Mr. Prickett #38
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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

WILLIAM B. WEINBERGER, Plaintiff,	)	
v.	)	Civil Action No. 5642
UOP, INC., et al., Defendants.	)	

REPLY BRIEF OF THE SIGNAL COMPANIES, INC.
IN SUPPORT OF ITS MOTION TO DISMISS AND
TO QUASH SERVICE OF PROCESS

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December 20, 1978

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ARGUMENT

A. Plaintiff Lacks Standing To Sue Derivatively On Behalf Of UOP Inc. Because He Was Not A Stockholder Thereof When The Complaint Was Filed.

Plaintiff apparently concedes that under Delaware Law, in order to maintain a derivative action, the plaintiff must be a stockholder of the corporation on whose behalf the action is brought at the time the suit is filed (Plaintiff's Answering Brief ("P.B."), p. 12). Plaintiff argues that he was a stockholder of UOP in July, 1978, when the suit was filed, because he did not lose his status as a stockholder of UOP notwithstanding the merger of UOP and Sigco ("the merger") in May, 1978. Plaintiff's argument is imaginative, but wholly without legal precedent or logical merit; indeed, it is directly contrary to the established law of Delaware.

Plaintiff's contention that he remained a stockholder of UOP after the merger is apparently predicated on two theories: one, that the transaction was actually a redemption of common stock prohibited by §§ 151 and 160,* and two, that he had a "vested right" to remain as a stockholder of UOP. Defendant Signal respectfully submits that both of these contentions are without merit, and that no valid

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* Unless otherwise noted, all statutory citations are to the Delaware General Corporation Law, i.e., 8 Del. C. § ___.

reason has been presented by the plaintiff showing why Signal's present motion to dismiss the derivative counts should not be granted.

1. The merger of Sigco and UOP was specifically authorized under 8 Del. C. § 251 and was not a redemption.

Plaintiff contends that the merger between UOP and Sigco, which was effected under § 251, was actually a redemption of common stock prohibited by §§ 151 and 160. In making this novel assertion, plaintiff has failed to recognize the significant differences between a merger and a redemption, and more particularly he has not dealt with the facts in this case in light of such differences.

Generally speaking, a redemption is the purchase by a corporation of its own outstanding shares as permitted by charter provision or by vote of the majority of the stockholders, subject to the limitations of §§ 160 and 151. No filing with the Secretary of State is normally required to effect a redemption and the corporation which accomplishes the redemption remains in existence without any basic change in its framework. A merger, on the other hand, is a very different transaction. In a merger, the transaction must be approved by the directors and stockholders of the constituent corporations (which was done in the present case), and the merger agreement must be filed with the Secretary of State (in this case the filing took place on May 26, 1978). Also, in a merger, dissenting stockholders have statutory appraisal rights which are not available in a redemption. Finally, after a merger one or more of the constituent corporations ceases to exist (here, Sigco), and there are often drastic changes in the basic composition of the survivor. It is therefore quite apparent that a merger and a redemption are completely different transactions, each of which is, and has been for many years, specifically recognized and authorized under the Delaware Corporation Law.

The direction of plaintiff's argument is obvious: he knows that as a merger, the UOP-Sigco merger fully complies with Delaware Law and results in his not being a stockholder of UOP after consummation of the merger on May 26, 1978. Therefore, he simply calls it something else--namely, a redemption--and then argues that it fails to meet the criteria of the Delaware Law applicable to redemptions. To this end, plaintiff characterizes the present merger transaction as a "_de facto_ redemption", and then states " . . . no other provision of the D.G.C.L. can have independent legal significance to authorize the redemption of the ireedeemable common stock of the surviving corporation upon a § 251 merger" (P.B., p. 18). This position of the plaintiff is wholly without support and indeed is directly contrary to the long and unbroken line of cases holding that the various sections of the Delaware General Corporation Law have independent legal significance and must be accorded independent and equal weight. For example, in Hariton v. Arco Electronics, Inc., Del. Ch., 182 A.2d 22 (1962), aff'd, Del. Supr., 188 A.2d 123 (1963), this Court stated:

> "[T]he various sections of the Delaware General Corporation Law conferring authority for corporate action are independent of each other and . . . a given result may be accomplished by proceeding under one section which is not possible, or is even forbidden by another." (Emphasis added.) 182 A.2d 26.

In Hariton, the plaintiff attacked a sale of assets under § 271 and a subsequent dissolution of the corporation on the grounds that the transaction was a de facto merger; that there had not been compliance with the provisions of § 251; and that plaintiff was denied appraisal rights because of the manner in which the transaction had been structured. Relying on the doctrine of independent legal significance, this Court concluded:

> "[T]he transaction complained of was not a de facto merger, either in the sense that there was a failure to comply with one or more of the requirements of § 271 of the Delaware Corporation Law, or that the result accomplished was in effect a merger entitling plaintiff to a right of appraisal." 182 A.2d 27.

On appeal, the Supreme Court affirmed, Chief Justice Southerland stating:

> "We now hold that the reorganization here accomplished through § 271 and a mandatory plan of dissolution and distribution is legal. This is so because the sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end. This is not an anomalous result in our corporation law." 188 A.2d 125.

See also, Federal United Corp. v. Havender, Del. Supr., 11 A.2d 331 (1940) (elimination of accrued dividends, though forbidden by charter provision, may be accomplished by a merger); Langfelder v. Universal Laboratories, Inc., 68 F. Supp. 209 (D. Del. 1946), aff'd, 163 F.2d 804 (3rd Cir. 1947).

In Orzeck v. Engelhart, Del. Supr., 195 A.2d 375, 377 (1963), Justice Wolcott held:

> "[T]he uniform interpretation given the Delaware Corporation Law over the years . . . [is] that action taken in accordance with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections. The mere fact that the result of actions taken under one section may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section." (Emphasis added.)

Accord: Wolfensohn v. Madison Fund, Inc., Del. Ch., 247 A.2d 197 (1968), aff'd, Del. Supr., 253 A.2d 72 (1969), and Willard v. Harrworth Corp., Del. Ch., 258 A.2d 914 (1969), aff'd, Del. Supr., 267 A.2d 579 (1970). For more recent decisions see, e.g., Baker v. Providence and Worcester Company, Del. Ch., 364 A.2d 838, 847 (1976), rev'd on other grounds, Del. Supr., 378 A.2d 121 (1977), and Baron v. Wolf, Del. Ch., C. A. 4972 (Jan. 15, 1976) (unreported decision, a copy of which is attached hereto as Exhibit A).

Not only has the plaintiff misconstrued the doctrine of independent legal significance, he has also failed to consider a prior case which refutes the very contention being made by him in the present case. In Coyne v. Park & Tilford Distillers Corp., Del. Supr., 154 A.2d 893 (1959), the plaintiff presented a claim factually similar to the claim presented here by Weinberger, seeking to enjoin a merger because cash was to be paid to the minority stockholders. The court rejected the plaintiff's contentions and, in effect, held that a merger, legally accomplished in accordance with the statute, was a valid transaction even though it could not be accomplished under some other section. The fact that cash was paid to the minority stockholders did not detract from or in any way change the result that a merger was legally accomplished. See also, Grimes v. Donaldson, Lufkin & Jenrette, 392 F. Supp. 1393, 1403 (D. Fla. 1974), aff'd mem., 521 F.2d 812 (5th Cir. 1975), where the court held:

> "To the extent the plaintiff contends that a merger between two corporations can never be effectuated with the minority receiving cash for their interest, Delaware law is specifically to the contrary. 8 Del. Code Ann. § 251 (1970) . . . . [citations omitted] It is clear that the Delaware legislature has determiend that a stock-

holder has no absolute right to his interest in the corporation and may be forced to surrender his shares for a fair cash price . . . . [citations omitted] Indeed, statutes similar to the Delaware statute under which this merger is proposed exist in many states in the country." (Emphasis by the court.)

The leading commentator on the General Corporation Law, Professor Folk, concurs entirely in this view of Delaware law:

> "[T]he Delaware courts frequently note that mergers, to the extent authorized by statute, are 'encouraged and favored.' Indeed, '[m]erger statutes are enacted, not in aid of dissenting shareholders alone, but are as well in aid of majority stockholders and also in aid of the public welfare if the notion is not entirely outmoded that healthy business conditions are in some degree conducive to the general good.' The 1967 revision of the statute, in particular, reflects the 'continuing legislative approval' of mergers and the avoidance of their disruption by protesting stockholders.
>
> "This generally favorable attitude finds concrete expression in specific judicial doctrines. First, <u>a merger is itself 'an act of independent legal significance,' and if the transaction conforms to all statutory and judicial conditions, it need not meet requirements of other related statutes</u>." (Emphasis added.)

Folk, <u>The Delaware General Corporation Law</u>, § 251 at p. 332 (1972) (footnotes omitted).

2. Plaintiff's continued retention of <u>his share certificate is irrelevant.</u>

The plaintiff, Weinberger, has not yet surrendered the certificate representing the 90 shares of UOP stock which he owned immediately prior to the merger. This fact does not make the plaintiff a stockholder of UOP for the purpose of determining whether he had standing to bring the derivative counts of his complaint.

The merger agreement provided for the automatic conversion of the non-Signal shares into a right to receive cash,* a result specifically approved by Chief Judge Latchum in Heit v. Tenneco, Inc., 319 F. Supp. 884 (D. Del. 1970), where he held at 886:

> "[P]laintiff, along with all other stockholders of Case, lost his status as a Case shareholder on August 4, 1970, when Case merged [into Tenneco] . . . . On that date, the Case stock of plaintiff was automatically converted into $5.50 Cumulative Pre-

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* The Merger Agreement, duly filed on May 26, 1978, provides, inter alia:

> "Each share of Common Stock, $1.00 par value, of UOP (herein called the 'UOP Stock'), other than those shares then held by The Signal Companies, Inc., a Delaware corporation (herein called 'Signal'), or held in the Treasury of UOP, which shall be outstanding at the Effective Time of the Merger shall, at such time and by virtue of the merger without any action on the part of the holder thereof, be converted into and exchanged for the right to receive $21.00 cash, payable by the surviving corporation, and each holder of such UOP stock, at the Effective Time of the Merger (except Signal and the shares held in the Treasury of UOP), shall, upon the merger, cease being a stockholder of UOP and shall by such merger be converted from a stockholder into a creditor of UOP for an amount equal to the product of the number of shares of UOP Stock held of record by such holder at the Effective Time of the Merger and $21.00." (Complaint, Ex. A, p. B-2.)

ferred Stock of Tenneco, Inc. pursuant to Delaware law and the terms of the merger agreement . . . ." (Emphasis added.)*

It is also the case that Weinberger has never owned any of the presently outstanding UOP stock, all of which is owned by Signal, and therefore he is not now (and was not when his complaint was filed), a stockholder of UOP. At the time of the merger, UOP was recapitalized. All of the previously outstanding stock (of which plaintiff's stock was a part) was cancelled and new stock was issued to Signal (Complaint, Ex. A, p. B-2).

In conclusion, then, to plaintiff's argument that he was a stockholder of UOP when the complaint was filed because there was an illegal redemption, the short answer is that the shares of UOP were not redeemed; rather, they were automatically converted into the right to receive cash upon the effectiveness of the merger pursuant to § 251 and the Merger Agreement. The provisions of §§ 151 and 160 and the legislative history of those sections have no bearing whatsoever on the UOP merger or on this litigation. When the

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* Plaintiff claims the Tenneco case is distinguishable because the exchange there involved was for preferred stock of the survivor and not cash as in the present case. However, the Case shareholders were forced to give up their common stock in Case, and that stock was automatically converted into something else--preferred stock of Tenneco. Plaintiff thus apparently contends that a forced automatic conversion of one's stock interest in a merger constitutes a de facto redemption only when the merger involves cash and not other property. There is no rational basis for such a distinction, and the Tenneco decision clearly refutes plaintiff's claims that he is still a shareholder of UOP.

Merger Agreement was filed on May 26, 1978, all UOP shareholders other than Signal became creditors of the surviving corporation and lost their status as shareholders of UOP. Accordingly, plaintiff was not a shareholder of UOP when his complaint was filed on July 5, 1978 and the derivative counts must therefore be dismissed.

3. Plaintiff's rights were not vested and plaintiff has no right to receive shares or other securities of the surviving corporation.

Another of plaintiff's grounds for his assertion that he was, and remains, a stockholder of UOP is his claim that the stockholders of UOP " . . . had the vested right to continue to hold their shares [of UOP]" (P.B., p. 16).* This contention is equally devoid of merit and authority as his previously discussed argument about redemption, and again, is directly contrary to well-settled Delaware law.

Plaintiff's convoluted argument appears to be that because the General Assembly in 1967 adopted a so-called "savings clause" at the same time the amendment to § 251 permitting cash mergers was adopted, all shareholders of corporations in existence prior to January, 1968 have the "vested right" not to be forced out by a cash merger under

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* In another breath, plaintiff argues that he has a " . . . vested right to a security interest in the surviving corporation" (P.B., p. 12). Thus, it is not entirely clear as to what plaintiff really wants or believes he is entitled to.

amended § 251. This "savings clause" appears in the Code as § 393, viz.:

> "All rights, privileges and immunities vested or accrued by and under any laws enacted prior to the adoption or amendment of this chapter, all suits pending, all rights of action conferred, and all duties, restrictions, liabilities and penalties imposed or required by and under laws enacted prior to the adoption or amendment of this chapter, shall not be impaired, diminished or affected by this chapter."

Plaintiff claims this language of § 393 bars the application of the 1967 amendment to § 251, which permitted cash to be paid in a merger transaction in the case of any corporation incorporated prior to January 2, 1968, the effective date of the amendment. If correct (which clearly it is not), this argument will undoubtedly come as an unpleasant surprise to the many pre-1968 corporations which have concluded cash merger transactions over the past ten years as well as to the courts which have previously considered and rejected similar arguments.

In Coyne v. Park & Tilford Distillers Corp., supra, the plaintiffs brought an action to enjoin a merger on the ground that the transaction was void, claiming that § 253--the short-form merger statute--was unconstitutional as applied to those minority shareholders who had acquired their stock prior to the enactment of § 253 in 1957. More particularly, plaintiffs alleged that the cash-out provision of § 253 was invalid as applied to them because when they had acquired their shares the merger statute required securities of the surviving corporation to be offered on a merger, and that their right to remain as shareholders of the surviving corporation was "vested" and not subject to change by a later enacted statute. Chief Justice Southerland analyzed this claim and announced a holding which is dispositive of plaintiff's claim here:

> "Plaintiffs' constitutional point is this:
>
> "Each acquired his shares before the passage of the 1957 amendment. When he bought his stock Section 251 permitted only the conversion of shares into shares in a merger. The right to demand in a merger conversion of his shares into other shares became vested, and no subsequently enacted statute could destroy it. Keller v. Wilson & Co., 21 Del. Ch. 391, 190 A. 115.
>
> "The first answer to this contention is that both plaintiffs acquired their shares after the passage of the 1941 amendment permitting the conversion of shares into 'other securities'. Since, as heretofore noted, they might have been converted into notes or bonds, the premise of plaintiffs' argument is unsound.
>
> "But the overriding answer to the contention is the reserved power of the State to amend corporation charters and the power reserved in the Park & Tilford charter. Section 364 [predecessor of 394] of our corporation law, 8 Del. C. § 364, provides:
>
>> "'This chapter may be amended or repealed, at the pleasure of the Legislature, but any amendment or repeal shall not take away or impair any remedy against any corporation under this chapter, or

its officers, for any liability which shall have been previously incurred. This chapter and all amendments thereof shall be a part of the charter of every corporation except so far as the same are inapplicable and inappropriate to the objects of the corporation.'

"This provision has been in our law since (at least) 1901. 22 Del.L. p. 353. The corporation's charter contains a similar reservation. It reads:

"'Fifteenth: This corporation reserves the right to amend, alter, change or repeal any provision contained in this certificate of incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.'

"Such provisions have been construed in our courts. They are held to authorize the enactment of statutes changing the rights of stockholders in respect of shares acquired prior to such enactment. Davis v. Louisville Gas & Electric Co., 16 Del. Ch. 157, 142 A. 654. We do not read the comments on the Davis case by the Supreme Court in the Keller case (21 Del.Ch. 401 ff., 190 A. 120) as weakening its force. On the other hand, the broad holding in the Keller case was certainly modified by the Havender case. [Federal United Corp. v. Havender, Del. Supr., 11 A.2d 331 (1940)]."

Id. at 154 A.2d 897. See also, Grimes v. Donaldson, Lufkin & Jenrette, supra, at 392 F. Supp. 1403.

Plaintiff does not refer to Coyne in his brief; indeed, he has chosen to ignore this holding which might have as well been written to rule upon the present motion. He fails to note that the Supreme Court has ruled that there is no "vested right" to remain as a shareholder in a merged corporation. He also fails to note the provision of § 394, identical in language to its predecessor, § 364, quoted by the Chief Justice in Coyne, and the provision in the UOP charter expressly allowing the corporation to act upon future amendments in the law similar to that relied upon by Chief Justice Southerland above.* The instant case presents the identical setting under § 251 which the Court in Coyne disposed of under § 253, and the same result must follow here.

Under the facts of the present case there is even less reason than in Coyne for any argument over "vested rights". Here the plaintiff, Weinberger, acquired his UOP stock in April, 1975 (Signal Exhibits A and B**), some eight years after the amendment to § 251 permitting precisely the kind of cash merger about which he now complains. Plaintiff

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* The relevant provision of the UOP charter provides:

> "ELEVENTH: Upon the written consent or vote of the holders of a majority in aggregate number of the shares of stock of the Corporation then outstanding and entitled to vote, every statute of the State of Delaware (a) increasing, diminishing, or in any way affecting the rights, powers or privileges of stockholders of corporations organized under the general laws of said State, or (b) giving effect to the action taken by any part, less than all, of the stockholders of any such corporation, shall be binding upon the Corporation and every stockholder thereof, to the same extent as if such statute had been in force at the date of the making, filing and recording of this Certificate of Incorporation of the Corporation."

** Marked at plaintiff Weinberger's deposition taken on December 6, 1978.

therefore acquired his shares with at least constructive knowledge (since everyone is presumed to know the law) that under Delaware Law his shares could be "cashed out". This subsequent purchase eliminates any claim that Weinberger may advance that he "relied" on an alleged right to retain his shares or to receive only other stock or securities upon a merger. As Chief Justice Southerland noted in Coyne, a shareholder purchasing shares after a statutory amendment has been adopted permitting notes or other property to be exchanged for stock on a merger cannot be said to have purchased them in reliance upon some "vested right". We submit that the claim of plaintiff here, where the shares were purchased many years after the amendment expressly authorizing a cash merger was adopted, is even less convincing than that in the Coyne case.

In any event, the "right" which the plaintiff contends was "vested" under § 393 is not one which is considered under Delaware Law to be a "vested right" under that section. On this point, Professor Folk writes:

> "[B]ecause of the liberalized case law and the amendments to the Delaware corporation law, the question whether a given right is 'vested' is now more theoretical than practical. Today, indeed, if corporate action conforms both substantively and procedurally to the requirements of the statute, it is likely that no interests affected by such action will be denominated as 'vested'. Very probably, the only 'vested right' left is that specified

> in § 394: neither a statutory nor a charter amendment may 'take away or impair any remedy . . . against any corporation or its officers for any liability which shall have been previously incurred.' <u>Finally, it would appear that the reserved power specified in § 394 has primacy over § 393, which purports to save from impairment all rights, privileges and immunities 'vested or accrued' under prior statutes, and 'all duties, restrictions, liabilities and penalties imposed or required by' prior statutes."</u> (Emphasis added.)

Folk, <u>The Delaware General Corporation Law</u>, § 394 at p. 560 (1972) (footnotes omitted).

In summary, there is simply no basis or authority to support plaintiff's "vested rights" argument. Even in the very recent cases of <u>Singer</u> v. <u>Magnavox Co.</u>, Del. Supr. 380 A.2d 969 (1977), and <u>Tanzer</u> v. <u>International General Industries, Inc.</u>, Del. Supr., 379 A.2d 1121 (1977), there is no holding or even suggestion that stockholders have the right, vested or otherwise, to remain stockholders of the corporation in which they have invested. Both the statutes and case law mandate the holding here that plaintiff had no right to retain his stock in UOP, and that upon the effectiveness of the merger of Sigco and UOP, in May, 1978 plaintiff lost his status as a stockholder of UOP and became instead a creditor thereof. Accordingly, plaintiff was not a stockholder of UOP when this action was filed in July, 1978, and he has no standing to maintain the derivative counts.

B. Plaintiff Cannot Maintain The Derivative Counts Because They Are Moot.

As a separate ground for its motion to dismiss the derivative counts of the present complaint, Signal contends that these counts are moot. In his response to this ground for dismissal, plaintiff completely misses the point. Here, Signal is now the sole stockholder of UOP. If the derivative claims are successful, and if UOP is therefore the successful "plaintiff", Signal would be both the winner and loser in this litigation. In other words, in the derivative action Signal is suing itself. This is the very situation condemned by the Supreme Court in _Bokat_ v. _Getty Oil Co._, Del. Supr., 262 A.2d 246 (1970).

Plaintiff attempts to distinguish the _Bokat_ case by pointing out that there Tidewater was merged into Getty and Getty survived the merger and the suit in behalf of Tidewater against Getty was thereafter owned by Getty. Here, UOP was merged with Sigco and UOP survived the merger. What plaintiff fails to note is that as a result of the merger, UOP became a wholly-owned subsidiary of Signal, and Signal became the equitable and ultimate owner of the very claims which plaintiff would assert against Signal on behalf of UOP--just as Getty owned the claims asserted against it in the _Bokat_ case. As the sole stockholder of UOP, only Signal has standing to maintain a derivative action on behalf of UOP.

See Braasch v. Goldschmidt, Del. Ch., 199 A.2d 760 (1964). Accordingly, plaintiff's derivative claims have become moot and should be dismissed.*

C. Service Of Process On Sigco, Incorporated Must Be Quashed Because It Was Not In Existence When Such Service Was Purportedly Made.

In light of Beals v. Washington International, Inc., Del. Ch., 386 A.2d 1156 (1978), plaintiff apparently now concedes that service of process upon Sigco's registered agent was improper. The Beals case is also a complete answer to plaintiff's contention that Signal has no standing to raise the issue of improper service on Sigco.

Plaintiff's suggestion that he should be permitted to "re-serve" Sigco by serving the Secretary of State is senseless. 8 Del. C. § 321 permits service upon the Secretary of State only when service upon a Delaware corporation cannot be otherwise accomplished by due diligence. In the instant case, service cannot be made upon Sigco because it ceased to exist when the Merger Agreement was filed on May 26, 1978. In short, the Beals case mandates that the purported service of process upon Sigco be quashed, with prejudice.

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* Plaintiff's reliance upon Kramer v. Becker, (P.B., Ex. A), Miller v. Steinbach, 268 F. Supp. 255 (S.D.N.Y. 1967), and Dasho v. Susquehanna Corp., 461 F.2d 11 (7th Cir., 1972), cert. denied, 408 U.S. 925 (1972), is misplaced. In Kramer, the court cited with approval, the Braasch decision, but held that it was distinguishable from the facts there presented. Miller v. Steinbach was decided under Pennsylvania law and the federal securities statutes. To the extent that Kramer and Miller may be inconsistent with Bokat and Braasch, they do not represent Delaware law. In the Dasho case, the mootness issue was not presented to or decided by the court.

CONCLUSION

For the reasons stated, the derivative counts of the complaint should be dismissed, and service of process upon Sigco, Incorporated, should be quashed.

Respectfully submitted,

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December 20, 1978

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COURT OF CHANCERY
OF THE
STATE OF DELAWARE

GROVER C. BROWN
VICE-CHANCELLOR

January 15, 1976

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Re: Baron, et al. v. Wolf,
et al., C. A. No. 4972
Submitted: January 14, 1976

Gentlemen:

In this derivative action, plaintiff stockholders, in addition to seeking damages and other permanent relief, ask the Court initially to issue a temporary restraining order on behalf of Allied Artists Pictures Corporation to prevent the planned redemption of the preferred stock of the corporation now set for January 20, 1976. Also set for this same date is a vote of shareholders on a proposed merger of Allied Artists with Kalvex, Inc., the present owner of 52 per cent of the preferred stock of Allied Artists which, because of a delinquency in the payment of cumulative dividends on the preferred stock, has resulted in the control of Allied Artists by Kalvex. See Baron v. Allied Artists Pictures Corporation, Del.Ch., 337 A.2d 653 (1975). Technically,

Exhibit A

it is the intention of the management of Allied Artists and Kalvex, which to all intents and purposes is identical, to make an irrevocable deposit pursuant to the terms of the preferred stock Certificate of Designation of some $778,000, which would constitute the full amount of the stated redemption price of the preferred stock (that being $11.00 per share) as well as an amount equal to all accumulated but unpaid dividends on such stock. It is this irrevocable deposit which plaintiffs seek to enjoin and, at present, this forms the sole basis for determining whether or not a restraining order should issue, as I see it.

Plaintiffs point out that according to the latest corporate financial information available to them, Allied Artists has no surplus, as defined by 8 Del.C. § 154, and had no net profits for either of the past two fiscal years. Accordingly, they argue that under 8 Del.C. § 170, it is illegal for Allied Artists to pay a dividend on any of its stock, including the preferred. They further contend that by intending to deposit an amount to pay both the redemption price as well as the amount equal to the unpaid preferred dividends, Allied Artists is, in fact, about to pay an illegal dividend, and thus, the irrevocable deposit must be enjoined if the status quo is to be maintained and irreparable harm to the corporation avoided.

As further authority plaintiffs rely on dicta of the Delaware Supreme Court in Pennington v. Commonwealth Hotel Const. Corporation, Del.Supr., 155 A.514, 518 (1931) where it was stated that where a corporation is a going concern as opposed to one redeeming preferred stock as part of a liquidation, "it is certain that the dividends to be paid the owners of the stock redeemed must be dividends declared from profits or surplus and not from capital." It is also the view of Professor Folk that this is the status of Delaware law. See Folk, The Delaware General Corporation Law, pp. 185, 186.

The defendant corporations do not dispute this as a general principle (at least not at this point). However, it is their position that from a legal standpoint Allied Artists is not paying "dividends" as such as part of the redemption. They say that § 170 has no application here, but rather 8 Del.C. § 160 controls. This latter statute, particularly at § 160(a)(1), specifically authorizes a corporation to redeem preference stock out of capital provided the shares so redeemed will be thereafter retired pursuant to § 243 and the capital of the corporation reduced in accordance with § 244. And while § 160 makes no mention of accumulated dividends, defendants turn to the language of the Certificate of Designation to illustrate that this is of no consequence. The critical language is as follows:

> "[t]he redemption price for the shares of Convertible Preferred Stock (except in the

case of shares redeemed through the operation of the Sinking Fund provided in Subdivision D hereof) shall be eleven dollars ($11) per share, together with a sum in the case of each share, computed at the annual dividend rate for such share from the date on which dividends on such share became cumulative to and including the date fixed for redemption, less the aggregate of all dividends theretofore paid thereon."

Thus, technically, as defendants point out, there is no direction that unpaid dividends, as such, be paid as part of the redemption price, but rather the redemption price is fixed at $11.00 per share plus an amount computed at the annual dividend rate from the date dividends became cumulative to the date of redemption, less the amount of any dividends actually paid during the interim. This, they say, is clearly a formula for arriving at the redemption price at any given time and, although it may coincide with the method used to compute the amount of a preferred dividend arrearage while the stock remains unredeemed, it is nonetheless a formula to be used for redemption under § 160 and has nothing to do with paying dividends under § 170. (Parenthetically, it should be noted that the language in Pennington was "plus all unpaid, accrued or accumulated dividends thereon." [Emphasis added])

Moreover, defendants assert that it is also of no consequence that as a practical matter the formula for the redemption price under § 160 will have the effect of satisfying unpaid dividends out of capital, which could not be done under § 170. They point to case precedents which hold that different sections of the Corporation Law have independent legal significance and that the legality of action authorized by one section is not always dependent upon satisfaction of the requirements of another. Federal United Corp. v. Havender, Del.Supr., 11 A.2d 331 (1940); Hariton v. Arco Electronics, Inc., Del.Supr., 188 A.2d 123 (1963); Orzeck v. Englehart, Del.Supr., 195 A.2d 375 (1963). As stated in Orzeck at 195 A.2d 377:

> "The mere fact that the result of actions taken under one section may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section."

Thus, as I suggested during argument, the issue seems to boil down to this at the present stage of the proceedings: Is there any precedent that holds that what is a dividend under one section is, by any other name, a dividend for the purpose of another section? Counsel have offered none so far.

Turning to an analysis of the authorities that have been offered, Pennington held that a payment to stockholders as a return on their investment is, in general, a dividend, and it further noted that any return to stockholders on account of money put into the corporation by them could only be paid from current or accumulated profits. 155 A.517. As noted by defendants, however, the forerunner of § 160 which allows preferred shares to be redeemed out of capital was enacted subsequent to Pennington.

Continuing on, § 151(b) provides that any preferred stock can be redeemed, in cash, at "such price or prices, or such rate or rates, and with such adjustments, as shall be stated in the certificate of incorporation or in the resolution ... providing for the issue of such stock ... ." (Emphasis added.) This appears to be what the corporation is doing here. It is redeeming at a "price ... with such adjustments" established by the document creating the preference and providing for the issue. In view of this I cannot conclude that plaintiffs have demonstrated a probability of ultimate success, see Gimbel v. Signal Oil Companies, Del.Ch., 316 A.2d 599 (1974), simply by showing that what Allied Artists is purporting to do under the authority of §§ 160 and 151(b) in redeeming the stock it could not do under § 170 if it was not redeeming the stock.

The application for the temporary restraining order is denied. IT IS SO ORDERED. As to defendants' motion to dismiss, I do not consider it proper for decision at this time in the absence of an opportunity for plaintiffs to adequately respond, and consequently I offer no opinion thereon.

Very truly yours,

GCB:mlw
cc: Register in Chancery