy, a board's failure formally to consider an opportunity does not, alone, amount to a breach of duty on the directors' part. Nevertheless, the Kenetech board's apparent acceptance of Lerdal's assertions at face value, without conducting any independent analysis or seeking independent advice, tends to show a disregard for corporate

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40Defendants assert that because this court can simply require Lerdal to transfer the shares to the company as a remedy, Christenson does not face personal liability. Defendants misinterpret the complaint, which clearly requests, to the extent the stock cannot be transferred, that *all of the defendants* be held *jointly and severally liable* to Kenetech.

interests. After all, independent accountants and lawyers may have been able to structure an acceptable transaction for Kenetech.

In the context of the well-pleaded allegations of the complaint, particularly the highly valuable nature of the opportunity to Kenetech and its stockholders, I am satisfied that Christenson is "conflicted" for purposes of considering a demand. Since only half of the present board is capable of impartially considering a demand, such exercise is excused as futile.

C. Does the Complaint State a Claim for Usurpation of a Corporate Opportunity?

Giving fair consideration to the arguments of the parties, I conclude that the complaint states a claim upon which relief can be granted, within the meaning of Rule 12(b)(6). Thus, I do not accept, at this stage of the proceedings, defendants' multiple explanations why the corporate opportunity doctrine is not relevant to this case.

The basic framework of Delaware's corporate opportunity doctrine was laid down by the Delaware Supreme Court in Guth v. Loft, Inc., as follows:

if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself. 42

Of course, as the Supreme Court recently recognized, because corporate opportunity cases arise in widely varying factual contexts, "[h]ard and fast rules are not easily crafted to deal with such an array of complex situations."43

The peculiar facts of this case, involving a particularly striking "opportunity" for the corporation to benefit its stockholders, would seem to present a sufficiently substantial question of fiduciary misconduct to survive a motion to dismiss. Defendants advance several arguments,

however, that they say require dismissal. First, defendants argue that because Kenetech did not have in place any policy or plan for repurchasing its stock, Kenetech had no cognizable expectancy in the Hillman offer. Next, defendants say that Section 160 of the DGCL, the contractual limitations in the Notes and the PRIDES Certificate of Designations barred Kenetech from repurchasing its own shares. Finally, defendants assert that the opportunity was presented to Lerdal in his individual capacity and not as a director. I take each argument in turn.

1. Kenetech's "Expectancy" in the Opportunity

First, defendants argue that the Hillman offer was not the type of opportunity that Delaware law requires be presented to the corporation. Defendants say that because Kenetech had no share repurchase program in effect, Hillman's offer did not constitute an opportunity in the (company's line of business. Defendants cite to Equity Corp. v. Milton, which can be read to stand for the proposition that a corporation may have no expectancy in receiving an opportunity to buy a block of its own stock at market prices. Unsurprisingly, neither that case nor any other holds that a Delaware corporation has no expectancy in being presented with an opportunity to repurchase a large block of its own stock for little or no consideration (thus providing nearly cost-free returns to its stockholders). And I need no authority to conclude otherwise.

The question, then, is whether plaintiffs allege that Kenetech could have taken advantage of that opportunity.

2. Section 160

A Delaware corporation may not repurchase its own shares "when the capital of the corporation is impaired or when such purchase or redemption would cause impairment of the capital of the corporation." A surplus exists (meaning that the capital is not impaired) when the net assets of a corporation exceed its total liabilities. Defendants argue that Kenetech's capital was impaired in the amount of $131,710,000. Thus, Kenetech could not purchase Hillman's shares even if it wanted to do so.

At first blush, this is a substantial impediment to Kenetech's ability to take advantage of the opportunity presented. Nevertheless, the well-

45§ Del. C. § 160(a)(1).
46§ 154.
pleaded allegations of the complaint, taken as true, show that this balance sheet capital account deficit would not have prevented Kenetech from acting. This is so because the Eco-Electrica project was being carried at a low book value and, it is alleged, Christenson and the rest of the board believed that its actual worth could exceed $200 million. Further, on December 15, 1997, Kenetech obtained financing for the project, thus making more likely an ultimate realization of a substantial sale price for the asset.

The complaint alleges that if the board revalued its assets to reflect the market value of Eco-Electrica, it could have eliminated the capital deficit and, thus, avoided the obstacle to a repurchase presented by Section 160(a). Certainly, a corporation may "revalue properly its assets and liabilities to show a surplus and thus conform to the statute."47 For these reasons, neither Lerdal nor the other defendants can claim at this stage that Section 160 really represented a barrier to a $1,000 stock repurchase by Kenetech.

3. The Senior Notes Restriction

Because of its default in payment on the Senior Notes, Kenetech was contractually restricted from repurchasing its own shares for value. Defendants argue that this contractual provision barred Kenetech from taking advantage of the Hillman offer. Yet, the Senior Notes holders had already waived their rights in allowing bonus payments in excess of $1 million to Kenetech's officers. Thus, the complaint alleges, there was reason to believe that the holders of the Senior Notes would not have objected to Kenetech's paying $1,000 to repurchase the Hillman block of common stock. Additionally, the restrictions found in the Senior Notes Indenture are not necessarily as forbidding as defendants suggest. For example, Kenetech could complete "any purchase or redemption . . . made by exchange for, or out of the substantially concurrent sale of, Capital Stock of the Company."48 At least at this stage of the proceeding, it is fair to infer that some means of effectuating the transaction without violating the Senior Notes Indenture could have been arranged by a properly motivated and counseled board of directors.

I recognize that in Broz, the Supreme Court held on post-trial appeal that the corporation could not take the opportunity presented, in part because certain note restrictions "severely limited the discretion of CIS as

to the acquisition of new assets and substantially restricted the ability of
CIS to incur new debt."49 That may, ultimately, prove to be the case here
too. But in the context of this motion to dismiss, I draw a contrary
inference based on the well-pleaded allegations of the complaint and the
terms of the Indenture.50

4. The PRIDES Certificate

Since Kenetech was in arrears in paying dividends on the PRIDES,
Kenetech was prohibited by Section 2(c) of the PRIDES Certificate of
Designations from repurchasing its own shares. Pertinently, this provides
that "no shares of any Junior Stock may be purchased, redeemed, or
otherwise acquired by the Corporation or any of its subsidiaries (except in
connection with a reclassification or exchange of any Junior Stock through
the issuance of other Junior Stock . . . )" whenever full dividends on the
PRIDES have not been paid.

Of course, reliance on this provision to require dismissal of
plaintiffs' claim requires a certain ironic sensibility. The restriction against
common share repurchases was undoubtedly included in the PRIDES
certificate to protect the holders of those "senior" securities against
depredation by the "junior", i.e., common, stockholders. Yet, based on the
well-pleaded allegations of the complaint, I must conclude at this stage of
the proceedings that the PRIDES holders were substantially harmed by
Kenetech's failure to purchase the Hillman block of shares. This is so
because the PRIDES were facing mandatory conversion into common
shares on May 14, 1998. Had the repurchase and retirement of the Hillman
block reduced the amount of outstanding common, the PRIDES holders
would have received in the mandatory conversion a substantially greater
percentage of the common equity.

As with the Senior Notes Indenture, I am unable, at this stage of the
case, to conclude with assurance that the PRIDES Certificate of
Designation presented such an obstacle to Kenetech's repurchase of the
Hillman block as to require dismissal. In this regard, I rely in part on the
fact that the PRIDES Certificate is a part of the corporation's Certificate of
Incorporation and is subject to amendment in accordance with Section 242
of the DGCL. Defendants are correct that a repurchase in violation of the

49Del. Supr., 673 A.2d at 155.
50Because I reach this conclusion, I find it unnecessary to address plaintiffs' argument
that the directors' fiduciary duties might have required them to authorize a breach of either the
indenture or the PRIDES certificate of designation as a matter of economic efficiency.
Certificate would constitute an *ultra vires* act. However, as plaintiffs point out, Kenetech could have tried to get an amendment of the Certificate between October and December 1997. Alternatively, had the board actually considered its options and obtained advice, skilled counsel might have suggested some other mechanism to avoid the problems posed by the Certificate. Put simply, the Certificate does not present such a clear barrier to taking the opportunity as to require dismissal of the complaint. Rather, plaintiffs must be given the opportunity to prove their allegation.

5. The Capacity in which Lerdal Received the Offer

The complaint does not expressly allege that Lerdal became aware of the opportunity to purchase the Hillman block in his capacity as a President and CEO of Kenetech. Nevertheless, considering all of the relevant well-pleaded allegations of the complaint, it is fair to draw such an inference. For example, paragraph 12 alleges that "On or about October of 1997, Lerdal was advised that a stockholder of Kenetech, Hillman Company, was shopping the [block] and was going to sell [it] in 1997." The same paragraph goes on to allege that "the other individual Defendants were also advised that the [block] was for sale and considered jointly purchasing it."

When questioned at oral argument, defendants' counsel properly conceded that in the circumstances, it is reasonable to infer that the offer was made to Lerdal *specifically because* he was the President and CEO of the Company. Thus, I will not consider this argument further.

* * *

For the reasons stated above, plaintiffs adequately allege against Lerdal a claim for improper usurpation of a corporate opportunity. For the same reasons, I conclude that it states a claim for relief against the other defendants who knowingly acquiesced in Lerdal's alleged usurpation and failed to take steps to protect Kenetech's interest in purchasing the shares itself.

V. CONCLUSION

In summary, plaintiffs have established that demand under Court of Chancery Rule 23.1 is excused because they have shown that half of the present Kenetech board is unable to impartially consider any such demand. Further, I conclude that the complaint states a claim upon which relief may
be granted against each person named as a defendant. Accordingly, I have
today entered the attached order denying the motion to dismiss in all
respects. Counsel are directed to confer and to report to the Court within
thirty (30) days on a schedule for the disposition of this matter.

ORDER

For the reasons stated in the Court's Memorandum Opinion dated
July 26, 2000, the defendants' Motion to Dismiss IS HEREBY DENIED.

LEONARD LOVENTHAL ACCOUNT v. HILTON HOTELS CORP.

No. 17,803

Court of Chancery of the State of Delaware, New Castle

October 10, 2000

Michael Hanrahan, Esquire, Gary F. Traynor, Esquire, and Paul A.
Fioravanti, Jr., Esquire, of Prickett, Jones & Elliott, Wilmington, Delaware;
and Terry Rose Saunders, Esquire, Chicago, Illinois, of counsel, for
plaintiff.

Jesse A. Finkelstein, Esquire, and J. Travis Laster, Esquire, of Richards,
Layton & Finger, Wilmington, Delaware, for defendant.

CHANDLER, Chancellor

This lawsuit challenges a "poison pill" Rights Agreement (the
"Rights Plan" or, simply, the "Plan") between defendant Hilton Hotels
Corporation and ChaseMellon Shareholder Services L.L.C. adopted by the
Hilton board of directors on November 29, 1999. Plaintiff Leonard
Loventhal Account (the "Trust") brings the action individually and as a
class action on behalf of all holders of Hilton common stock on
November 29, 1999. The complaint asserts five claims related to the Rights Plan. Pending before me is defendant Hilton's motion to dismiss.

The Delaware courts first examined and upheld the right of a board of directors to adopt a poison pill rights plan fifteen years ago in Moran v. Household International, Inc. Since that decision, others have followed which affirmed the validity of a board of directors' decision to adopt a poison pill rights plan. Today, rights plans have not only become commonplace in Delaware, but there is not a single state that does not permit their adoption.

Plaintiff does not challenge recent innovations found in the Rights Plan, such as the flip-in feature, the grand-fathering provision, or the exchange option, all developed since the announcement of Moran fifteen years ago. Rather, plaintiff challenges five fundamental aspects of the Rights Plan, four of which have existed since the earliest days of the poison pill.

The plaintiff asserts that: (i) the Rights Plan is not a valid and enforceable contract between Hilton and Hilton's common stockholders (the "Stockholders") because the Stockholders are not a party to or bound by the Rights Plan ("Claim I"); (ii) the Rights Plan imposes transfer restrictions on Hilton common stock in violation of 8 Del. C. § 202 and Hilton's by-laws ("Claim II"); (iii) Hilton has violated section 158 of the Delaware General Corporation Law (the "DGCL"), 8 Del. C. § 158, Hilton's by-laws (the "by-laws"), and 6 Del. C. § 8-401 by not issuing "clean" and unlegended stock certificates for shares of Hilton common stock upon request ("Claim III"); (iv) the Rights Plan violates 8 Del. C. §§ 151 and 242 by altering all shares of Hilton common stock and the rights of the holders of those shares without an amendment of Hilton's certificate of incorporation ("Claim IV"); and, (v) the Rights Plan violates 8 Del. C. §§ 102(b)(7) and 141(a) and Hilton's certificate of incorporation by attempting to eliminate any liability that may accrue to the Hilton board

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of directors (individually, the "Hilton Directors" and collectively, the "Hilton Board") ("Claim V").

Hilton has moved to dismiss the complaint. It relies primarily on the doctrine of *stare decisis* and the established line of cases beginning with *Moran*, discussed in greater detail below, to argue for the dismissal of Claims I, II, III, and IV. Alternatively, Hilton contends that the plaintiff fails to state a claim upon which relief can be granted. Hilton has moved to dismiss Claim V based on the approval of similar provisions by the Delaware courts. Hilton also argues that each claim is barred by the equitable doctrines of acquiescence and laches. The plaintiff has cross-moving for summary judgment on Claim I.

For reasons more fully described below, I grant Hilton's motion to dismiss in its entirety, thereby rendering plaintiffs motion for summary judgment on Claim I moot.

I. FACTUAL BACKGROUND

The plaintiff, the Trust, has been a holder of Hilton common stock from before November 29, 1999, the date that the Rights Plan was adopted by the Hilton Board, to the present. Hilton is a Delaware corporation that owns, franchises, and manages hotels worldwide. Its total market capitalization is approximately $4 billion. The Hilton Board is composed of 14 members, all elected to 3 year terms.

The Rights Plan, adopted by the Hilton Board on November 29, 1999, is actually the third such agreement Hilton has entered into. The Hilton Board first adopted a rights plan on July 14, 1988 (the "1988 Plan"), valid for ten years until it expired on July 27, 1998. On July 9, 1998, in anticipation of the expiration of the 1988 Plan, the Hilton Board adopted a second rights plan (the "1998 Plan") that would also be valid for ten years until July 27, 2008. The 1998 Plan included among its terms a provision that the 1998 Plan would terminate if Hilton entered into a merger or other acquisition that was approved by the Hilton Board.

On September 8, 1999, Hilton announced that it had entered into an agreement and plan of merger dated September 3, 1999, with Promus Hotel Corporation ("Promus"). Under the terms of the 1998 Plan, the closing of the Hilton-Promus merger would terminate that plan. As a result, on November 29, 1999, the Hilton Board adopted the current Rights Plan. The parties to the Rights Plan were Hilton and ChaseMellon Shareholder Services L.L.C. as Rights Agent. On November 30, 1999, the stockholders of Hilton and Promus voted in favor of the merger. The merger became effective later that day.
As the popularity of the poison pill defense has grown among Delaware directors over the past fifteen years, plans once described as "novel and complicated" have become increasingly commonplace and rudimentary. Presently, practitioners can look to numerous corporation law guides and treatises for examples and explanations of the basic provisions and forms of this popular takeover defense mechanism. Claims I, II, III, and IV involve provisions of the Rights Plan that are commonly found in many, if not most, models of poison pill rights plans. Claim V challenges a provision that is less common in rights plans, but common in other types of agreements often entered into by Delaware corporations.

The Rights Plan has a structure similar to many other poison pill rights plans that have been adopted since Moran. Under the Rights Plan, each shareholder receives in the form of a dividend authorized by the Hilton Board one preferred share purchase right (a "Right" held by a "Right Holder") for each share of common stock outstanding as of November 30, 1999. Initially, the Rights attach to Hilton's outstanding common shares (the "Hilton common shares"), and each Right entitles the holder to purchase for $80 one one-hundredth of a share of Series A Junior Participating Preferred Stock (the "Preferred Stock") having the rights, powers and preferences set forth in the Certificate of Designations. Upon the occurrence of certain triggering events, including the acquisition of 20 percent or more of Hilton common stock by any person or affiliated group, the Rights entitle the Right Holder to purchase two shares of Hilton common stock or other securities at half-price. This is designed to massively dilute the holdings of the unwanted, potential acquirer.

The genesis of this lawsuit is intriguing. It was precipitated by an exchange of correspondence following the adoption of the Rights Plan by the Hilton Board. On November 30, 1999, Steven F. Bollenbach, the president and chief executive officer of Hilton, sent a letter to each Hilton stockholder informing them of the Rights Plan (the "Bollenbach Letter") and enclosing the Summary of Rights to Purchase Preferred Shares (the

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4 See, e.g., Bryan, The Delaware Law of Corporations & Business Organizations at 3-33, 3-93 to 94, 3-147, 3-196 (includes the rights plans of Cooper Tire & Rubber Company, Service Merchandise Company, Inc., Ben & Jerry's Homemade, Inc., and Barnes & Noble, Inc.).
"Summary of Rights"). In this letter, Bollenbach stated that the Rights Plan had been adopted by the Hilton Board and that "[t]his new plan is substantially similar to the prior plan with changes deemed appropriate as a result of the Promus merger." The letter continued,

[n]o action on your part is required at this time, and no money should be sent to Hilton. The rights will automatically attach to the shares of Common Stock you hold and will trade with them. There is no need to send in your certificates to have this reference added. You will be notified if the Rights are ever triggered and become exercisable.7

In response to this letter and the attached Summary of Rights, the Trust wrote back to Bollenbach in a letter dated January 18, 2000 (the "Trust Letter") to inform Hilton that the Trust "does not accept these rights that Hilton is attempting to attach to the Trust's shares of Hilton common stock. The Trust does not consent to being deemed or treated as an owner of rights and does not agree that the rights may be attached to or made with the shares of Hilton common stock that the Trust own."8 The Trust Letter further asserted that the Trust refused to be treated as an owner of rights associated with the Rights Plan, to have its Hilton share certificates evidence the Rights or be deemed "Rights Certificates," or to have a legend relating to the Rights placed on any stock certificates for shares owned by the Trust or any transferee of the Trust. The Trust separately requested that 100 shares of Hilton common stock owned by the Trust be registered in record in the name of the Trust.

On February 16, 2000, the Trust received from Hilton a stock certificate (the "Certificate") with a legend incorporating the terms of the Rights Plan and indicating that the Certificate evidences Rights that are attached to the shares of Hilton common stock. On February 20, 2000, the Trust filed the current action against Hilton.

7Compl. Ex. C.
8Compl. Ex. D.
UNREPORTED CASES

II. ANALYSIS

A. The Legal Standard on a Motion to Dismiss

A motion to dismiss under Court of Chancery Rule 12(b)(6) will be granted where it appears with "reasonable certainty" that the plaintiff could not prevail on any set of facts that can be inferred from the pleadings.9 The plaintiff, however, is entitled to all reasonable inferences that can be drawn from the complaint.10

The plaintiff has moved for summary judgment on Claim I. Summary judgment will only be granted where the moving party demonstrates the absence of genuine issues of material fact and that it is entitled to judgment as a matter of law.11 On any application for summary judgment, the Court must view all of the evidence in the light most favorable to the non-moving party.12 The fact that the parties have filed cross motions does not alter that standard.13 The Court retains the discretion to deny both motions if it decides that the record requires a more thorough development to clarify the law or its application to the case.14

With those standards in mind, I turn to the issues involved in this case. Each of the plaintiff's five claims attacks different aspects of the Rights Plan. As such, I will analyze each claim in turn after a brief discussion of the stare decisis doctrine.

B. The Doctrine of Stare Decisis

The Delaware Supreme Court has described the stare decisis doctrine as follows:

when a point has been once settled by decision it forms a precedent which is not afterwards to be departed from or lightly overruled or set aside. . . . This rule [of stares decisis] is grounded upon public policy and should be followed except for urgent reasons and upon clear manifestation of error. Its

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10Id. (citing In re USACafes, 600 A.2d at 47).
support rests upon the vital necessity that there be stability in our courts in adhering to decisions deliberately made after careful consideration.15

As a general rule, the doctrine of *stare decisis* is applicable "[t]o a decision of a court higher in rank, or of the same rank, but not to a decision of a court lower in rank than the court in which the decision is cited as precedent."16 The Court of Chancery has also discussed *stare decisis* and held that "[t]he prerequisites necessary for the application of the doctrine . . . are: a judicial opinion by the court, on a point of law, expressed in a final decision."17

The United States Supreme Court has stated that the following questions are applicable when a court considers the application of *stare decisis*:

- whether related principles of law have so far developed as to have left the old rule no more than a remnant of abandoned doctrine; or whether facts have so changed or come to be seen so differently, as to have robbed the old rule of significant application or justification.18

Hilton argues that *Moran* considered and upheld the basic concept of a stockholder rights plan, including its core elements and the manner in which it operates. Nearly identical challenges to fundamental attributes of rights plans that existed in the Household rights plan are foreclosed by the powerful effect of *Moran* and *stare decisis*. I agree.

*Stare decisis* is not merely a narrow legal principle that can be avoided by slight adjustments to legal arguments that have previously been made in depth and definitively ruled upon. *Stare decisis* is not a strictly theoretical concept without important practical applications. Rather, *stare decisis* is founded on public policy. It forms arguably the most important tenet upon which legal reasoning rests. As the Delaware Supreme Court noted, the practical administration of justice requires that this policy be followed absent "urgent reasons and clear manifestations of error."

Additionally, plaintiff can make no tenable argument disputing the enduring vitality of *Moran*. More than 2,300 rights plans currently in

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19 *Planned Parenthood v. Casey*, 112 S. Ct. 2791, 2808-09 (1192) (citations omitted).
effect attest to the continuing application and relevance of that decision fifteen years ago. In this case, the plaintiff has challenged several provisions and aspects of the Hilton Rights Plan that were not only contained in the Household rights plan, but figured prominently in the litigation that led to the decisions of the Delaware courts. This case therefore provides this Court the opportunity to reaffirm the basic principles of stare decisis and apply it to several of the issues in dispute.

C. Is Hilton's Poison Pill Rights Plan Enforceable Against Common Stockholders Who Are Not a Party to that Plan?

The plaintiff Trust does not challenge the Hilton Board's statutory authority to adopt the Rights Plan, but rather asserts that the Rights Plan "is not a contract with or enforceable against the Hilton Stockholders." The Trust bases this claim on four separate contentions: (i) the Hilton stockholders are not a party to the Rights Plan; (ii) there is no mutuality of obligation and no consideration between Hilton and the Hilton stockholders with respect to the Rights Plan; (iii) the Rights Plan is an unconscionable contract of adhesion; and, (iv) the Rights Plan is an illusory contract.

The Trust specifically points to section 16 of the Rights Plan ("section 16") as evidence that the Plan purports to create a direct agreement between Hilton and the Hilton stockholders. The Trust challenges the ability of Hilton to enforce section 16 of the Rights Plan against the Hilton stockholders without a formal acceptance of the Rights Plan by the Hilton stockholders. Section 16 states:

AGREEMENT OF RIGHT HOLDERS. Every holder of a Right by accepting the same consents and agrees with [Hilton] and the Rights agent and with every other holder of a Right that: (a) prior to the Distribution Date, the Rights will be transferable only in connection with the transfer of the [Hilton common stock]; (b) as of and after the Distribution Date, the Right Certificates are transferable only on the registry books of the Rights Agent if surrendered at the office of the Rights Agent designated for such purpose, duly endorsed or accompanied by a proper instrument of transfer with all required certifications completed; and (c) [Hilton] and the Rights Agent may deem and treat the Person in whose name the Right Certificate (or, prior to the Distribution Date, the associated [Hilton common stock] certificate) is registered as the absolute owner thereof and of the Rights evidenced