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July 15, 2011

BY eFILING
AND BY HAND

The Honorable Leo E. Strine, Jr.
Court of Chancery
New Castle County Courthouse
500 North King Street
Wilmington, Delaware 19801

RE: In re Southern Peru Copper Corporation Shareholder Litigation, Del. Ch., C.A. No. 961-CS

Dear Chancellor Strine:

At the close of post-trial oral argument, the Court requested that the parties submit (i) brief argument on the relevance of post-signing facts, and (ii) parts of the record the parties wish to highlight to support their oral argument presented to the Court. This is plaintiff's submission.

I. RELEVANCE OF POST-SIGNING FACTS

The Court may not rely on hindsight to determine whether Defendants have satisfied their fiduciary duties.[1] Thus, the fact that post-transaction "[t]he price of copper increased significantly higher than anyone predicted"[2] is irrelevant. "The Court cannot permit the *ex post* results of a decision to cloud analysis of a board's *ex ante* judgment."[3]

The Court should, however, consider all information that was knowable to the directors up to and until the time the Transaction was voted upon by the stockholders. As this Court has

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[1] Gentile v. Rossette, 2010 WL 2171613, *2 (Del. Ch.) ("The Court must resist the temptation to dismiss all of this as the product of unfounded speculative fervor and instead consider fair price and process without the benefit of tech bubble hindsight."); see also In re Del Monte Foods Co. S'holder Litig., 2011 WL 532014, *15 (Del. Ch.) ("Time-bound mortals cannot foresee the future. The test therefore cannot be whether, with hindsight, the directors actually achieved the best price."); McGowan v. Ferro, 859 A.2d 1012, at 1023 n.49 (Del. Ch. 2004) (rejecting both plaintiff's and defendants' post-closing evidence as irrelevant).

[2] Parker Dep. Tr. 48:3-6.

[3] Khanna v. McMinn, 2006 WL 1388744, *26 (Del. Ch.) ("Although the acquisition appears disastrous with the benefit of hindsight, the Court cannot permit the *ex post* results of a decision to cloud analysis of a board's *ex ante* judgment.")

recognized, a merger agreement is "not an ordinary contract. Before the Merger could occur, the shareholders of [the company] ha[ve] to approve it. The directors of [the company are] under continuing fiduciary duties to the shareholders to evaluate the proposed transaction." Frontier Oil v. Holly Corp., 2005 WL 1039027, *27 (Del. Ch.). The Delaware Supreme Court has explicitly held that the "directors of a Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced." Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003) (emphasis added); see also 8 Del. C. §146 (expressly setting forth a corporations right to submit a transaction for a stockholder vote even if subsequently the transactions is determined to no longer be advisable). Handelsman acknowledged this obligation by purportedly contacting Goldman concerning the Transaction prior to closing.[4]

The Court should consider three telling post-signing facts that were knowable prior to the time of the stockholder vote in determining whether the Transaction was entirely fair:

- Southern blew past its 2004E EBITDA by 37%[5] while Minera underperformed by -1%[6];
- Because of the fixed exchange ratio, Southern paid Grupo approximately $670 million more in stock for Minera than Grupo asked; and
- If the Special Committee simply agreed to Grupo's original proposal for $3.147 billion in Southern stock, measured by dividing Grupo's ownership of Minera by the 20-day average closing share price of SPCC beginning 5 days prior to closing of the Transaction,[7] Southern would have issued 52.7 million shares instead of 67.2 million shares.

Though the Court may consider Southern's post-closing financial performance in determining damages to Southern resulting from the Transaction, plaintiff respectfully submits that there is no evidence in the record demonstrating that Southern's post-closing performance would not have been even better had it issued a fair number of shares in the Transaction. Nor is there any evidence demonstrating that the Transaction was the cause of Southern's financial performance. To the contrary, as evident by Defendants own submission, Southern began to outperform its peers after it disclosed a significant increase in reserves at Toquepala,[8] not after

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[4] Trial Tr. 216:18-217:5 (Handelsman – Cross); but see Sanchez Dep. Tr. 128:17-20.

[5] See JX 106 at 24 (forecast: $733 million); JX 20 (actual: $1.004 billion).

[6] See JX 106 at 24 (forecast: $687 million); JX 20 (actual: $681.3 million).

[7] JX 156 at SP COMM 007078.

[8] See AMC Defs.' Post-Trial Opening Br. at 22; JX 141. In the time that Southern has performed well it is also notable that Minera's Cananea mine (its largest, which is the second largest copper mine in Mexico, not "the world"), was shut down due to labor disputes. JX 145 at

the Transaction. In any event, it is well settled under Delaware law that "the scope of recovery for a breach of fiduciary duty of loyalty is not to be determined narrowly." Int'l Telecharge, Inc. v. Bomarko, Inc., 766 A.2d 437, 411 (Del. 2000). Rather, uncertainties in awarding damages are resolved against Defendants. Thorpe v. CERBCO, Inc., 1993 WL 443406, *12 (Del. Ch.).

II. FACTUAL SUPPORT FOR ORAL ARGUMENT

A. Burden Shift

At the post-trial hearing, the Court sought additional evidence concerning the structure and effectiveness of the Special Committee.

1. Structure

Mandate. The Special Committee was given the power to "evaluate" the Transaction.[9] The Special Committee was not given the power to consider any alternative transactions.[10] The Special Committee members did not believe that they had the ability to negotiate with Grupo.[11] Defendants' counsel stated that he did not think "the record reflects why exactly those words were used" in the Special Committee's mandate.[12] The Court may want to refer to Mr. Ortega's cover letter to the Board which states "you will find an amendment to the original draft that takes into consideration the remarks made by Mr. Harold S. Handelsman in connection with the mandate of the COD, to confirm that they are entrusted solely to evaluate the Transaction."[13]

Voting. The Transaction was neither made subject to the Special Committee's approval[14] nor a majority of the minority vote. On October 8, 2004, Grupo and the Committee agreed that the Transaction would be subject to a 2/3 vote.[15] Three days earlier, on October 5, 2004, Grupo, Cerro and the Committee had agreed that Southern would issue 67 million shares for Minera in the Transaction, and that Cerro would vote in favor of the Transaction.[16] Grupo and Cerro's

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25. Thus, it is hardly a conclusive inference that Southern's performance post-closing is in any way related to the Transaction.

[9] JX 16 at SP COMM 000440-41.

[10] In re Southern Peru Copper Corporation S'holder Deriv. Litig., Consol. C.A. No. 961-CS, Post-Trial Argument, Tr. at 116:4-7 (Del. Ch. July 12, 2011) ("Post-Trial Arg. Tr.").

[11] Trial Tr. at 14:10-19 (Palomino – Direct); id. at 143:19-144:12 (Handelsman – Direct). See, also, Palomino Dep. Tr. 39:18-40:5, 106:10-11; Handelsman Dep. Tr. 34:25-35:15.

[12] Post-Trial Arg. Tr. at 114:10-13.

[13] JX 16 at SP COMM 000440.

[14] JX 16 at SP COMM 000440-42.

[15] JX 129 at 25.

[16] Id.

shares together constituted approximately 68% of Southern's voting power.[17] On October 13, 2004, Mr. Larrea wrote to Mr. Handelsman seeking to memorialize Grupo and Cerro's agreement that Cerro would vote in favor of the Transaction and would receive registration rights.[18] On December 22, 2004, Phelps Dodge entered into a voting agreement by which it irrevocably agreed to vote in favor of the Transaction in exchange for registration rights.[19] The Merger Agreement permitted Grupo to vote against the deal, but did not permit the Special Committee to terminate the Transaction.[20] Southern's stock price rose from $45.92 per share to $55.89 per share between the signing and closing of the Transaction.[21]

Harold Handelsman. While he served on the Special Committee charged with evaluating Southern's proposed acquisition of Minera, Handelsman's client Cerro relied on him to negotiate Cerro's exit from Southern (despite his supposed bullishness on copper). Mr. Handelsman abstained from voting on the Transaction, although he does not appear to have left the deliberations during the vote.[22]

Minutes. Certain minutes of Special Committee meetings were not produced during discovery, including those for the final meeting held on October 21, 2004 and for two August 2004 meetings.[23]

2. Effectiveness

a. Pricing Terms

Initial Offer vs. Final Agreement. The Special Committee agreed to give Grupo exactly what it demanded for Minera -- $3.1 billion worth of Southern stock.[24]

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[17] Id. at 64.

[18] JX 52.

[19] JX 15.

[20] JX 13 at 39-40.

[21] JX 18 at 5-7.

[22] JX 129 at 27.

[23] Pre-Trial Stip. at 8-10 & n.4.

[24] Compare JX 156 (May 7, 2004 demand for $3.1 billion worth of Southern stock) with JX 129 at 27 (Special Committee agreed to give Grupo 67.2 million shares on October 21, 2004) with JX 18 at 7 (Southern's stock closed at $45.92 on October 21, 2004). Mr. Palomino insisted that Grupo's initial suggestion that it receive 72.3 million shares of Southern stock (worth $3.1 billion) was "not a proposal to the committee of disinterested directors that states what the consideration, the proposed consideration is." Trial Tr. at 110:23-111:2 (Palomino – Cross); see id. at 112:23-24 ("that was not what was presented as a proposal to the committee"). Mr.

Floating vs. Fixed Exchange Ratio. The Special Committee testified that they believed a floating exchange ratio was a "nonstarter."[25] Goldman Sachs gave the Committee no advice as to the wisdom of a fixed vs. floating exchange ratio.[26] Southern believed that copper prices (and Southern's stock price) were likely to go up.[27]

Relative Copper Price Sensitivity. Goldman Sachs did not advise the Special Committee that increases in long-term copper prices would affect Minera more than Southern.[28] The 2005 10-K makes clear that this was not the case.[29] Furthermore, on June 11, 2004, Goldman did advise the Special Committee that Southern would benefit more than Minera if the short-term copper price increased. A 15% change in the short-term copper price would have caused Southern's 2004E EBITDA to increase by 21%, while Minera's would have increased by only 17%.[30] As UBS stated, "Low metal price environments favor Minera Mexico."[31]

b. Other Terms

Debt. Minera was contractually obligated to make mandatory prepayments on its long-term credit facilities when, among other things, the price of copper exceeded $0.88 per pound. Minera was required to pay an amount equal to 75% of the excess cash flow generated by the sales of such metals at the higher metal price.[32]

Dividend. The $100 million special dividend was a mechanism to "bridge the difference" between what Grupo wanted and what the Special Committee was willing to pay.[33]

Palomino testified that when the Committee received Grupo's May 7, 2004 proposal (JX 156), "We finally got something that we can really work on." Id. at 28:1-2.

[25] Trial Tr. 155:5-10 (Handelsman – Direct).

[26] See JXs 96-98, 100-106.

[27] Handelsman Dep. Tr. at 100:24-101:1; Trial Tr. at 312:22-313:4 (Jacob – Cross).

[28] See JXs 96-98, 100-106.

[29] JX 137 at 42, 44.

[30] JX 101 at SP COMM 003348. Unlike Goldman's DCF sensitivities, this increase in the copper price accounted for revised production plans. JX 101 at SP COMM 003348.

[31] JX 103 at SP COMM 006940.

[32] JX 125 at 54. The difference between Minera's assumed net debt stated in the February 3, 2004 Presentation ($1.268 billion, see JX 108 at AMC0019913) to Southern's Board and Minera's assumed net debt stated as of June 30, 2004 ($1.060 billion, see JX 107 at SP COMM 006674) was a result of this contractual prepayment. JX 125 at 20. Goldman advised the Special Committee on at least two occasions that Minera management planned to reduce its net debt to $754 million by 2006. JX 100 at SP COMM 003443; JX 101 at SP COMM 003344.

[33] Trial Tr. at 128:8-9 (Palomino – Cross).

Governance.

NYSE Listing: On February 3, 2004, Grupo proposed that Southern will remain a NYSE-listed company after the Transaction.[34]

Related Party Transaction Review: Southern's Audit Committee was "thoroughly reviewing" related party transactions before the Transaction was proposed,[35] and all related party transactions with Grupo in 2002, 2003, and 2004 were below $10 million.[36]

Proportionate Representation of Minority Stockholders: Prior to the Transaction, minority stockholders were entitled to elect 2 of the Company's 15 directors.[37] In connection with the Transaction, all Founders Shares were converted into ordinary common shares and Cerro and Phelps Dodge sold their shares. Grupo owned a majority of the Company's common stock and possessed the ability to elect all directors on the Board following the Transaction.[38]

B. Relative Valuation Inputs

1. Optimization of Mine Plans

Defendants' counsel stated that the process of reassessing and optimizing mining operations and reserves is something that takes six years to do.[39] The Court may want to consider that Winters, Dorsey & Company did not begin its work on Minera until the summer of 2003,[40] just after Jamie Claro (Cerro's other appointee to Southern's Board at the time) met with German Larrea to discuss Southern's acquisition of Minera.[41] Prior to the time Grupo proposed the Transaction, Winters had prepared two reports for Minera, and Mintec prepared its first report in March 2004.[42] Mintec continued to work on optimization plans for Cananea until at least August 2004.[43] The optimization of Minera's mines increased the consideration to be paid in the Transaction by at least 10.7 million Southen shares.[44] Neither Winters, Mintec, nor any

[34] JX 108 at AMC0019924.

[35] Trial Tr. 278:6-10 (Ortega – Cross).

[36] Trial Tr. at 279:5-280:9 (Ortega – Cross); JX 128 at A61-A62.

[37] JX 124 at 2; JX 116 at SP COMM 001542.

[38] JX 139 at 3-4.

[39] Post-Trial Tr. 145; see also id. at 80-81.

[40] JX 101 at 49.

[41] JX 30.

[42] JX 100 at SP COMM 003442; JX 125 at 20; Parker Dep. Tr. 38:13-39:19.

[43] Parker Dep. Tr. 38:25-39:5; JX 105 at SP COMM 006799.

[44] JX 105 at SP COMM 006801.

other independent mining consultant performed similar work for Southern's mines.[45] Southern's life of mine plans were last revised in 1998 and 1999.[46] Mine plans for Southern prepared in 2004 would likely have been "significantly different" than the older mine plans.[47] A&S advised the Special Committee that there was optimization potential at both Toquepala and Cuajone,[48] but this advice was not followed.

2. Cash Flow Projections

In both 2004 and 2005, Southern consistently beat its financial projections by a wide margin. In 2004, Southern beat its projected EBITDA by 37%, and in 2005 beat its projected EBITDA by 135%.[49] Minera's 2004 performance, however, was dead-on with projections, and it exceeded 2005 performance by only 45% as compared to Southern's 135% mark.[50]

3. Copper Prices

There is no evidence in the record to support a rational belief that anyone was anything close to $1.30 bullish on long-term copper prices.

Palomino stated at his deposition that "[w]hat we did is we used the copper price that was what we believed the right copper price or the best copper price to use for a long term forecast as would be necessary in this transaction."[51]

Goldman's research indicated a long-term copper price of $0.90 per pound.[52] Goldman also presented to the Special Committee analysts' and comparable companies' estimates of short-term and long-term copper prices, as follows:

Date	2004E Avg.	2005E Avg.	Long-Term Avg.
6/11/04[53]	$1.218/lb	$1.121/lb	$0.85/lb
6/23/04[54]	$1.249/lb	$1.134/lb	$0.878/lb

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45 Parker Dep. Tr. 44:5-19; Sanchez Dep. Tr. 81:1-6.

46 Trial Tr. 318:11-18 (Jacob – Cross); JX 128 at A14; JX 123 at 19.

47 See Parker Dep. Tr. 47:13-17.

48 JX 75 at SP COMM 006957; see also JX 102 at SP COMM 6977.

49 Compare JX 106 at SP COMM 004926 and JX 20.

50 Compare JX 106 at SP COMM 004926 and JX 20.

51 Palomino Dep. Tr. 191:16-20.

52 JX 106 at 28.

53 JX 101 at SP COMM 003371.

54 JX 102 at SP COMM 006969.

Date	2004E Avg.	2005E Avg.	Long-Term Avg.
7/8/04[55]	$1.243/lb	$1.13/lb	$0.89/lb
9/15/04[56]	$1.24/lb	$1.21/lb	N/A
10/21/04[57]	$1.227/lb	$1.219/lb	$0.91/lb

UBS's research indicated a long-term copper price outlook of $0.90 to $0.95 per pound.[58] UBS's research indicated that "the current peak of the cycle will take place in 2004 and that the down-cycle will start in 2005."[59]

Southern's SEC filings state that it believed $0.90 per pound was "reflective of the full price cycle of the metal market."[60] For years after the relevant period, Southern continued to use a copper price of $0.90 per pound for long-term business and production planning.[61] Southern did not raise the copper price it used for long-term planning until December 31, 2007, when it raised its long-term copper price outlook to $1.20 per pound.[62] The average price of copper in 2007 was $3.225 per pound,[63] and the three year average copper price was $2.664 per pound.[64]

Defendants counsel stated that Southern did not change its outlook on copper prices sooner because the SEC would not let Southern change is outlook sooner.[65] The Court may want to refer to Mr. Jacob's explanation: "the company management decided to change the basic assumption for reserve estimations from 90 cents to $1.20."[66] The Court may also want to consider that since 2004 Southern has reported its reserves based on both its management's long-term copper price estimates and on the SEC required three-year average copper price.[67]

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[55] JX 103 at SP COMM 006877.

[56] JX 105 at SP COMM 006814.

[57] JX 106 at SP COMM 004931.

[58] JX 103 SP COMM 006929.

[59] JX 103 SP COMM 006930.

[60] JX 128 at A14.

[61] See JX 128 at A14. See, also, JX 125 at 45.

[62] JX 143 at 66. See, also, JX 92 at 179:2-23 and 188:12-189:1.

[63] JX 143 at 11.

[64] Id. at 67.

[65] Post-Trial Arg. Tr. 142:5-9.

[66] Jacob Dep. Tr. 87:10-17; see also JX 143 at 66.

[67] JX 128 (2004 10-K) at A12-A14; JX 137 (2005 10-K) at 42-44; JX 142 (2006 10-K) at A60-A62; JX 143 (2007 10-K) at 67-69; JX 144 (2008 10-K) at 67-68; JX 145 (2009 10-K) at 70-71; JX 147 (2010 10-K) at 69-71.

Defendants' counsel also stated that the Special Committee "had a sensitivity analysis that went all the way up to $1.20 at least" and that the Special Committee "knew what that relative valuation looked like at $1.20, which was even more fair than it was at lower prices."[68] Goldman performed sensitivity analyses for copper prices ranging from $0.80 per pound to $1.00 per pound.[69] The highest DCF equity value for Minera using Minera management projections was $3.053 billion.[70] The highest DCF equity value for Minera using projections approved by A&S was $2.414 billion.[71]

C. Damages

On October 21, 2004, Goldman valued Minera using 6.3x to 6.5x 2005E EBITDA multiple.[72] During the post-trial argument, the Court inquired whether plaintiff had applied comparable companies' multiples to Minera. Below is a table demonstrating the number of Southern shares that would have been issued in the Transaction if Minera was valued at various 2005E EBITDA multiples:[73]

Basis for Multiple	2005E EBITDA Multiple	Implied Minera Equity Value	Number of Southern Shares Issued[74]
Southern[75]	5.6x	$2.548 billion	55.5 million
Grupo Mexico[76]	4.4x	$1.802 billion	40.3 million
Comparable Companies (Mean and Median)[77]	4.8x	$2.051 billion	45.9 million

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[68] Post-Trial Arg. Tr. at 121.

[69] See JXs 101-106.

[70] JX 101 at SP COMM 003375.

[71] Id.

[72] JX 106 at SP COMM 004926.

[73] Calculations are performed using 2005E EBITDA of $622 million as per A&S, $1 billion of net debt, and assumption of 50% of present value of tax benefits (see JX 106 at SP COMM 004926) as follows:

Implied Minera Equity Value = (MM 2005E EBITDA * 2005E EBITDA Multiple (adjusted for special dividend)) – net debt + (50% pv of tax benefits).

Number of Southern Shares Issued = Implied Minera Equity Value/Southern October 21, 2004 stock price ($45.92 per share).

[74] As of October 21, 2004.

[75] JX 106 at SP COMM 004926 (per Goldman's Wall Street Research).

[76] JX 106 at SP COMM 004913.

[77] Id.

Basis for Multiple	2005E EBITDA Multiple	Implied Minera Equity Value	Number of Southern Shares Issued[74]
Beaulne[78]	4.95x	$2.144 billion[79]	48.0 million

In sum, the Court may want to consider that if Minera was valued using Southern's multiple,[80] the 5.6x 2005E EBITDA multiple that Defendants state in the November 2004 Roadshow was used in the Transaction,[81] Southern would have issued 12.2 million fewer shares in the Transaction. Valuing Minera at any of the other multiples considered would have resulted in Southern issuing even less shares in the Transaction.

As always, counsel is available at the Court's convenience should Your Honor have any questions.

Respectfully yours,

/s/ Ronald A. Brown, Jr.

Ronald A. Brown, Jr.
(DE Bar No. 2849)

cc: S. Mark Hurd, Esquire (by eFiling)
Kevin M. Coen, Esquire (by eFiling)
Richard L. Renck, Esquire (by eFiling)

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78 JX 47 at Exhibit 4.

79 See JX 47 at 41 ($2.179 billion using Minera 2005E EBITDA of $642.8).

80 See JX 73 (UBS November 2003 Meeting Agenda) ("applying the same multiple to both companies").

81 JX 107 at SP COMM 006674. Use of the lower multiple was possible only because the Roadshow relies a higher projected copper production for Minera (365.4 Mt) than A&S approved (329.1 Mt). Compare JX 107 (Roadshow) at 4 ("Assumes copper production of 365.4Mt") with JX 103 (July 8, 2004 Presentation) at 27 (A&S revised Minera copper production of 338.5Mt as of June 2004) and JX 106 (October 21, 2004 Presentation) at 17 (A&S revised Minera copper production of 329.1Mt). The Roadshow production projections (365.4 Mt) are higher than Minera management's own unadjusted projections (355.0 Mt) stated in the October 21, 2004 Presentation. JX 106 at 17.

EXHIBIT 1

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Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
In re DEL MONTE FOODS COMPANY SHAREHOLDERS LITIGATION.

C.A. No. 6027-VCL.
Submitted: Feb. 11, 2011.
Decided: Feb. 14, 2011.

Background: Shareholders of corporation brought action seeking injunction to delay shareholder vote on sale of corporation to high bidder.

Holdings: The Court of Chancery, Laster, Vice Chancellor, held that:
(1) evidence established a reasonable likelihood of success on the merits of shareholders' claim that directors failed to act reasonably in connection with process to sell corporation;
(2) evidence established a reasonable likelihood of success on the merits of shareholders' claim that high bidder to purchase corporation aided and abetted breaches of fiduciary duty;
(3) shareholders would suffer irreparable injury absent injunction;
(4) corporation would be enjoined from conducting a stockholder vote on the merger for a period of only 20 days.

So ordered.

West Headnotes

[1] Injunction 212 ⚿138.42

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)3 Subjects of Relief
212k138.42 k. Corporate Management and Dealings. Most Cited Cases

Evidence established a reasonable likelihood of success on the merits of shareholders' claim that directors failed to act reasonably in connection with process to sell corporation, as would support issuance of preliminary injunction to delay sale for purposes of permitting other bidders to come forward; although board was misled by self-interested financial advisor, board's lack of involvement in sale process enabled financial advisor to engage in self-interested dealing that tainted the sale process.

[2] Injunction 212 ⚿138.42

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)3 Subjects of Relief
212k138.42 k. Corporate Management and Dealings. Most Cited Cases

Evidence established a reasonable likelihood of success on the merits of shareholders' claim that high bidder to purchase corporation aided and abetted breaches of fiduciary duty that resulted from misconduct by bank facilitating sale of corporation, as would support issuance of preliminary injunction to delay sale for purposes of permitting other bidders to come forward; bidder knowingly participated in bank's self-interested activities, and agreed with bank to keep another bidder's involvement from the corporation's board.

[3] Injunction 212 ⚿138.42

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)3 Subjects of Relief
212k138.42 k. Corporate Management and Dealings. Most Cited Cases

Shareholders of corporation would suffer irreparable injury absent preliminary injunction to delay sale of corporation to winning bidder; because corporation had agreed to be purchased without directors' knowledge that the bank facilitating the transaction was engaging in self- interested dealing with the winning bidder, stockholders would be deprived forever of the unique opportunity to receive a pre-vote topping bid in a process free of taint from bank's improper activities.

[4] Injunction 212 138.42

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)3 Subjects of Relief
212k138.42 k. Corporate Management and Dealings. Most Cited Cases

Corporation would be preliminarily enjoined from conducting a stockholder vote on the merger for a period of 20 days, during which time the parties would be enjoined from enforcing deal protection measures, in action by shareholders alleging that bank facilitating sale of corporation engaged in self-interested dealing with winning bidder; delay would provide ample time for a serious and motivated bidder to emerge, but would also leave ample time for the existing merger agreement to be concluded should no other bidders come forward.

Stuart M. Grant, Michael J. Barry, Diane Zilka, Christine M. Mackintosh, Grant & Eisenhofer P.A., Wilmington, Delaware; Hung G. Ta, Brenda F. Szydlo, Michele S. Carino, Grant & Eisenhofer P.A., New York, New York; Randall J. Baron, A. Rick Atwood, Jr., David T. Wissbroecker, Edward M. Gergosian, David A. Knotts, Robbins Geller Rudman & Dowd LLP, San Diego, California; Plaintiffs' Co-Lead Counsel.

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OPINION

LASTER, Vice Chancellor.

***1** On November 24, 2010, Del Monte Foods Company ("Del Monte" or the "Company") entered into an agreement and plan of merger with Blue Acquisition Group, Inc. and its wholly owned acquisition subsidiary, Blue Merger Sub Inc. (the "Merger Agreement" or "MA"). Blue Acquisition Group is owned by three private equity firms: Kohlberg, Kravis, Roberts & Co. ("KKR"), Centerview Partners ("Centerview"), and Vestar Capital Partners ("Vestar"). Because KKR is the lead firm, I generally refer to the sponsor group as "KKR." The Merger Agreement contemplates a $5.3 billion leveraged buyout of Del Monte (the "Merger"). If approved by stockholders, each share of Del Monte common stock will be converted into the right to receive $19 in cash. The consideration represents a premium of approximately 40% over the average closing price of Del Monte's common stock for the three-month period ended on November 8, 2010. The $19 price is higher than Del Monte's common stock has ever traded.

The stockholders of Del Monte are scheduled to vote on the Merger on February 15, 2011. The plaintiffs seek a preliminary injunction postponing the vote. They originally asserted that the individual defendants, who comprise the Del Monte board of directors (the “Board”), breached their fiduciary duties in two separate ways: first by failing to act reasonably to pursue the best transaction reasonably available, and second by disseminating false and misleading information and omitting material facts in connection with the stockholder vote. The defendants mooted the disclosure claims through an extensive proxy supplement released during the afternoon of February 4, 2011 (the “Proxy Supplement”).

This case is difficult because the Board predominantly made decisions that ordinarily would be regarded as falling within the range of reasonableness for purposes of enhanced scrutiny. Until discovery disturbed the patina of normalcy surrounding the transaction, there were only two Board decisions that invited serious challenge: first, allowing KKR to team up with Vestar, the high bidder in a previous solicitation of interest, and second, authorizing Barclays Capital, the financial advisor to Del Monte, to provide buy-side financing to KKR.

Discovery revealed a deeper problem. Barclays secretly and selfishly manipulated the sale process to engineer a transaction that would permit Barclays to obtain lucrative buy-side financing fees. On multiple occasions, Barclays protected its own interests by withholding information from the Board that could have led Del Monte to retain a different bank, pursue a different alternative, or deny Barclays a buy-side role. Barclays did not disclose the behind-the-scenes efforts of its Del Monte coverage officer to put Del Monte into play. Barclays did not disclose its explicit goal, harbored from the outset, of providing buy-side financing to the acquirer. Barclays did not disclose that in September 2010, without Del Monte's authorization or approval, Barclays steered Vestar into a club bid with KKR, the potential bidder with whom Barclays had the strongest relationship, in violation of confidentiality agreements that prohibited Vestar and KKR from discussing a joint bid without written permission from Del Monte.

***2** Late in the process, at a time when Barclays was ostensibly negotiating the deal price with KKR, Barclays asked KKR for a third of the buy-side financing. Once KKR agreed, Barclays sought and obtained Del Monte's permission. Having Barclays as a co-lead bank was not necessary to secure sufficient financing for the Merger, nor did it generate a higher price for the Company. It simply gave Barclays the additional fees it wanted from the outset. In fact, Barclays can expect to earn slightly more from providing buy-side financing to KKR than it will from serving as Del Monte's sell-side advisor. Barclays' gain cost Del Monte an additional $3 million because Barclays told Del Monte that it now had to obtain a last-minute fairness opinion from a second bank.

On the preliminary record presented in connection with the injunction application, the plaintiffs have established a reasonable probability of success on the merits of a claim for breach of fiduciary duty against the individual defendants, aided and abetted by KKR. By failing to provide the serious oversight that would have checked Barclays' misconduct, the directors breached their fiduciary duties in a manner reminiscent of *Mills Acquisition Co. v. Macmillan, Inc.,* 559 A.2d 1261 (Del.1989). In that decision, the Delaware Supreme Court enjoined a transaction-ironically a leveraged buyout sponsored by KKR-when self-interested management and their financial advisor concealed information from the board. Like management's deal-specific, buy-side conflict in *Mills,* Barclays' deal-specific, buy-side conflict tainted the advice it gave and the actions it took.

To hold that the Del Monte directors breached their fiduciary duties for purposes of granting injunctive relief does not suggest, much less preordain, that the directors face a meaningful threat of monetary liability. On this preliminary record, it appears that the Board sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays. Unless further discovery reveals different facts, the one-two punch of exculpation under Section 102(b)(7) and full protection under Section 141(e) makes the chances of a judgment for money damages vanishingly small. The same cannot be said for the self-interested aiders and abetters. But while the directors may face little threat of liability, they cannot escape the ramifications of Barclays' misconduct. For purposes of equitable relief, the Board is responsible.

To remedy (at least partially) the taint from Barclays' activities, the plaintiffs ask that the vote on the Merger be enjoined for a meaningful period (30 to 45 days) and that the parties to the Merger Agreement be enjoined from enforcing the deal protections during that time. They have not sought (nor would I grant) a decree enjoining the Merger pending a post-trial adjudication. The plaintiffs argue that this limited injunctive relief will restore (albeit incompletely) the stockholders' unique opportunity to receive a topping bid free of fiduciary misconduct. Such an injunction would deprive KKR temporarily of the advantages it obtained by securing a deal through collusion with Barclays, while at the same time preserving the stockholders' ability to determine for themselves whether to accept the $19 per share Merger price. The plaintiffs analogize this limited relief to an injunction conditioned on the making of corrective disclosures, which similarly imposes a temporary transactional delay and then allows stockholders to decide for themselves whether to accept a deal.

***3** For the reasons that follow, I grant the relief plaintiffs seek, although for a shorter time period that takes into account the transaction's exposure to the market. The defendants are enjoined preliminarily from proceeding with the vote on the Merger for a period of 20 days. Pending the vote on the Merger, the parties to the Merger Agreement are enjoined from enforcing the no-solicitation and match-right provisions in Section 6.5(b), (c) and (h), and the termination fee provisions relating to topping bids and changes of recommendation in Section 8.5(b). The injunction is conditioned on the plaintiffs posting a bond in the amount of $1.2 million.

I. FACTUAL BACKGROUND

The facts are drawn from the record developed in connection with the plaintiffs' application for a preliminary injunction. The parties have submitted numerous documentary exhibits and the deposition testimony of seven fact witnesses. With their answering briefs, the defendants lobbed in four affidavits from witnesses who were deposed. Each of these lawyer-drafted submissions sought to replace the witnesses' sworn deposition testimony with a revised and frequently contradictory version. Had the differing averments been elicited by defense counsel during deposition, as they readily could have been, then plaintiffs' counsel could have tested the witnesses' assertions through cross-examination. Except on routine or undisputed matters, I have discounted these “non-adversarial proffers” FN1 and relied on the deposition testimony and contemporaneous documents. What follows are the facts as they are likely to be found after trial, based on the current record.

FN1. *In re W. Nat. Corp. S'holders Litig.*, 2000 WL 710192, at *19 (Del.Ch. May 22, 2000) (describing witness affidavits and explaining that the Court of Chancery will “ordinarily attach little if any weight to such inherently self-serving and non-adversarial proffers”); *see Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1232 (Del.Ch.2000) (“To the extent the affidavits contradict the depositions, this Court will exclude the offending affidavit testimony.”); *see also Chesapeake Corp. v. Shore*, 771 A.2d 293, 302 & n. 7 (Del.Ch.2000) (expressing disappointment with the proffering of less-knowledgeable board members rather than the chairman or top managers and stating “ ‘[t]he production of weak evidence when strong is, or should have been, available can lead only to the conclusion that the strong would have been adverse.’ “ (quoting *Kahn v.*

Lynch Comm. Sys., Inc., 638 A.2d 1110, 1119 n. 7 (Del.1994))).

A. Moses Works Behind The Scenes To Put Del Monte In Play.

Investment banks generate large fees from doing deals. To facilitate transactional activity, investment bankers routinely pitch deals to parties they hope might be interested. Coverage officers for investment banks regularly visit past, present, and potential clients to suggest mergers, acquisitions, and other strategic alternatives. Barclays is no exception.

Barclays has a strong presence in the consumer food and pet product sectors where Del Monte operates. Peter J. Moses is the Barclays managing director with coverage responsibility for Del Monte. Barclays and Del Monte have enjoyed a close relationship. In 2009, Barclays acted as joint book-runner on Del Monte's $450 million issuance of 7.5% senior subordinated notes and as joint dealer-manager and solicitation agent on Del Monte's tender offer and consent solicitation for its 8 5/8 % senior subordinated notes. During late 2009, Barclays advised Del Monte on and arranged financing for its unsuccessful acquisition of Waggin' Train LLC. In January 2010, Barclays acted as co-lead arranger for Del Monte's $1.2 billion senior secured credit facility. Barclays understood that it was one of Del Monte's principal investment banks.

Del Monte's stable businesses throw off large amounts of cash, a critical attribute for debt-fueled LBOs. In fiscal 2010, for example, Del Monte generated $3.7 billion in net sales and $250 million in cash flow. According to the bankers deposed in this case, the debt markets in late 2009 were again receptive to leveraged acquisitions, having shaken off the cobwebs from the concussive impact of Lehman Brothers' bankruptcy. Mergers and acquisitions activity in the canned food and pet products sectors had picked up. Investment bankers were busy pitching Del Monte on potential acquisitions and pitching potential acquirers on Del Monte.

***4** Like many large banks, Barclays has strong relationships with various LBO shops. KKR is one of Barclays' more important clients. Tarone Tr. 95. Over the past two years, KKR has paid Barclays over $66 million in fees. Barclays has worked with KKR on half a dozen projects in the consumer and retail space, including a large transaction where Barclays acted as both sell-side advisor and provided buy-side financing for KKR. Tarone Tr. 93-94.

On December 17, 2009, Moses and other Barclays bankers met with KKR to present various opportunities, including an acquisition of Del Monte. In early January 2010, Moses met with KKR again. KKR said it was ready “to take the next step” with Del Monte and planned to partner with Centerview on a bid. PX 16. Moses responded by outlining with prophetic clarity the process Del Monte would follow: a narrow, private solicitation of interest from a small group of approximately five sponsors with no strategic bidders. Moses made similar pitches during the same time period to other private equity firms, including Apollo Management.

B. Apollo's Expression Of Interest And Del Monte's Process

Before KKR could “take the next step,” Apollo sent Del Monte a written expression of interest in an acquisition at $14 to $15 per share. After receiving the letter, Del Monte reached out to Barclays. Moses believed Del Monte was also reaching out to other banks, including Goldman Sachs, a firm that ran an earlier process for the Company.

Moses told Del Monte that Barclays was well-positioned to advise Del Monte because Barclays “knew many of the entities that might be an interested buyer.” Ben. Tr. 59. Moses did not mention that he personally had been pitching Apollo, KKR, and other private equity firms on acquiring Del Monte. The Board did not learn of Moses' efforts to stir up the initial LBO bid until discovery in this litigation.

Moses also did not mention that Barclays planned from the outset to seek a role in providing buy-side financing. Barclays' internal "Project Hunt [Del Monte] Screening Committee Memo" dated January 25, 2010, stated bluntly that "Barclays will look to participate in the acquisition financing once the Company has reached a definitive agreement with a buyer." PX 54. A March 2010 version of the memo reiterated Barclays' intent. The Board did not learn that Barclays intended from the outset to have a buy-side role until discovery in this litigation.

Barclays immediately began advising Del Monte on responding to Apollo's expression of interest and exploring strategic alternatives. Moses recommended that the Board pursue a targeted, non-public process that tracked precisely what Moses had previewed with KKR and the other private equity firms. There are sound and reasonable justifications for such an approach, including a desire to avoid market leaks that could disrupt company operations and spook employees. But a narrow, targeted process involving a few large private equity firms also furthered Barclays' goal of providing buy-side financing. Private equity buyers are generally more likely than strategic buyers to require financing, and Barclays was one of a limited group of institutions with sufficient resources to handle a transaction as large as the Del Monte LBO.

***5** Barclays then identified the five LBO shops that would be invited to submit expressions of interest: KKR, Apollo, The Carlyle Group, CVC Partners, and the Blackstone Group. The Board adopted Barclays' recommendation.

Despite efforts to keep the process quiet and private, word leaked out. Vestar and Campbell's Soup contacted Barclays and asked to be included, which they were. Blackstone dropped out, and Del Monte entered into confidentiality agreements with the six participants. Each of the participants agreed not to discuss the confidential information they obtained from Del Monte or their bids with anyone, including each other. A critical provision stated:

> In addition, you agree that, without the prior written consent of the Company, you and your Representatives will not disclose to any other person (other than your Representatives) the fact that you are considering a possible transaction with the Company, that this Agreement exists, that the Confidential Information has been made available to you, that discussions or negotiations are taking place concerning a possible transaction involving the Company or any of the terms, conditions, or other facts with respect thereto (including the status thereof).... Without limiting the generality of the foregoing, you further agree that you will not, directly or indirectly, share the Confidential Information with or enter into any agreement, arrangement or understanding, or any discussions which would reasonably be expected to lead to such an agreement, arrangement or understanding with any other person, including other potential bidders and equity or debt financing sources (other than your Representatives as permitted above) regarding a possible transaction involving the Company without the prior written consent of the Company and only upon such person executing a confidentiality agreement in favor of the Company with terms and conditions consistent with this Agreement.

PX 18 at 2 (the "No Teaming Provision"). By securing this language, the Board ensured that Del Monte would have the contractual right to control the competitive dynamics of the process and determine whether any bidders would be allowed to work together on a joint bid. The confidentiality agreement also contained a two-year standstill. *Id.* at 4.

The confidentiality agreements provided a collateral benefit to Barclays. Absent Company consent, the signatories could not discuss potential financing with any source other than Barclays. *Id.* at 2. As with the decision to engage in a targeted, non-public canvass of private equity buyers, there are sound and reasonable justifications for such a provision. At the same time, the limitation served

Barclays' interests in obtaining a piece of the buy-side financing. Because of the provision, Barclays would have the first crack at discussing financing with each bidder, its credit group would be familiar with the deal, and its bankers could more persuasively pitch for a piece of the action. See Tarone Tr. 129-31. The lead banker on Barclays' financing team acknowledged that Barclays would express interest in providing financing when discussing capital structures with bidders and that this put Barclays in the catbird seat for the business. *See Id.* at 89-93.

***6** After executing a confidentiality agreement, each potential bidder was provided with access to non-public information and received presentations from Del Monte senior management. All potential bidders were directed to submit non-binding indications of interest by March 11, 2010. Five did; Campbell's Soup did not. Carlyle proposed a transaction in a range of $15.50 to $17.00 per share and asked for permission to explore debt financing with Bank of America, JPMorgan, Deutsche Bank, and Credit Suisse. Apollo proposed a transaction in a range of $15.50 to $17.00 per share and asked for permission to explore financing with Bank of America, JPMorgan, Morgan Stanley, Deutsche Bank, Credit Suisse, UBS, and BMO Capital Markets. CVC proposed a transaction at $15.00 to $16.50 per share, expressed interest in taking on an equity partner, and proposed to raise financing through its internal debt financing team. KKR expressed interest in a transaction at $17 per share. KKR did not ask for permission to talk to any banks and stated only that their bid contemplated "newly raised debt in line with the guidance provided by Barclays." PX 20 at 3. To a Barclays' banker seeking a buy-side role, KKR's letter would have been the most reassuring, particularly because KKR had worked with Barclays in a dual role before.

Vestar's bid raised tactical issues. Vestar expressed interest in a transaction in a range of $17.00 to $17.50 per share, making it the high bidder. Everyone understood that Vestar would need to pair up with at least one other sponsor. Vestar had made clear from the outset, and confirmed in its expression of interest, that "[it] would expect to commit to half of the required equity in this transaction and would look to partner with another private equity firm to fill out the remaining portion." PX 50 at 2. Vestar thus was not going to bid alone. Its advantage was expertise in the food business and its strength as an operator. James Ben, who led the Barclays M & A team, regarded Vestar as a valuable participant in the sale process and expected that the firm would be a value-promoting partner for another bidder, though more for its operational expertise than as a source of capital. Ben Tr. 93-94. Moses suggested that Vestar consider pairing up with Carlyle. Ben considered pairing Vestar with Apollo. CVC had expressed interest in a second sponsor and was another logical option. Internal KKR documents reflect concern about Vestar working with another firm.

During its regularly scheduled meeting on March 18, 2010, the Board considered the five indications of interest. The Board decided that the Company's stand-alone growth prospects were sufficiently strong that it was not in the stockholders' best interests to proceed further with the process. The directors also concluded that Barclays had pushed too far, too fast, and that Barclays had not been hired to actually sell the company. *See* Martin Tr. 23-24. Moses blamed Richard Wolford, Del Monte's Chairman, President, and CEO. He believed Wolford turned against the LBO at the last minute, spoke privately with the directors, and allowed Moses to walk into a hostile meeting unaware. KKR thought that "Barclays didn't do such a good job here w/ Wolford and the board." PX 23. When Barclays later kicked off the LBO process again, Moses would do a better job setting the table.

C. KKR Continues To Pursue Del Monte.

***7** The Board specifically instructed Barclays "to shut [the] process down and let buyers know the company is not for sale." PX 57. Over the ensuing months, KKR reached out to Del Monte on at least two occasions. In April 2010, KKR representatives met with Wolford and David Meyers, Del Monte's CFO. KKR said it wanted to keep the lines of communication open about future opportunities. In May 2010, KKR approached Del Monte about jointly pursuing acquisitions. Del Monte declined, both because KKR's capital was too expensive and because Del Monte had all the capital it needed. KKR also continued to meet with Barclays.

D. Barclays Pairs Up Vestar With KKR.

In September 2010, Moses sensed that the timing was right to put the Del Monte LBO back together. Moses had lunch with Brian Ratzan of Vestar. Moses suggested that it might be “an interesting time to make another approach to [Del Monte]” and that, if Vestar were interested, “the ideal partner would be KKR.” Ratzan Tr. 35. Moses said that it was an “opportune time” for approaching Del Monte because “[t]he company had missed its numbers for a couple of quarters [and] [t]he stock price was down.” *Id.* at 36. On September 14, Moses discussed the idea with KKR. After meeting with KKR, Moses called Ratzan. Moses then emailed his colleagues that Vestar “is going to partner with KKR on [Del Monte]. So team wi[ll] be kkr, vestar and hooper (centerview). Obviously this is confidential.” PX 60.

At the time, both Vestar and KKR were bound by their confidentiality agreements with Del Monte. The No Teaming Provision prohibited Vestar and KKR from entering into any “agreement, arrangement or understanding, or any discussions which would reasonably be expected to lead to such an agreement, arrangement or understanding with any other person, including other potential bidders and equity or debt financing sources (other than your Representatives as permitted above) regarding a possible transaction involving the Company without the prior written consent of the Company....” Vestar and KKR did not have “prior written consent” from Del Monte. Nor did Barclays. In fact, Barclays was not authorized at that time to do anything on behalf of Del Monte. The Board had instructed Barclays “to shut [the] process down and let buyers know the company is not for sale.” PX 57.

By pairing Vestar with KKR, Barclays put together the two highest bidders from March 2010, thereby reducing the prospect of real competition in any renewed process. There were other logical pairings that would have promoted competition. Teaming up Vestar and KKR served Barclays' interest in furthering a deal with an important client (KKR) that previously had used Barclays for buy-side financing. After Moses paired Vestar with KKR, Vestar never considered working with a different sponsor.

E. KKR Makes Its Bid.

On October 11, 2010, representatives of KKR asked to meet with Wolford. During the meeting, KKR delivered a written indication of interest from KKR and Centerview to acquire Del Monte for $17.50 in cash. The price represented a 28.7% premium over the closing price of Del Monte's common stock on the previous trading day. While nominally higher than the $17 offered in March, it was a step back given intervening market developments. Del Monte and Barclays calculated that an equivalent bid would have been $18.32. *See* PX 72 (“I landed on $18.32/share as the equivalent offer relative to the $17 previously”).

***8** The KKR letter did not mention Vestar, and Vestar representatives did not attend the meeting. In preparing for the meeting, KKR and Vestar agreed not to disclose Vestar's participation because “it's just another thing Rick will have to go back to his board and explain. Will be easier to bring in Vestar once we have traction with the Company.” PX 24.

After the October 11, 2010, meeting, Barclays worked with KKR to conceal Vestar's participation. For example, on October 31, Brown of KKR emailed his colleagues that Vestar would not attend a meeting with Del Monte because of the complications it would create. PX 26 ("delicate time for Board, don't want to upset matters potentially w[ith] a group change at a critical juncture. Vestar ultimately ok w[ith] this"). Moses agreed that it was best to keep Vestar's involvement hidden. *See* PX 62 (e-mail from Moses to Brown, dated Oct. 31, 2010, "agree at this point that we keep meeting to K[KR] and Centerview from your side.").

F. The Board Adopts A Single-Bidder Strategy.

On October 13, 2010, the Board met to consider KKR's indication of interest. The Board met again on October 25. Management discussed the Company's long range plan and the challenges and risks associated with its execution. Management suggested that a transaction with KKR potentially represented a "risk-free alternative" to the long range plan. On the question of whether to sell, management faced conflicts of its own. Wolford planned to retire in 2012 and was being pressed by the Board for a succession plan. Wolford was resisting and had said he would rather sell the Company than remake his team. From an economic standpoint, Wolford would receive an additional $24 million if Del Monte was sold before his retirement. Del Monte CFO Meyers also planned to retire in 2012 and would receive an additional $5 million if the Company was sold before then. *See* Proxy Supp. at 6-11.

After deciding to pursue discussions with KKR, the Board considered whether to conduct a pre-signing market check. The Board concluded that none was needed. First, KKR's indication of interest at $17.50 per share was at the high end of the indications of interest that the Company had received in March 2010, although lower on a relative basis after adjusting for intervening market trends. Second, the Board felt that no other potential bidders were lurking in the wings, because only Campbell's Soup came forward when word of the private process leaked in early 2010. Third, no one other than KKR had communicated with Del Monte in the eight months since the Board instructed Barclays to tell bidders that Del Monte was not for sale. Fourth, the Board was concerned that a renewed process could have detrimental effects on employees, customers, and the stock price, particularly if the process did not result in a completed transaction. Finally, the Board considered that the previous high bid of $17.50 had been submitted by Vestar, a firm that needed to partner with a larger sponsor to make a bid. At the time, the Board did not know that Barclays had teamed Vestar with KKR.

***9** The Board ultimately decided to adopt a single-bidder strategy of negotiating only with KKR. During the meeting, the Board formally authorized the Company to "reengage" Barclays as its financial advisor. After the meeting, the Chairman of the Strategic Committee, Terence Martin, met with Moses and Ben to negotiate Barclays' new engagement letter. Martin "personally directed that Barclays was not to speak or act on Del Monte's behalf until the terms of the engagement letter had been finalized." Martin Aff. ¶ 22. The Barclays representatives did not tell Martin that Moses had been communicating with Vestar and KKR, put the two firms together, and helped spur the KKR bid. Barclays then began advising Del Monte on the bid Moses engineered.

G. The Initial Negotiations With KKR.

Between October 26 and November 9, 2010, Barclays interacted with KKR. Barclays reported frequently to Del Monte management and the Strategic Committee, but Barclays was the principal point of contact for KKR.

On October 27, 2010, the Board asked Barclays to tell KKR that the $17.50 per share offer was insufficient, but that the Company was prepared to give KKR access to due diligence information to allow them to submit a higher offer. On November 4, KKR attended a meeting with Del Monte management. Barclays and KKR agreed that Vestar would not attend and to keep Vestar's involvement secret from the Company

On November 8, 2010, news of a potential Del

Monte LBO leaked when the *London Evening Standard* reported that KKR had offered to acquire the Company for $18.50 per share. Later in the day, KKR contacted the Board and raised its offer to $18.50 with a request for exclusivity. Vestar's participation still went unmentioned.

On November 9, 2010, the Board met to discuss KKR's proposal. The Board declined to grant formal exclusivity, but did not reach out to any other bidders. The Board also declined to approve a transaction at $18.50 per share. At the same time, the Board signaled its receptivity by authorizing KKR to begin discussing financing commitments with lenders. According to an internal KKR email, “Barclays guidance was we should read real significance into their authorizing full access with instructions to get us to a point of being firm/done based on the price we raised to.” PX 29.

H. Del Monte Finally Learns About Vestar's Involvement And Barclays' Buy-Side Desires.

With momentum building towards a deal, the time had come for the repeat M & A players to hit up the Board with two unsavory requests. First, during the week of November 8, 2010, KKR “formally approached Barclays Capital to request that the Company allow KKR/Centerview to include Vestar in the deal as an additional member of the sponsor group.” Proxy Supp. at 3. Note the artful phrasing. Barclays had paired Vestar with KKR in September, and they had been *de facto* partners since at least October. Yet Barclays had never been “formally approached,” and technically Vestar had never been “included in the deal as an additional member of the sponsor group.”

***10** No one suggested that adding Vestar was necessary for KKR to proceed with its bid. There is no evidence that including Vestar firmed up a wavering deal. The Board was not told that Vestar in fact had been partnered with KKR since September, when Barclays put them together. The contemporaneous record does not reflect any consideration given to the ramifications of permitting KKR to team up with the firm who previously submitted the high bid and who could readily have teamed with Carlyle, Apollo, CVC, or another large buyout shop. The Board did not consider rejecting KKR's request, enforcing the confidentiality agreement, and inviting Vestar to participate with a different sponsor to generate competition. The Board did not seek to trade permission for Vestar to pair with KKR for a price increase or other concession.

The second unsavory request was when Barclays finally asked Del Monte if it could provide buy-side financing, as Barclays had been planning to do since at least January 2010. Barclays had long been signaling KKR about its desire to participate. On November 8, Moses asked KKR to give Barclays one third of the debt. KKR agreed. The next day Brown reported by email to the KKR investment committee that Barclays had “asked us to use JPM, BofA and Barclays themselves as the financing banks; we find that acceptable and will ask to add one more.” PX 29. Also on November 9, Barclays asked Del Monte management for permission to provide buy-side financing to KKR. They agreed. *See* PX 40. On November 12, Brown reported to his KKR colleagues that “Barclays has been cleared to be a financing bank.” JX 30.

At the time Barclays asked for and obtained Del Monte's permission to provide buy-side financing, *Del Monte and KKR had not yet agreed on price.* Barclays' buy-side participation was not used to extract a higher price. Nor was it necessary to finance the deal. No one thought that KKR needed Barclays, and other banks were already clamoring for their shares. Barclays simply wanted to double-dip. Through its buy-side role, Barclays will earn $21 to $24 million, as much and possibly more than the $23.5 million it will earn as the sell-side advisor.

On November 23, 2010, Del Monte executed a letter agreement that formally authorized Barclays to provide financing to KKR. In contrast to the Barclays witnesses, who reluctantly admitted when pressed that providing buy-side financing *might* create the *appearance* of a *potential* conflict, the

November 23 letter acknowledged that Barclays' relationship became adverse to Del Monte and that if push came to shove, Barclays would look out for itself. In the language of the letter, "[i]n the event that Barclays Capital is asked to provide acquisition financing to a buyer of the Company, the Company should expect Barclays Capital to seek to protect its interests as a lender, which may be contrary to the interests of the Company." PX 35 at 1. Because of the conflict of interest, Barclays insisted in the letter agreement that Del Monte obtain a second fairness opinion. *Id.* ("Barclays Capital believes that it is essential, in addressing such conflicts of interest, for the Company to receive independent financial advice, including an additional fairness opinion, from an independent third party firm who is not involved in the acquisition financing...."). Not only did Del Monte fail to secure any benefits for itself or its stockholders as the price of Barclays' buy-side participation, but Del Monte actually incurred an additional $3 million for a second financial advisor. Del Monte hired Perella Weinberg Partners LP to fulfill this role. Perella Weinberg's fee is not contingent on closing. On the plus side, this helps make its work independent. On the minus side, Del Monte incurred a $3 million expense to help Barclays make another $24 million, and Del Monte will have to bear this expense even if the deal does not close.

I. Barclays Continues To Negotiate With KKR.

***11** Between November 19 and 22, 2010, at the same time it was working with KKR to provide financing for the deal, Barclays ostensibly negotiated with KKR over the price. On November 22, Barclays reported that KKR was willing to consider paying $18.75 per share. Internally, Barclays already had evaluated a $19 price for KKR, and KKR had secured authority from its Investment Committee to bid up to $19 per share. The Board declined the $18.75 figure and instructed Barclays to go back to KKR.

On November 24, 2010, Barclays reported that KKR had made its best and final offer of $19 per share. Later in the day, the Board met to consider the offer. Barclays and Perella Weinberg delivered their fairness opinions. The Board reviewed the provisions of the proposed Merger Agreement that had been negotiated between outside counsel to the Company and KKR. After discussion and an executive session, the Board unanimously approved the Merger Agreement.

J. The Terms Of The Merger Agreement

Section 6.5(a) of Merger Agreement provided for a 45-day post-signing go-shop period during which Del Monte had the right to "initiate, solicit and encourage any inquiry or the making of any proposal or offers that could constitute an Acquisition Proposal." The Merger Agreement defines "Acquisition Proposal" broadly as

> any bona fide inquiry, proposal or offer from any person or group of persons other than Parent or one of its subsidiaries for, in one transaction or a series of related transactions, (A) a merger, reorganization, consolidation, share exchange, business combination, recapitalization, liquidation, dissolution or similar transaction involving an acquisition of the Company (or any subsidiary or subsidiaries of the Company whose business constitutes 15% or more of the net revenues, net income or assets of the Company and its subsidiaries, taken as a whole) or (B) the acquisition in any manner, directly or indirectly, of over 15% of the equity securities or consolidated total assets of the Company and its subsidiaries, in each case other than the Merger.

MA § 6.5(d)(i). Once the go-shop period ended, Del Monte was bound by a customary no-solicitation clause that prohibited Del Monte, among other things, from "initiat[ing], solicit[ing], or knowingly encourage[ing] any inquiries or the making of any proposal or offer that constitutes or reasonably could be expected to lead to an Acquisition Proposal." *Id.* § 6.5(b). The no-solicitation clause permits Del Monte to respond to a Superior Proposal, defined generally as an Acquisition Proposal (but with the references to 15% changed to

50%) that the Board determines is "more favorable to the Company's stockholders from a financial point of view" than the Merger and "is reasonably likely to be consummated." *Id.* § 6.5(d)(iii).

During the go-shop period, Del Monte was authorized to, among other things, waive or release any party from any pre-existing standstill agreements with the Company, and Del Monte could do so "at its sole discretion." *Id.* § 6.5(a). This is a salutary provision that eliminates any argument from the acquirer that it has an explicit or implicit contractual veto over the decision to grant a waiver or release. Exercising this authority, Del Monte released Carlyle, CVC, Apollo, and Campbell's Soup from the standstill provisions in the confidentiality agreements they executed in February 2010.

***12** Section 8.3(a) of the Merger Agreement permits Del Monte to terminate its deal with KKR to accept a Superior Proposal prior to the stockholder vote on the merger if

> (i) the Company Board authorizes the Company, subject to complying with the terms of this Agreement, to enter into one or more Alternative Acquisition Agreements with respect to a Superior Proposal; (ii) immediately prior to or substantially concurrently with the termination of this Agreement the Company enters into one or more Alternative Acquisition Agreements with respect to a Superior Proposal; and (iii) the Company immediately prior to or substantially concurrently with such termination pays to Parent or its designees in immediately available funds any fees required to be paid pursuant to Section 8.5.

Id. § 8.3(a). Prior to exercising the termination right, Del Monte must have given KKR written notice describing the material terms and conditions of the Superior Proposal and negotiated with KKR in good faith for three business days to enable KKR to match the Superior Proposal. *Id.* § 6.5(h). The match right must be complied with for each change in the financial terms of or other material amendment to the Superior Proposal, except that after the first match the three business day period becomes two business days. *Id.*

If Del Monte terminates the Merger Agreement to enter into a transaction with an Excluded Party-defined generally as a person or group who made an Acquisition Proposal during the go-shop period-then Del Monte owes KKR a termination fee in the amount of $60 million, representing 1.13% of total deal value and 1.5% of equity value, or approximately $0.312 per share. *Id.* § 8.5(b). If Del Monte terminates the Merger Agreement to enter into a transaction with a party other than an Excluded Party, then the termination fee increases to $120 million, representing 2.26% of total deal value, 3.0% of the total equity value, and approximately $0.624 per share. *Id.*

The Board decided to let Barclays run the go-shop. In carrying out this assignment, Barclays had a direct financial conflict. In its role as sell-side financial advisor, Barclays had earned $2.5 million for its fairness opinion (despite the conflict of interest giving rise to the need for a second banker) and would earn another $21 million if the deal closed. For its role in the buy-side financing for KKR, Barclays stood to earn another $21 to $24 million. As Ben acknowledged, Barclays would earn substantially more for executing the LBO with KKR than it would for any other strategic alternative. If another bidder emerged that did not need financing or who chose not to use Barclays, then Barclays would lose its buy-side financing fees. Martin testified that it "never occurred to us that [Barclays] wouldn't do a good job." Martin Tr. 64.

Other advisors were available. Perella Weinberg had rendered the second fairness opinion necessitated by Barclays' conflict and could have handled the process. Goldman Sachs had a prior relationship with Del Monte and independently approached Del Monte about managing the go-shop. Upon learning of Goldman's interest, Barclays told KKR that Goldman was trying to "scare up competition." PX 32 ("Goldman has been pushing the company to help run their go-shop and scare up competition against us (!)....”). Brown of KKR told Barclays that he would “manage it” directly with Goldman. *Id.* He solved the problem by letting Goldman participate in 5% of the syndication rights for the acquisition financing, which “squared things away there.” PX 33. After that, Goldman dropped its efforts to conduct the go shop.

***13** During the go-shop period, Barclays contacted fifty-three parties, including thirty strategic buyers. Three requested and were provided with confidentiality agreements. Two parties from the early 2010 process re-engaged. No one expressed interest.

K. The Proxy Supplement

On January 12, 2011, Del Monte issued its definitive proxy statement on Schedule 14A. Many of the disclosures about the background of the transaction were false and misleading, in part because Barclays hid its behind-the-scenes activities from the Board. On February 4, after the completion of discovery in connection with the preliminary injunction application, Del Monte issued the Proxy Supplement to moot the plaintiffs' disclosure claims. The Proxy Supplement disclosed that the Company learned significant facts about Barclays' role and interactions with KKR only as a result of this litigation.

Among other things, the Proxy Supplement disclosed the following:

• “Since the filing of the Definitive Proxy Statement, the Company has learned that as early as January 2010, representatives of Barclays Capital had indicated their intent to seek to participate as a financing source in connection with any future transaction pursued by the Company subject to the internal approval of Barclays Capital and subject to the approval of the Company if Barclays Capital were also acting as financial advisor to the Company.” Proxy Supp. at 2.

• “Since the filing of the Definitive Proxy Statement by the Company, the Company has learned that financing sources other than Barclays Capital could have provided sufficient financing for the transaction at $19.00 per share without the participation of Barclays Capital.” *Id.* at 4.

• “Since the filing of the Definitive Proxy Statement, the Company has learned that beginning in August 2010 and September 2010, after Barclays Capital's engagement with the Company had formally concluded, Barclays Capital had routine business development discussions with, among others, KKR and Vestar, concerning potential strategic opportunities, including a potential acquisition of the Company. In the course of the discussions between Barclays Capital and Vestar, Barclays Capital and Vestar discussed that KKR/Centerview would be a good partner with Vestar and a good strategic match with Vestar if the potential for a transaction involving the Company arose. At the time of these discussions, Barclays Capital believed that Vestar and KKR/Centerview had had prior discussions about potential opportunities in the consumer sector, including the possibility of an acquisition of the Company if the opportunity reemerged. The Company also has learned since the filing of the Definitive Proxy Statement that, subsequent to the routine business development discussions in August and September 2010 discussed above, KKR/Centerview and Vestar had discussions about working together on an indication of interest regarding a transaction with the Company.” *Id.* at 2-3.

***14** • “Since the filing of the Definitive Proxy Statement, the Company has learned that during the period between October 11, 2010 and the week of November 8, 2010 there were discussions among the sponsors concerning the conversations between KKR/Centerview and the Company and about potentially adding Vestar as an acquisition partner at a later point in time in the event negotiations progressed with the Company.” *Id.* at 3.

The defendants released this information on the afternoon of Friday, February 4, 2011, apparently expecting that stockholders could digest it, determine how to vote, and either submit proxies or revocations or appear and vote at the special meeting on Tuesday, February 15. In light of the relief granted, I need not separately consider whether the timing and manner of dissemination were adequate under the circumstances.

II. LEGAL ANALYSIS

To obtain a preliminary injunction, the plaintiffs must demonstrate (i) a reasonable probability of success on the merits; (ii) that they will suffer irreparable injury if an injunction is not granted; and (iii) that the balance of the equities favors the issuance of an injunction. *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Co.,* 506 A.2d 173, 179 (Del.1986). The plaintiffs have met the first and second elements. After due consideration of the third element, I find that the circumstances call for a limited injunction along the lines the plaintiffs have requested.

A. The Probability of Success on the Merits

The first element of the familiar injunction test requires that the plaintiffs establish a reasonable probability of success on the merits. This showing "falls well short of that which would be required to secure final relief following trial, since it explicitly requires only that the record establish a reasonable probability that this greater showing will ultimately be made." *Cantor Fitzgerald, L.P. v. Cantor,* 724 A.2d 571, 579 (Del.Ch.1998) (internal quotation marks omitted). Because the disclosure claims have been mooted, the pertinent claims are (i) breach of fiduciary duty against the director defendants and (ii) aiding and abetting by KKR.

1. The Breach of Fiduciary Duty Claim

"Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness." *Reis v. Hazelett Strip-Casting Corp.,* 2011 WL 303207, at *8 (Del.Ch. Feb.1, 2011). Delaware applies enhanced scrutiny when directors face potentially subtle structural or situational conflicts that do not rise to a level sufficient to trigger entire fairness review, but also do not comfortably permit expansive judicial deference. *Id.* at *8-10; *see Paramount Commc'ns Inc. v. QVC Network Inc.,* 637 A.2d 34, 42 (Del.1994) [hereinafter, " *QVC* "] ("[T]here are rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors. In these situations, a court subjects the directors' conduct to enhanced scrutiny to ensure that it is reasonable.").

***15** Enhanced scrutiny has both subjective and objective components. Initially, the directors "bear the burden of persuasion to show that their motivations were proper and not selfish." *Mercier v. Inter-Tel (Del.), Inc.,* 929 A.2d 786, 810 (Del.Ch.2007). Adapted to the M & A context, the directors must show that they sought "to secure the transaction offering the best value reasonably available for the stockholders." *QVC,* 637 A.2d at 44. The key verb is "sought." Time-bound mortals cannot foresee the future. The test therefore cannot be whether, with hindsight, the directors actually achieved the best price. "Rather, the duty can only be to try in good faith, in such a setting, to get the best available transaction for the shareholders. Directors are not insurers." *Citron v. Fairchild Camera and Instrument Corp.,* 1988 WL 53322, at * 16 n. 17 (Del.Ch. May 19, 1988) (Allen, C.); *accord In re Dollar Thrifty S'holder Litig.,* 2010 WL 3503471, at *32 (Del.Ch. Sept.8, 2010).

Having made the necessary subjective showing, the directors next must demonstrate that "their actions were reasonable in relation to their legitimate objective." *Mercier,* 929 A.2d at 810. The directors bear the burden of proving that they (i) followed a reasonable decision-making process and based their decisions on a reasonable body of information, and (ii) acted reasonably in light of the circumstances then existing. *QVC,* 637 A.2d at 45. The reasonableness standard permits a reviewing court to address inequitable action even when directors may have subjectively believed that they were acting properly.[FN2] That said, the objective standard does not permit a reviewing court to freely substitute its own judgment for the directors'.

> FN2. *See, e.g., Hubbard v. Hollywood Park Realty Enters., Inc.,* 1991 WL 3151, at *10 (Del.Ch. Jan.14, 1991) ("[O]ccasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably."); *id.* at *7 n. 9 ("To be 'inequitable', such conduct does not necessarily require a dishonest, selfish, or evil motive."); *Stahl v. Apple Bancorp, Inc.,* 579 A.2d 1115, 1121 (Del.Ch.1990) (Allen, C.) ("Fiduciaries who are subjectively operating selflessly might be pursuing a purpose that a court will rule is inequitable."); *Blasius Indus., Inc. v. Atlas Corp.,* 564 A.2d 651, 663 (Del.Ch.1988) (Allen, C.) (holding that, where board acted with purpose of interfering with shareholder vote, "even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders" and noting "parenthetically that the concept of an unintended breach of the duty of loyalty is unusual but not novel"). Each of these cases involved the question of injunctive relief; none addressed the separate issue of whether defendant directors could be held liable for monetary damages.

> [A] court applying enhanced judicial scrutiny should be deciding whether the directors made **a reasonable** decision, not **a perfect** decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.

QVC, 637 A.2d at 45 (emphasis in original). Put differently, enhanced scrutiny "is not a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith." *In re Toys "R" Us, Inc. S'holder Litig.,* 877 A.2d 975, 1000 (Del.Ch.2005); *accord Dollar Thrifty,* 2010 WL 3503471, at *17 ("[A]t bottom *Revlon* is a test of reasonableness; directors are generally free to select the path to value maximization, so long as they choose a reasonable route to get there."). What typically drives a finding of unreasonableness is evidence of self-interest, undue favoritism or disdain towards a particular bidder, or a similar non-stockholder-motivated influence that calls into question the integrity of the process. *See Dollar Thrifty,* 2010 WL 3503471, at *18-19; *Toys "R" Us,* 877 A.2d at 1000-01.

***16** In evaluating the adequacy of the directors' decision-making and the information they had available, a reviewing court necessarily will consider the extent to which a board has relied on expert advisors. When responding to a takeover bid or considering a final-stage transaction, the directors' advisors play a pivotal role.

> Frequently, the outside directors who find themselves in control of a corporate sale process have had little or no experience in the sale of a public company. They are in *terra incognito* [sic]. Naturally, they turn for guidance to their specialist advisors who will typically have had a great deal of relevant experience.

William T. Allen, *Independent Directors In MBO Transactions: Are They Fact or Fantasy?,* 45 Bus. Law.2055, 2061 (1990). "It is obvious that no role is more critical with respect to protection of shareholder interests in these matters than that of the expert lawyers [and here I add financial advisors] who guide sometimes inexperienced directors through the process." *In re Fort Howard Corp. S'holders Litig.,* 1988 WL 83147, at *12 (Del.Ch. Aug.8, 1988) (Allen, C.).

Because of the central role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, this Court has required full disclosure of investment banker compensation and potential conflicts.[FN3] This Court has not stopped at disclosure, but rather has examined banker conflicts closely to determine whether they tainted the directors' process.[FN4]

FN3. *See In re John Q. Hammons Hotels Inc. S'holder Litig.,* 2009 WL 3165613, at *16 (Del.Ch. Oct.2, 2009) (emphasizing importance of disclosure of potential banker conflict of interest and explaining that "[t]here is no rule ... that conflicts of interest must be disclosed only where there is evidence that the financial advisor's opinion was actually affected by the conflict"); *David P. Simonetti Rollover IRA v. Margolis,* 2008 WL 5048692, at *8 (Del.Ch. June 27, 2008) ("[I]t is imperative for the stockholders to be able to understand what factors might influence the financial advisor's analytical efforts.... For that reason, the ... benefits of the Merger to [the investment bankers,] beyond its expected fee, must also be disclosed to ... stockholders."); *see also In re Lear Corp. S'holder Litig.,* 926 A.2d 94, 114 (Del.Ch.2007) (requiring disclosure of CEO conflict of interest where CEO acted as negotiator; "Put simply, a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price.").

FN4. *See Ortsman v. Green,* 2007 WL 702475, at *1 (Del.Ch. Feb.28, 2007) (ordering expedited discovery where target's financial advisor participated in the buy-side financing even though company retained a separate financial advisor to render a fairness opinion); *Khanna v. McMinn,* 2006 WL 1388744, at *25 (Del.Ch. May 9, 2006) (finding plaintiffs had raised facts sufficient to "create a reasonable doubt that the transaction was the product of a valid exercise of business judgment" where investment bank provided a bridge loan to the target and thus had an interest in ensuring the closing of the transaction); *In re Prime Hospitality, Inc. S'holders Litig.,* 2005 WL 1138738, at *12 (Del.Ch. May 4, 2005) (rejecting settlement of *Revlon* claim and questioning "how can the Court attribute weight to the notion that Bear Stearns [the allegedly conflicted banker] was retained by Prime to shop the company?").

In *Toys "R" Us,* Vice Chancellor Strine considered whether an investment banker's role in providing stapled financing created a conflict of interest that merited injunctive relief. At the outset of the sale process challenged in that case, the sell-side investment banker, First Boston, asked about possibly providing buy-side financing for purchasers of a subsidiary. "The board promptly nixed that idea." 877 A.2d at 1005. Then, following a lengthy process during which the form of the transaction shifted from a sale of the subsidiary to a sale of the whole company, and two months after the process culminated in an executed merger agreement, First Boston again asked to be permitted to provide a portion of the buy-side financing. This time the board agreed. Vice Chancellor Strine described that decision as "unfortunate, in that it tends to raise eyebrows by creating the appearance of impropriety, playing into already heightened suspicions about the ethics of investment banking firms." *Id.* at 1006. He suggested it would have been "[f]ar better, from the standpoint of instilling confidence, if First Boston had never asked for permission, and had taken the position that its credibility as a sell-side advisor was too important in this case, and in general, for it to simultaneously play on the buy-side in a deal when it was the seller's financial advisor." *Id.* He likewise noted that "it might have been better, in view of First Boston's refusal to refrain, for the board of the Company to have declined the request, even though the request came on May 12, 2005, almost two months after the board had signed the merger agreement." *Id.* Nevertheless, after reviewing in detail the public, yearlong, multi-phase process that the board and its banker conducted, Vice Chancellor Strine concluded "upon close scrutiny" that First Boston's appearance of conflict did not have "a causal influence" on the board's process. *Id.* He cautioned that "[i]n general, however, it is advisable that investment banks representing sellers not create the appearance that they desire buy-side work, especially when it might be that they are more likely to be selected by some buyers for that lucrative role than by others." *Id.* at 1006 n. 46.

***17** Applying these principles to the current case shows that Barclays' activities went far beyond what took place in *Toys "R" Us.* Barclays set out to provide acquisition financing, as established by the internal screening memos from January and March 2010. Barclays' Del Monte coverage officer pitched a Del Monte LBO to KKR, Apollo, and other private equity firms that would be likely to use Barclays for acquisition financing. Once it secured the sell-side role, Barclays structured a small, private process that maximized the likelihood that it could provide acquisition financing. Barclays never disclosed to the Board its interactions with the private equity shops or its desire to provide acquisition financing.

After the early 2010 process terminated, Barclays became more aggressive. In September, Barclays paired up Vestar and KKR in violation of their confidentiality agreements with Del Monte. Barclays then assisted Vestar and KKR in preparing an indication of interest. After being re-engaged by Del Monte, Barclays again did not disclose its interactions with the banks or its plan to secure a buy-side role, and it actively concealed the fact that Vestar and KKR were working together. When KKR "formally requested" permission to make a joint bid with Vestar, Barclays did not come clean, and Del Monte agreed without seeking to extract any pro-stockholder concession or other advantage. Before the Merger Agreement was signed and with price negotiations still ongoing, Barclays sought and obtained a buy-side role and worked with KKR to develop financing. As a result, at the same time Barclays ostensibly was negotiating to get KKR to pay more, Barclays had an incentive as a well-compensated lender to ensure that a deal was reached and that KKR did not overpay.

But for Barclays' manipulations, the Del Monte process would have played out differently. If the directors had known at the outset of Barclays' intentions and activities, the Board likely would have hired a different banker. Del Monte had good relationships with Goldman Sachs and Bank of America/Merrill Lynch, and the Board easily could have tapped either firm. Even if the directors decided to proceed with Barclays, the Board and its experienced counsel doubtless would have taken steps to protect the integrity of the process. As soon as Barclays disclosed its buy-side aspirations, the Board likely would have followed *Toys "R" Us* and "nixed that idea." The Board and its counsel likely also would have limited the role of Barclays lending group, chaperoned its discussions with bidders, or used another bank to provide confidential feedback to the potential sponsors about leverage parameters and market expectations.

Although Barclays' activities and non-disclosures in early 2010 are troubling, what indisputably crossed the line was the surreptitious and unauthorized pairing of Vestar with KKR. In doing so, Barclays materially reduced the prospect of price competition for Del Monte. Vestar had been the high bidder in the early 2010 process, and although Vestar needed a partner, a non-conflicted financial advisor could have teamed Vestar with a different sponsor. It was to address precisely this risk of competition-limiting behavior that Del Monte secured the No Teaming Provision. Barclays' efforts caused Vestar and KKR to violate the No Teaming Provision. Most egregiously, Barclays actively concealed the pairing from the Del Monte Board. It was not until the week of November 8 that KKR “formally requested” to be allowed to partner with Vestar. Barclays continued to hide its involvement and recommended that the pairing be permitted.

***18** The record does not reflect meaningful Board consideration or informed decision-making with respect to the Vestar pairing. There are no minutes that suggest hard thinking about how acceding to KKR's request might affect Del Monte. Martin testified about the issue as follows:

> Q. The next paragraph [of the proxy] starts off, it says, “Later during the week of November 8, 2010, KKR and Centerview approached Barclays Capital about the possibility of including Vestar in the deal as an additional member of the sponsor group. Representatives of KKR indicated that Vestar's prior experience in the food industry would make them an ideal partner for KKR/Centerview in connection with a potential investment in the Company. After discussions between KKR, Centerview and the Company, the Company permitted KKR and Centerview to approach Vestar to become an additional member of the sponsor group.” Do you see that?
>
> A. I do.
>
> Q. Did that happen at a Board meeting?
>
> A. I don't recall.
>
> Q. Do you recall the Board approving the concept of KKR contacting Vestar and getting them involved as part of the KKR group?
>
> A. I don't recall that.
>
> Q. Do you recall how it happened?
>
> A. I do not.
>
> Q. When is the first time you heard about it?
>
> A. I don't remember.
>
> Q. Do you recall the Board ever authorizing KKR in writing at any time prior to the week of November 8, 2010 to communicate with Vestar about teaming up to buy Del Monte?
>
> A. I do not recall anything of that nature.
>
> Q. Was there any discussion at the Board level of whether it was advisable to allow a company that previously had been bidding against KKR in the January, early January process, to now instead team up with KKR in the late 2010 process?
>
> [DEFENSE COUNSEL]: Objection.
>
> A. I don't remember any conversations about that.

Martin Tr. 49-51. It was not reasonable for the Board to accede to KKR's request and give up its best prospect for price competition without making any effort to obtain a benefit for Del Monte and its stockholders.

Barclays similarly crossed the line with its late-stage request for permission to be one of KKR's lead banks. There was no deal-related reason for the request, just Barclays' desire for more fees. Del Monte did not benefit. The immediate consequence was to force Del Monte to spend $3 million to hire a second bank. The more serious consequence was to taint the final negotiations. At the time Barclays made its request, the Merger Agreement was not yet signed, and Barclays and KKR were still negotiating over price. Barclays' internal documents from January and March 2010 had stated that “Barclays will look to participate in the acquisition financing once the Company has reached a definitive agreement with a buyer.” But Barclays could not wait.

In considering Barclays' request, the Board again failed to act reasonably. The Board did not ask whether KKR could fund the deal without Barclays' involvement, and Del Monte did not learn until this litigation that Barclays was not needed on the buy-side. If the Board had refused Barclays' request, then Del Monte could have had a non-conflicted (or at least not directly conflicted) negotiator bargain with KKR. Without some justification reasonably related to advancing stockholder interests, it was unreasonable for the Board to permit Barclays to take on a direct conflict when still negotiating price. It is impossible to know how the negotiations would have turned out if handled by a representative that did not have a direct conflict. The burden of that uncertainty must rest with the fiduciaries who created it.

***19** Finally, Barclays' conflict tainted the go-shop process. What Barclays did looks good on the surface, but the "who" is as important as the "what." As Vice Chancellor Strine explained in *Netsmart,* "body language" can be critical. *In re Netsmart Techs., Inc. S'holder Litig.,* 924 A.2d 171, 188 (Del.Ch.2007). There, a special committee permitted the company's CEO to drive a sale process involving private equity bidders who likely would retain management.

> In easily imagined circumstances, this approach ... could be highly problematic. If management had an incentive to favor a particular bidder (or type of bidder), it could use the ... process to its advantage, by using different body language and verbal emphasis with different bidders. "She's fine" can mean different things depending on how it is said.

Id. at 194. I recognize that the level of interaction in the due diligence meetings discussed in *Netsmart* differs from what takes place in a go-shop, particularly in the early outreach phase, but an analogous principle applies.

The Strategic Committee delegated the task of running the go-shop to Barclays and had no direct insight into how Barclays interacted with the parties it contacted. Barclays had a strong interest in ensuring that a particular kind of buyer (private equity) acquired Del Monte and a keen desire to see the deal close with KKR. In the last two years, Barclays has earned $66 million from KKR. If another bidder declined or did not need Barclays' financing, the bank would lose half of the approximately $44.5 to $47.5 million that Barclays stands to earn from its dual role. To recoup the lost financing fees, Barclays would have had to find a bidder willing to pay between $24.25 and $26 per share, or an additional $1.2 and $1.4 billion. Not likely.

Although the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the Board. Delaware law requires that a board take an "active and direct role in the sale process." *Citron v. Fairchild Camera & Instrument Corp.,* 569 A.2d 53, 66 (Del.1989). "[T]he role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management [and here I add other contingently compensated professionals like investment banks] may not necessarily be impartial." *QVC,* 637 A.2d at 44.

This is a case like *Mills Acquisition Co. v. Macmillan, Inc.,* 559 A.2d 1261 (Del.1989), in which the Delaware Supreme Court held that injunctive relief was required when a board's lack of involvement in a sale process enabled management and their financial advisor to steer the deal to KKR, their preferred bidder. In *Mills,* management's conflict arose out of their buy-side interest in a leveraged buyout sponsored by KKR. *Id.* at 1272. Management tainted the sale process by communicating with KKR without board approval and clandestinely passing information to KKR about the bidding process. *Id.* at 1275. Despite their independence, the directors failed adequately to oversee the process and permitted the conflicted management team and their financial advisor to exploit the opportunities it presented. *Id.* at 1280-81, 1284 n. 32.

***20** In enjoining the proposed transaction, the

Delaware Supreme Court spoke directly to the implications of a board being misled by conflicted individuals:

> [W]hen corporate directors rely in good faith upon opinions or reports of officers and other experts "selected with reasonable care," they necessarily do so on the presumption that the information provided is both accurate and complete. Normally, decisions of a board based upon such data will not be disturbed when made in the proper exercise of business judgment. However, when a board is deceived by those who will gain from such misconduct, the protections girding the decision itself vanish. Decisions made on such a basis are voidable at the behest of innocent parties to whom a fiduciary duty was owed and breached, and whose interests were thereby materially and adversely affected.

Id. at 1283-84. The Delaware Supreme Court also addressed the role of management's financial advisor, finding that the board's reliance on his advice "share[d] the same defects" as the board's reliance on conflicted management. *Id.* at 1284 n. 33.

[1] Here, the taint of self-interest came from a conflicted financial advisor rather than from management. Like the directors in *Mills,* the Del Monte Board was deceived. At a minimum, Barclays withheld information about its buy-side intentions, its involvement with KKR, and its pairing of KKR and Vestar. As in *Mills,* "there can be no dispute but that such silence was misleading and deceptive. In short, it was a fraud upon the board." *Id.* at 1283. I therefore conclude that the plaintiffs have established a reasonable likelihood of success on the merits of their claim that the director defendants failed to act reasonably in connection with the sale process. This does not mean that any director necessarily will face money damages. The question currently before the Court is whether there is a sufficient likelihood of success on the merits to support injunctive relief, and that is all I address. *See id.* at 1284 n. 32.

2. The Aiding and Abetting Claim

The plaintiffs claim that KKR aided and abetted the directors' breaches of fiduciary duty. "[T]he four elements of an aiding and abetting claim [are] (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty ... (3) knowing participation in that breach by the defendants, and (4) damages proximately caused by the breach." *Malpiede v. Townson,* 780 A.2d 1075, 1096 (Del.2001) (internal quotation omitted). The critical element is "knowing participation."

A third-party bidder who negotiates at arms' length rarely faces a viable claim for aiding and abetting. "Knowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach. Under this standard, a bidder's attempts to reduce the sale price through arm's-length negotiations cannot give rise to liability for aiding and abetting." *Id.* at 1097. The "long-standing rule that arm's-length bargaining is privileged and does not, absent actual collusion and facilitation of fiduciary wrongdoing, constitute aiding and abetting helps to safeguard the market for corporate control by facilitating the bargaining that is central to the American model of capitalism." *Morgan v. Cash,* 2010 WL 2803746, at *8 (Del.Ch. July 16, 2010) (internal footnotes omitted). *See also Tomczak v. Morton Thiokol, Inc.,* 1990 WL 42607, at * 16 (Del.Ch. Apr.5, 1990) (granting summary judgment in favor of defendant Dow on claim of aiding and abetting breach of fiduciary duty because "what Dow essentially did [in the transaction] was to simply pursue arm's-length negotiations with Morton Thiokol through their respective investment bankers in an effort to obtain ... the best price that it could.").

***21** Despite the general rule, "a bidder may be liable to the target's stockholders if the bidder attempts to create or exploit conflicts of interest in the board. Similarly, a bidder may be liable to a target's stockholders for aiding and abetting a fiduciary breach by the target's board where the bidder and the board conspire in or agree to the fiduciary breach." *Malpiede,* 780 A.2d at 1097-98 (internal footnotes omitted). An acquirer is free to seek the lowest possible price through arms' length negotiations with the target board, but "it may not knowingly participate in the target board's breach of fiduciary duty by extracting terms which require the opposite party to prefer its interests at the expense of its shareholders." *Gilbert v. El Paso Co.,* 490 A.2d 1050, 1058 (Del.Ch.1984), *aff'd* 575 A.2d 1131 (Del.1990). Creating or exploiting a fiduciary breach is not part of legitimate arm's-length bargaining; it is an impermissible intrusion into the relationship between the fiduciary and beneficiary.

[2] KKR knowingly participated in Barclays' self-interested activities. When Barclays secretly paired Vestar with KKR in September 2010, KKR knew it was bound by the No Teaming Provision and was barred from discussing a Del Monte bid with anyone absent prior written permission from Del Monte. KKR nevertheless worked with Barclays and Vestar on a joint bid and agreed to keep Vestar's involvement hidden from the Board. KKR also knowingly participated in the creation of Barclays' buy-side conflict. Before the Board had cleared Barclays to provide financing to KKR, Barclays and KKR had agreed that Barclays would be one of the lead banks. KKR necessarily knew that Barclays would not push as hard in the price negotiations when it stood to earn substantial fees from both sides of a successful deal. KKR later ensured that a conflicted Barclays would run the go-shop when KKR "squared things away" with Goldman for 5% of the syndication, ending Goldman's interest in running the go-shop process. On this record, the plaintiffs have established a reasonable likelihood of success on the merits of their claim that KKR aided and abetted the breaches of fiduciary duty that resulted from Barclays' misconduct.

B. Irreparable Harm

The second requirement for a preliminary injunction is a showing of irreparable injury if the injunction is not granted. *Revlon,* 506 A.2d at 179. Harm is irreparable unless "alternative legal redress [is] clearly available and [is] as practical and efficient to the ends of justice and its prompt administration as the remedy in equity." *T. Rowe Price Recovery Fund, L.P. v. Rubin,* 770 A.2d 536, 557 (Del.Ch.2000) (internal quotations and citations omitted).

[3] Absent an injunction, the Del Monte stockholders will be deprived forever of the opportunity to receive a pre-vote topping bid in a process free of taint from Barclays' improper activities. The threatened foreclosure of this unique opportunity constitutes irreparable injury. *See Hollinger Intern., Inc. v. Black,* 844 A.2d 1022, 1090 (Del.Ch.2004) ("[T]here is no doubt International faces irreparable injury. Without an injunction, it will be practically impossible to rescind the Barclays Transaction, the Strategic Process will be undermined, and International will lose the unique opportunities the Process may develop.").

***22** Absent an injunction, Del Monte's stockholders still could seek monetary damages. That inquiry, however, would "have to involve imprecise estimates," such as deriving the price Del Monte's stockholders might have received in an untainted process and comparing that to what they actually received. *Id.* Because of the obvious difficulties presented by this inquiry, stockholders "face a threat of irreparable harm when a seller's board breaches its *Revlon* duties by failing to adequately shop the company in advance of recommending that stockholders tender their shares to a chosen bidder." *In re Cogent, Inc. S'holder Litig.,* 7 A.3d 487, 515 (Del. Ch.2010). "No doubt there is the chance to formulate a rational remedy down the line, but that chance involves great cost, time, and, unavoidably, a large degree of imprecision and speculation. After-the-fact inquiries into what might have been had directors tested the market adequately ... necessarily involve[s] reasoned guesswork." *Netsmart,* 924 A.2d at 207.

Defenses to monetary damages further weigh in favor of pre-vote relief. Exculpation under Section

102(b)(7) can render empty the promise of post-closing damages. *See* *8 Del. C.* § 102(b)(7); *Lyondell Chem. Co. v. Ryan,* 970 A.2d 235, 244 (Del.2009). For directors who have relied on qualified advisors chosen with reasonable care, Section 141(e) provides another powerful defense. *See* *8 Del. C.* § 141(e); *In re Walt Disney Co. Deriv. Litig.,* 906 A.2d 27, 59-60 (Del.2006). In such cases, "the shareholders' only realistic remedy for certain breaches of fiduciary duty in connection with a sale of control transaction may be injunctive relief." *Police & Fire Ret. Sys. of the City of Detroit v. Bernal,* 2009 WL 1873144, at *3 (Del.Ch. June 26, 2009). In this action, unless post-closing discovery reveals additional facts, the plaintiffs face a long and steep uphill climb before they could recover money damages from the independent, outside directors on the Board. Admittedly other prospects for recovery are not so remote. By their terms, Sections 102(b)(7) and 141(e) do not protect aiders and abetters, and disgorgement of transaction-related profits may be available as an alternative remedy. That said, the skilled lawyers who represent KKR and Barclays doubtless will have many arguments against liability.

The unique nature of a sale opportunity and the difficulty of crafting an accurate post-closing damages award counsel heavily in favor of equitable relief. The plaintiffs have shown the necessary threat of irreparable harm.

C. Balancing of Hardships

The final element of the injunction standard is the balancing of hardships:

> [A] court must be cautious that its injunctive order does not threaten more harm than good. That is, a court in exercising its discretion to issue or deny such a ... remedy must consider all of the foreseeable consequences of its order and balance them. It cannot, in equity, risk greater harm to defendants, the public or other identified interests, in granting the injunction, than it seeks to prevent.

***23** *Lennane v. ASK Computer Sys., Inc.,* 1990 WL 154150, at *6 (Del.Ch. Oct.11, 1990) (Allen, C.). This element is by far the most difficult.

On the one hand, without an injunction, Del Monte's stockholders will lose forever the chance for a competitive process that could lead to a higher sale price for their company. On the other hand, granting an injunction jeopardizes the stockholders' ability to receive a premium for their shares. No one disputes, and the evidence establishes, that $19 is an attractive price. Any delay subjects the Merger to market risk. All else equal, a longer delay means greater risk. There is also the difficult question of the parties' contract rights, which Delaware courts strive to respect.

When there is no competing proposal, this Court rarely will enjoin a premium transaction pending trial. *See, e.g., Kohls v. Duthie,* 765 A.2d 1274, 1289 (Del.Ch.2000); *In re Wheelabrator Techs., Inc. S'holders Litig.,* 1990 WL 131351, at *9 (Del.Ch. Sept.6, 1990). To issue such an injunction requires both "a special conviction about the strength of the legal claim asserted" and "a strong sense that the risks in granting the preliminary relief of a[n] untoward financial result from the stockholders' point of view [are] small." *Solash v. Telex Corp.,* 1988 WL 3587, at *13 (Del.Ch. Jan.19, 1988) (Allen, C.).

At the same time, this Court has issued preliminary injunctions designed to cure pre-vote harm. Preliminary injunctions against merger votes pending the issuance of curative disclosures offer the prime example. Injunctions of that sort subject transactions to incremental market risk. *See* *Simonetti,* 2008 WL 5048692, at *14. They likewise interfere, albeit to a minor degree, with the parties' standard contract right to have the merger vote as soon as reasonably practicable. *See, e.g.,* MA § 6.2. Nevertheless, this Court has been willing to issue disclosure-based injunctions that delay transactions for as much as twenty days. *See* *La. Mun. Police Empls. ' Ret. Sys. v. Crawford,* 918 A.2d 1172, 1192 (Del.Ch.2007).

The plaintiffs ask me to enjoin the vote on the Merger for a meaningful period during which a competing bidder may come forward. The plaintiffs have proposed a delay of 30 to 45 days, derived from the 45-day length of the earlier go-shop period. To further remove the taint of Barclays' involvement, they ask that the parties be enjoined from enforcing the deal protections in the Merger Agreement during that period.

At this stage, it is not possible to remedy fully the effects of Barclays' maneuvers without blocking the deal and sending the parties back to the drawing board. I cannot, for example, split up the Vestar/KKR team and induce a topping bid from Vestar and a different partner. An injunction along the lines requested by the plaintiffs does not perfectly remedy the harm Barclays caused, but it does go part of the way. The core injury inflicted on the stockholders was Barclays' steering the deal to KKR. Barclays won by doubling up on fees. KKR won by getting Del Monte, free of meaningful competition, and securing a leg-up on potential competing bidders through the defensive measures in the Merger Agreement. The injunction sought by the plaintiffs partially cures this injury by limiting KKR's leg-up and providing a final window during which a topping bid could emerge.

***24** [4] I do not believe that a 30 to 45 day delay is warranted. A postponement of this length might be appropriate if Del Monte never had been exposed to the market. The reality is that although a conflicted banker conducted the go-shop process, the Del Monte transaction was shopped actively for 45 days. Since the go-shop process ended on January 10, 2011, the Company has been subject to an additional passive market check. A further delay of 30 to 45 days ignores the fact that many potential bidders have already evaluated this opportunity. I will therefore enjoin the merger vote for a period of only 20 days, which should provide ample time for a serious and motivated bidder to emerge. The resulting delay is comparable to the disclosure injunction in *Crawford.*

I agree with the plaintiffs that during the pre-vote period, the parties to the Merger Agreement should be enjoined from enforcing the deal protection measures. These measures are not being enjoined because they coerce stockholders, preclude any alternative to the board's chosen transaction, or otherwise fall outside the range of reasonableness. The go-shop lasted 45 days, during which the termination fee was $60 million, or 1.13% of transaction value ($4 billion of equity plus $1.3 billion of debt). After the go-shop, the termination fee increases to $120 million, or 2.26% of total deal value. If included in an arms' length deal untainted by self-interest, the defensive measures would be quite reasonable. *See Dollar Thrifty,* 2010 WL 3503471, at *23-32 (discussing alleged preclusiveness of termination fee); *Toys "R" Us,* 877 A.2d at 1015-22 (providing guidance on parameters for termination fees).[FN5]

FN5. That said, KKR's last two bid increases were 25 cents each. The Board has trumpeted its insistence on those increases as evidence of its (and implicitly Barclays') good faith. The go-shop period termination fee would require a competing bidder to top by more than a 25 cent increment. The post go-shop fee would require a bidder to top by over 50 cents. A strategic bidder that could generate incremental value from synergies might not be deterred. A private equity firm that uses the same models and strategies as KKR might view the fee differently. This in turn suggests (i) the importance of the pre-signing phase to developing price competition among private equity bidders, and (ii) the value of actual or *de facto* exclusivity to a private equity buyer. *See* Guhan Subramanian, *Go-Shops v. No-Shops in Private Equity Deals: Evidence and Implications,* 63 Bus. Law. 729, 759 (2008) (arguing that exclusivity is a valuable benefit "and therefore should be paid for"). When an independent and active board has been assisted by non-

> conflicted advisors, a Delaware court rarely will have cause to second guess this type of tactical decision. *See Toys "R" Us,* 877 A.2d at 1000.

Rather, the provisions are being enjoined because they are the product of a fiduciary breach that cannot readily be remedied post-closing after a full trial. KKR secured the deal protection measures as part of a negotiation that was tainted by Barclays' conflict. KKR should not benefit from the misconduct in which it participated.

The traditional deference given to agreements freely negotiated between sophisticated parties is limited by fiduciary principles. "Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties." *NACCO Indus., Inc. v. Applica Inc.,* 997 A.2d 1, 35 (Del.Ch.2009). Sophisticated businesses can "make their own judgments about the risk they should bear," and those contractual expectations should be respected. *Abry P'rs V, L.P. v. F & W Acq. LLC,* 891 A.2d 1032, 1061 (Del.Ch.2006). In the deal context, "[p]arties bargain for provisions in acquisition agreements because those provisions mean something." *NACCO,* 997 A.2d at 19. It is "critical to our law that those bargained-for rights be enforced, both through equitable remedies such as injunctive relief and specific performance, and, in the appropriate case, through monetary remedies including awards of damages." *Id.*

***25** When a party aids and abets a breach of fiduciary duty, however, the contract rights that the aider and abetter secures as a result of the interaction must give way to the superior equitable rights and interests of the beneficiaries. *See QVC,* 637 A.2d at 50-51; *ACE Ltd. v. Capital Re Corp.,* 747 A.2d 95 (Del.Ch.1999); *see also* Restatement (Second) of Contracts § 193 (1981) ("A promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on grounds of public policy."). In *QVC,* the Delaware Supreme Court rejected the argument that vested contract rights took precedence over a fiduciary breach. 637 A.2d at 51. The Supreme Court held that because the buyer knew it was participating in a breach of fiduciary duty when it negotiated the underlying deal, the buyer could not "be now heard to argue that it obtained vested contract rights by negotiating and obtaining contractual provisions from a board acting in violation of its fiduciary duties." *Id.* The Supreme Court therefore preliminarily enjoined the no-shop provision and the termination fee and affirmed the Court of Chancery's preliminary injunction against enforcement of a stock-option lockup. *Id.* at 36-37, 50-51.

In *ACE,* Vice Chancellor Strine discussed the tension between contract rights and the fiduciary duties owed to stockholders. In considering a buyer's attempt to enforce a no-shop clause, Vice Chancellor Strine noted that "there are many circumstances in which the high priority our society places on the enforcement of contracts between private parties gives way to even more important concerns." 747 A.2d at 194. He cited four factors that bear on the analysis:

> (1) whether the acquiror knew, or should have known, of the target board's breach of fiduciary duty; (2) whether the ... transaction remains pending or is already consummated at the time judicial intervention is sought; (3) whether the board's violation of fiduciary duty relates to policy concerns that are especially significant; and (4) whether the acquiror's reliance interest under the challenged agreement merits protection in the event the court were to declare the agreement enforceable.

Id. at 105-06 (citing Paul L. Regan, *Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-ups,* 21 Cardozo L.Rev. 1, 116 (1999)). After balancing the factors, Vice Chancellor Strine held that the contract provision could not be enforced as the buyer advocated because the stockholders' interests would take precedence. *Id.* at 106-10.

Applying the *ACE* factors to this case indicates that KKR's "bargained-for rights" should give way. First, as discussed above in the analysis of the aiding and abetting claim, KKR knew of and knowingly participated in the breach of duty. KKR knew that making Barclays one of its lead banks on the deal would give Barclays a direct conflict of interest at a time when KKR and Barclays were still negotiating over price. KKR knew that Barclays paired it with Vestar in violation of both firms' confidentiality agreements with Del Monte. KKR knew that the No Teaming Provision only be could waived by Del Monte in writing, that consent had not been given, and that the purpose of the provision was to prevent anticompetitive bidding alliances. KKR knew that Barclays subsequently concealed Vestar's involvement from Del Monte and agreed with Moses to keep Vestar out of meetings with Del Monte where Vestar's involvement would be discovered. KKR knew that the Vestar pairing served KKR's best interests. During the early 2010 process, Brown of KKR worried about Vestar partnering with another firm and wrote that KKR needed to be careful about this possibility.

***26** Second, the Merger is still pending. The stockholder vote is currently scheduled for February 15, 2011, and the drop-dead date is May 22, 2011. As in *ACE,* "[t]he merger has not closed, the eggs have not been 'scrambled,' and the court would not be in the position of unscrambling them. Put another way, the transaction has not gotten to the point where [KKR's] investment and settled expectations in the deal are so substantial that it is unfair for [its] contract rights to give way to the interests of [Del Monte's] shareholders." 747 A.2d at 109.

Third, "the board's violation of fiduciary duty relates to policy concerns that are especially significant." *Id.* at 106. "[F]iduciary responsibilities are of special importance in situations where a board is entering into a transaction as significant as a merger affecting stockholder ownership rights." *Id.* at 109. Delaware has a strong interest in policing the behavior of fiduciaries who agree to final-stage transactions. *See McMullin v. Beran,* 765 A.2d 910, 918 (Del.2000). This is particularly so when the illicit behavior is secretive and subversive, yet appears to elicit yawns from Wall Street players who regard it as par for the course. After Vice Chancellor Strine's comments about buy-side participation in *Toys "R" Us,* investment banks were on notice. Delaware's strong interest in policing the behavior of fiduciaries and their advisors is the "(sometimes unspoken) reason [that] our law has subordinated the contract rights of third party suitors to stockholders' interests in not being improperly subjected to a fundamental corporate transaction as a result of a fiduciary breach by their board." *ACE,* 747 A.2d at 109.

The fourth factor is "whether the acquiror's reliance interest under the challenged agreement merits its protection in the event the court were to declare the agreement unenforceable." *Id.* at 106. It is intended to account for the reliance interests of a "wholly innocent" acquiror who "was without knowledge or constructive notice" of the breach. Regan, *supra,* at 107-08. KKR is not such a party.

Lastly, in balancing the equities, I have considered whether a preliminary injunction of this nature would give KKR the right to terminate the Merger Agreement. If the Merger Agreement is not consummated by May 22, 2011, then both parties can walk. MA § 8.2(a). Prior to the drop-dead date, each party is obligated to use its reasonable best efforts to consummate the Merger. *Id.* § 6.8(a). The injunction will lift in twenty days, over two months before the drop-dead date.

The preliminary injunction will not cause the deal to fail because a closing condition cannot be met by the drop-dead date. Section 7.1(c) provides as a condition to closing that "[n]o court or other Government Entity of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any law (whether temporary, preliminary or permanent) that is in effect and restrains, enjoins or otherwise prohibits consummation of the Merger ." *Id.* § 7.1(c). Twenty days from now, the preliminary injunction will lift and there will be no injunction then "in effect" that would restrain, enjoin, or otherwise prohibit consummation of the Merger.

***27** The preliminary injunction will not, itself, give either party the right to terminate. Section 8.2 provides that either party may terminate the Merger Agreement if "any Order *permanently* restraining, enjoining or otherwise prohibiting consummation of the Merger shall become final and non-appealable." *Id.* § 8.2 (emphasis added). I have not permanently enjoined the Merger.

The defendants have suggested that a preliminary injunction limiting the deal protection provisions might invalidate the entire agreement because of the following nonseverability language in Section 9.4: "[T]he parties intend that the remedies and limitations thereon contained in Section 8.5(d) be construed as an integral provision of this Agreement and that such remedies and limitations shall not be severable in any manner that increases a party's liability or obligations hereunder or under the Financing Commitments or the Guarantees." The short answer is that I am not enjoining Section 8.5(d), which is a sole and exclusive remedy provision, but rather Section 8.5(b). A longer answer would need to address the question of whether a proven aider and abetter (and we are currently at a preliminary stage) could rely on such a provision.

If KKR attempts to terminate the Merger Agreement, then Del Monte has remedies. Under certain circumstances, KKR will owe Del Monte a reverse termination fee of $249 million. *See id.* § 8.4(c). Del Monte can also seek specific performance of KKR's obligations. *See id.* § 9.10.

D. The Injunction Bond

Under Court of Chancery Rule 65(c), "[n]o restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the Court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained." As the Delaware Supreme Court recently explained, "[a] party that is wrongfully enjoined may recover damages resulting from the injunction, but that recovery is limited to the amount of the bond." *Guzzetta v. Serv. Corp. of Westover Hills,* 7 A.3d 467, 469 (Del. Ch.2010). Because I am enjoining the defendants, Rule 65(c) requires that I focus on the costs and damages that may be incurred or suffered by them.

The parties have not presented evidence on this issue. Pointing to the magnitude of the deal premium over the pre-announcement market price, the defendants seek a bond in the amount of $1,076,612,698.80. There is some irony in the magnitude of the request, because the parties agreed in the Merger Agreement that "[a]ny party seeking an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement shall not be required to provide any bond or other security in connection with any such order or injunction." MA § 9.10. Admittedly that provision addressed a different species of claim, but it suggests how seriously the parties took the need for a billion-dollar bond.

***28** The premium over market price might well be one measure of damages to the stockholder class if the deal were lost, but that is a different question than the harm an improvidently granted injunction could inflict on the defendants. KKR necessarily believes that Del Monte is or could be made to be worth more than $19 per share, otherwise KKR would not have entered into the transaction. If the deal were lost, KKR would be deprived of that additional value. Although I have evidence of the healthy internal rates of return that KKR thinks it can achieve, KKR has not quantified its anticipated profits for purposes of a bond. The individual defendants stand to receive some transaction-related benefits, but they have not argued for a bond based on those amounts.

Importantly, and consistent with *Solash* and its progeny, I am not enjoining the transaction from closing pending the outcome of a trial. Rather, I am imposing a delay akin to a disclosure-based injunction. When those injunctions issue, this Court has required at most a nominal bond. *See Simonetti,* 2008 WL 5048692, at * 14 n. 68 (noting that a large bond for a disclosure injunction would be "unprecedented"). Even when transactions have been enjoined on substantive grounds, bonds traditionally have been small. *See, e.g., Levco Alternative Fund, Ltd. v. Reader's Digest Ass'n,* 2002 WL 31835461, at *1 (Del.Ch. Aug.14, 2002) (conditioning injunction against recapitalization on bond of $5,000); *Solar Cells, Inc. v. True N. P'rs, LLC,* 2002 WL 749163, at *8 (Del.Ch. Apr.25, 2002) (conditioning injunction against merger on bond of $2,500). In one case, this Court conditioned a deal-blocking injunction on a $500,000 bond. *See Emerald P'rs v. Berlin,* 726 A.2d 1215, 1218 & n. 1 (Del.1999) (describing bond). The outlier is *Gimbel v. Signal Co.,* 316 A.2d 599 (Del.Ch.1974), *aff'd,* 316 A.2d 619 (Del.1974). The *Gimbel* Court required a $25 million bond as a condition to a preliminary injunction blocking a $480 million transaction where the transactional premium was $75 million. *Id.* at 618.

Although I have not enjoined the deal, I have enjoined the $120 million termination fee that KKR otherwise would receive in the event of a topping bid. That figure strikes me as the best starting point for pricing the risk of a wrongful injunction. The likelihood of a topping bid, however, is low.[FN6] With KKR as the buyer and a market check (albeit a tainted one) already completed, a topping bid seems all the less likely. I will not be surprised if no one emerges. The amount of the bond should take into account the low probability of actual harm. There is likewise the need to balance the risk of chilling the socially-beneficial and wealth-enhancing efforts of responsible plaintiffs' counsel to remedy and deter breaches of fiduciary duty against the problem of over-incentivizing deal litigation by giving entrepreneurial law firms a free option to enjoin transactions. Lacking guidance from the parties as to an alternative figure that reflects the threatened harm to the defendants, and having attempted to balance the competing policy considerations in a rough and imperfect way, I set bond at $1.2 million, representing 1% of the enjoined termination fee.

FN6. *See* Subramanian, *Go-Shops v. No-Shops, supra,* 63 Bus. Law. at 747 (finding deal-jump rate in private equity deals of 8% where deal lacks a go-shop, 5% where deal involved private pre-signing market canvass plus go-shop, and 17% where single-bidder deal was followed by go-shop); John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M & A Lockups: Theory and Evidence,* 53 Stan. L.Rev. 307, 371 (2000) (finding deal-jump rate of 3-7%).

III. CONCLUSION

***29** The defendants are enjoined from proceeding with the stockholder vote on the Merger for a period of twenty days. To the extent the defendants wish to convene the meeting of stockholders on February 15, 2011, and adjourn it to a later date without holding the vote, they may freely do so. Pending the vote on the Merger, the defendants are enjoined from enforcing Section 6.5(b), (c) and (h), and Section 8.5(b) of the Merger Agreement. The injunction is conditioned on plaintiffs posting bond in the amount of $1.2 million. **IT IS SO ORDERED.**

Del.Ch.,2011.
In re Del Monte Foods Co. Shareholders Litigation
Not Reported in A.3d, 2011 WL 532014 (Del.Ch.)

END OF DOCUMENT

EXHIBIT 2

H

Editor's Note: Additions are indicated by Text and deletions by ~~Text~~.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
FRONTIER OIL CORPORATION, a Wyoming corporation, Plaintiff,
v.
HOLLY CORPORATION, a Delaware corporation, Defendant.
HOLLY CORPORATION, a Delaware corporation, Counterclaim Plaintiff,
v.
FRONTIER OIL CORPORATION, a Wyoming corporation, Counterclaim Defendant.

No. Civ.A. 20502.
Submitted May 4, 2004.
Decided April 29, 2005.

Stephen E. Herrmann, Gregory V. Varallo, C. Malcolm Cochran, IV, Daniel A. Dreisbach, Steven J. Fineman, Dawn N. Zubrick, and Lisa M. Zwally, of Richards, Layton & Finger, P.A., Wilmington, Delaware; David J. Margules, of Bouchard Margules & Friedlander, P.A., Wilmington, Delaware; Richard H. Caldwell, Kent W. Robinson, J. Wiley George, John Clutterbuck, and Charles B. Hampton, of Andrews Kurth, L.L.P., Houston, Texas, for Plaintiff and Counterclaim Defendant Frontier Oil Corporation.

A. Gilchrist Sparks, III, Kenneth J. Nachbar, and Patricia R. Uhlenbrock, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; Bruce L. Silverstein, Rolin P. Bissell, and Christian D. Wright, of Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware; Michael McKool, Jr., Lewis T. LeClair, and Gary J. Cruciani, of McKool Smith, P.C., Dallas, Texas, for Defendant and Counterclaim Plaintiff Holly Corporation.

MEMORANDUM OPINION

NOBLE, Vice Chancellor.

***1** Plaintiff and Counterclaim Defendant Frontier Oil Corporation ("Frontier") and Defendant and Counterclaim Plaintiff Holly Corporation ("Holly") on March 30, 2003, agreed to merge.[FN1] On August 19, 2003, Frontier concluded that Holly had repudiated the Merger Agreement and brought this action the next day. In this post-trial memorandum opinion, the Court explores how and why the transaction fell apart and determines the consequences of the parties' conduct.

FN1. Agreement and Plan of Merger Among Frontier Oil Corporation, Front Range Himalaya Corporation, Front Range Merger Corporation, Himalaya Merger Corporation and Holly Corporation and Related Documents (the "Merger Agreement") H 727.

I. FINDINGS OF FACT [FN2]

FN2. Not all of the Court's factual findings are presented under this heading. For convenience, some findings of fact are set forth during the analysis of the various issues.

A. *The Parties*

Frontier, a Wyoming corporation, and Holly, a Delaware corporation, are both mid-sized petroleum refiners. Frontier, headquartered in Houston, Texas, operates in a market that lies primarily on the eastern slope of the Rocky Mountains; Holly, with its headquarters in Dallas, Texas, focuses on the western slope of the Rockies. In addition, Holly owned and operated approximately 1,600 miles of pipeline with support facilities to transport crude oil and refined products.

B. *Merger Negotiations Begin*

For several years, Frontier had recognized the benefits of a combination with Holly. James R. Gibbs, Frontier's chief executive officer, predicted that Frontier and Holly together would be "one incredible company" which would be "either the largest or second largest refiner" in the Rocky Mountain region. C. Lamar

Norsworthy, IIII, Holly's chief executive officer, also saw the advantages that could result from joining with Frontier.

Serious efforts to bring Frontier and Holly together were frustrated for several years because of Holly's role as a defendant in a lawsuit brought in a Texas court by an entity controlled by major national petroleum companies.[FN3] Holly was accused of having engaged in anticompetitive conduct by opposing (and surreptitiously supporting the opposition to) the Longhorn pipeline, proposed by the plaintiff in that action. The Longhorn pipeline would have been competitive with Holly's pipeline facilities. Although Holly considered the Longhorn Litigation to be without merit, the plaintiff claimed damages in excess of $1 billion. W. John Glancy, Holly's general counsel, said that the litigation made him feel as if "he was in jail." More specifically, Glancy understood that the Longhorn Litigation severely impaired Holly's ability to borrow, tied up management time and energy, and "walled off [Holly] from the whole M & A field."[FN4] For Gibbs, the "uncertainty" and "risk" associated with the litigation deterred him from pursuing Holly. Eventually, Holly was able to negotiate a settlement under which it agreed to provide approximately $25 million worth of refined petroleum product transportation services.

FN3. *Longhorn Partners Pipeline, L.P. v. Holly Corp.*, No. 98–2991 (Dist. Ct. El Paso County, Texas) (the "*Longhorn Litigation*"); *see* PX 21.

FN4. Tr. at 1496–97.

The settlement was announced on November 15, 2002. A few days later, Gibbs called Norsworthy to propose negotiations that would lead to a merger between Holly and Frontier. Merger negotiations commenced in late November, but, by the end of January 2003, the parties had reached an impasse. Holly then turned its attention to enhancing shareholder value through creating (and sale to the public of a portion of) a master limited partnership ("MLP") into which it would contribute its pipeline assets.[FN5] Holly retained Lehman Brothers to assist in the MLP effort.

FN5. Placing its pipeline and terminal assets in a tax-advantaged master limited partnership would permit Holly to access greater value, both from the proceeds of the public offering and through the increase attributable to its retained interest. First, the operating income would not be taxed at the corporate level. This would support a higher EBITDA multiple on the pipeline assets than on Holly's refinery assets. Second, the projected income of the MLP would not be as susceptible to cycles in the petroleum refining market. With more reliable projections of operating income and cash distributions, the lower interest rates that Holly's advisers foresaw made the opportunity even more favorable.

C. *The Merger Agreement is Negotiated*

***2** In February 2003, merger negotiations resumed. By March 3, 2003, the parties had agreed upon the basic terms of a merger. For each share of Holly common stock, its shareholders would receive one share of Frontier and $11.11 in cash.[FN6] No protection, such as ceilings, floors, or collars, was afforded the shareholders to guard against fluctuation in market price.

FN6. The cash portion would total $172.5 million. The shareholders of Frontier would own approximately 63% of the combined company. As of March 28, 2003, the last full day of trading before announcement of the merger, the last reported sale price for Frontier was $17.85 per share, and for Holly it was $22.10 per share.

The merger terms were finalized on March 24, 2003. As to corporate governance, Norsworthy would become chairman of the board of the "new" Frontier; Gibbs would be its chief executive officer; and all directors of both constituent corporations would become directors of the "new" board. One adjustment to merger consideration was through a "contingent value right" ("CVR") that Holly shareholders would receive.[FN7] The contingent value right represented the potential value of a litigation claim asserted by Holly against the United States with respect to the sale of jet aviation fuel. The value of the claim was uncertain.

FN7. Thus, on combination of Frontier and Holly (the "Merger"), for each share of Holly, the Holly stockholders would receive one share of Frontier, $11.11 in cash, and a CVR.

D. *Enter Erin Brockovich*

During March 2003, in advance of a definitive merger agreement, the parties proceeded with their due diligence efforts. On March 15, Frontier delivered due diligence materials to Vinson & Elkins ("V & E"), the law firm representing Holly in the transaction. One of the items provided was an article from the February 22, 2003, edition of the *Los Angeles Times*, entitled "Cancer Cluster Alleged." FN8 The article described plans by activist Erin Brockovich and the Masry & Vititoe law firm to bring a mass toxic tort suit against Beverly Hills (California) High School, the Beverly Hills municipality, and three oil companies. An oilrig had been in operation for decades on the campus of Beverly Hills High School, next to the athletic field. Brockovich claimed that the students attending the high school suffered from a disproportionately high incidence of various cancers, which she attributed to exposure to air contaminants released during the drilling and on-site processing activities. The crude oil production activities were carried out, at that time, by Venoco, Inc. ("Venoco"), which had acquired its interest in the Beverly Hills site from Wainoco Oil & Gas Company ("Wainoco") in 1995. Wainoco had obtained its interest in 1985 from Waverly Oil Company, an assignee of Chevron USA, Inc. The article, however, failed to set forth one fact that would become critical to the Merger: Wainoco is a wholly-owned subsidiary of Frontier.

FN8. PX 37.

E. *Due Dilligence I: Holly Becomes Concerned About Beverly Hills*

V & E, following receipt of Frontier's due diligence materials, ascertained that Frontier had made no public disclosure regarding the threatened Beverly Hills litigation and realized that only limited information regarding the potential litigation was readily available. On March 27, 2003, as the final details of the Merger documents were being worked out, V & E informed Glancy about the possibility of a toxic tort suit involving prior operations of a Frontier subsidiary. Glancy promptly informed other senior Holly executives. With their sensitivity to complex litigation having been heightened by their unhappy experience in the Longhorn Litigation, Holly management decided to seek additional information from Frontier regarding Beverly Hills. In addition, Holly retained Gibson, Dunn & Crutcher ("Gibson Dunn"), a national law firm headquartered in Los Angeles, to provide advice and guidance with respect to toxic tort litigation in California. As Glancy phrased it in an e-mail to Currie Bechtol, Frontier's general counsel, Holly's management needed to know whether the Beverly Hills problem was "a gnat or an elephant." FN9

FN9. F 805.

F. *Frontier Describes the Potential Litigation as a "Bunch of Hooey"*

***3** Frontier attempted to assuage Holly's concerns in several ways. Gibbs told Norsworthy that the Beverly Hills problem "was likely to be a nuisance claim." FN10 Similarly, Julie H. Edwards, Frontier's chief financial officer, in talking to Matthew Clifton, Holly's president, characterized the claim as a "bunch of hooey" and a "Hollywood stunt." FN11

FN10. Tr. at 35.

FN11. Tr. at 430–31; 433.

Frontier was most persuasive, not in attacking Brockovich's motivations or her science, but with its argument that Frontier was protected from liability because of the separate and distinct corporate structure of Wainoco. In short, Frontier assured Holly that any liability could be confined to the subsidiary Wainoco and would not reach the parent Frontier. Frontier bolstered this argument by producing a Canadian tax ruling which, it claimed, demonstrated that the manner in which Frontier operated its subsidiaries would minimize the risk of any successful veil-piercing effort by toxic tort plaintiffs.

G. *The Boards' Reactions*

On March 28, at a special meeting, Frontier's Board unanimously approved the Merger Agreement, authorized Frontier's management to execute the Merger Agreement and related documents, and established a special committee to which it delegated the power to approve changes to the Merger Agreement.

Holly's Board also met on March 28. That meeting did not go as well as Frontier's. Holly's Board was informed of the potential for litigation arising out of the Beverly Hills problem. Alan Bogdanow, who led V & E's merger efforts for Holly, told the Board what was known about Beverly Hills and reviewed its potential consequences. Holly's Board minutes reflect Bogdanow's concerns:

> In respect of the potential California litigation, Mr. Bogdanow informed the Board that a recent article stated that Erin Brockovich and Ed Masry were preparing a lawsuit against the city of Beverly Hills, Beverly Hills Unified School District and three oil companies, alleging that there was an abnormally high rate of cancer, or a " cancer cluster," among former Beverly Hills High School students due to polluted air caused by oil wells operating in the area. Mr. Bogdanow noted that this raised the issue of a potential toxic tort claim against the Frontier subsidiary which once owned oil and gas wells in the Beverly Hills area that were sold in 1995 to Venoco, Inc.... Mr. Bogdanow, among other things, noted that (i) Frontier had not publicly disclosed the potential claim in its Securities and Exchange Commission filings, (ii) Frontier had a strong indemnity right against Venoco, but Venoco may not have the financial ability to satisfy all of its indemnification obligations, (iii) Frontier probably did not have insurance coverage that would cover such potential claim, (iv) potential legal defenses that might be available to Frontier, including expiration of the applicable statute of limitations period, whether any potential liability could be limited to Frontier's subsidiary, whether California has damage caps, and burden of proof issues were being looked at, (v) the Company was assessing whether the potential claim was a substantial practical risk, but there was no assurance as to whether a more meaningful assessment could be made in any particular time frame, (vi) Mr. Gibbs, the Chief Executive Office of Frontier, had stated that Frontier was not concerned about this matter becoming significant and that the previous Longhorn litigation against the Company had been much worse than this potential claim, which was considered by Frontier to be only a nuisance claim, ... and (vii) he did not know if the potential claim might raise a financing issue for Frontier. FN12

> FN12. PX 98 at 5–6. Holly's banker, Credit Suisse First Boston, expressed the view that Frontier would be able to meet its borrowing needs.

***4** Thus, the Board concluded that it would need additional information before deciding to proceed with the Merger. Holly's desire to take the time necessary to acquire the additional information was tempered by Frontier's concern that the plans for the Merger might be leaked to the public or that stock might be traded based on nonpublic information regarding the transaction. FN13 Nonetheless, Holly's Board directed its management to pursue various options regarding the threatened litigation, including:

> FN13. Frontier's sense of urgency is evidenced by a voicemail left by Gibbs for Norsworthy shortly before Holly's board meeting: "There is a locomotive running down the road—too many people know about this and we need to get it closed and out. There is not much exposure on the Brockovich lawsuit...." H 881.

> (i) strengthening Frontier's representations and warranties, (ii) strengthening the definition of material adverse effect, (iii) determining whether Frontier had any obvious legal defenses if a claim were made against it, (iv) clarifying the Board's rights under the merger agreement to terminate the merger in exercise of the Board's fiduciary duties, and (v) performing additional analysis of the potential claim over the weekend so that the Board could better evaluate the issue. FN14

FN14. PX 98 at 13.

The Board then decided to reconvene on Sunday, March 30, to evaluate any new information and to decide on a course of action.

H. *The Merger Agreement is Renegotiated*

The confluence of Holly's concerns about the risks associated with the potential Beverly Hills litigation and Frontier's desire to reach an agreement as quickly as possible resulted in several modifications to the Merger Agreement. These modifications were negotiated over a very short period of time. First, Section 4.8 of the Merger Agreement was changed to read as follows: FN15

FN15. Additions are noted in italics; deletions are struck through.

> *Except as set forth on Schedule 4.8 of the Frontier Disclosure Letter*, there are no actions, suits or proceedings pending against Frontier or any of its Subsidiaries or, to Frontier's knowledge, threatened against Frontier or any of its Subsidiaries, at law or in equity, or before or by any federal, state or foreign commission, court, board, bureau, agency or instrumentality, other than those that would not *have or reasonably be expected to* have, individually or in the aggregate, a Frontier Material Adverse Effect . FN16

FN16. PX 98 at 32.

Second, the Definition of "Material Adverse Effect" was modified to read as follows:

> *"Material Adverse Effect"* with respect to Holly or Frontier shall mean a material adverse effect with respect to (A) the business, assets and liabilities (taken together), *results of operations*, ~~material~~ condition *(financial or otherwise) or prospects* of a party and its Subsidiaries on a consolidated basis ..." FN17

FN17. PX 106 at 71.

Third, Schedule 4.8, referenced in Section 4.8, was added to the Frontier Disclosure Letter:

> Wainoco Oil & Gas Company ("Wainoco") owned an interest in an oil field from 1985 until early 1995 in the area where the Beverly Hills High School is located. News articles in February 2003 indicated that the Brockovich and Masry law firm were preparing a lawsuit involving that site. Wainoco sold its interest to Venoco, Inc. by a Purchase and Sale Agreement dated February 9, 1995. Frontier has not been contacted by anyone concerning a possible lawsuit, and does not have any knowledge of any litigation being filed.

> ***5** For avoidance of doubt and only for the limited purpose of the Agreement, Frontier agrees with, and for the sole benefit of, Holly that this potential litigation will be considered as "threatened" (as such term is used in Section 4.8 of the Agreement) and that the disclosure of the existence of this "threatened" litigation herein is not an exception to Section 4.8, 4.9 or 4.13 of the Agreement and despite being known by Holly, will have no effect with respect to, or have any limitation on, any rights of Holly pursuant to the Agreement.

When the Holly Board reconvened on March 30, Glancy presented (indeed, he read aloud) to the Board a six-page memorandum prepared by Jeffrey D. Dintzer of Gibson Dunn. In his memorandum, Dintzer summarized what was known about the anticipated Beverly Hills claim and he attempted to gauge its likely effects. FN18

FN18. PX 112.

I. *Gibson Dunn Explains the Risks*

Dintzer's memorandum informed the Board that the potential for litigation was first reported by a local Los Angeles television station on February 10, 2003. The report indicated that Brockovich and the law firm of Masry & Vititoe were preparing a lawsuit on behalf of at least twenty Beverly Hills High School students who had been diagnosed with one of three types of cancer: Hodgkin's disease, non-Hodgkins lymphoma, and thyroid cancer. Brockovich had identified the oil wells at the High School as the potential cause. According to an "environmental specialist" from Masry & Vititoe, tests of the area conducted seven times over five months revealed "abnormally high levels of benzene, methane and n-hexane—all by-products of the oil industry." FN19 This report also noted that while benzene is a known carcinogen, a recent test conducted by the South Coast Air Quality Management District ("SCAQMD") had found nothing abnormal, except for elevated levels of toluene.

FN19. *Id.*

Dintzer also discussed subsequent reports. For instance, one report noted that the current owner of the oil wells, Venoco, had acquired its ownership interest from Wainoco in 1995 and that "Wainoco has since changed its name to Frontier Oil Corporation." FN20 This report also quoted a Frontier representative as having said, "Anything to do with those sites and royalties would have been transferred to Venoco when they bought our assets." FN21 From this report, Holly's Board also learned that Brockovich had hosted a dinner for 600 alumni of, and parents of students attending, Beverly Hills High School and that 170 graduates and staff had developed one of the three cancer types over the last decade. Masry was quoted as having stated that the ratio of these cancers was eighteen times the national average.

FN20. *Id.*

FN21. *Id.*

Dintzer's memorandum, however, was not devoid of good news. For example, it described a March 25, 2003, release by the Superintendent of the Beverly Hills Unified School District which noted that tests conducted by SCAQMD on three separate occasions in February 2003 did not show "readings of benzene, hexane and other air toxic levels that are considered abnormal." FN22 In fact, the Superintendent was quoted as having said that the levels were "well below" what the California Environmental Protection Agency deemed to be the minimum exposure risk for public health. Moreover, the release observed that there was no "consistent evidence" that benzene exposure caused any cancer other than acute myelogenous leukemia and that "there is a threshold below which the risk of cancer from benzene exposure is negligible." FN23

FN22. *Id.*

FN23. *Id.* at 3.

***6** Holly's Board was warned that the lawsuit would be prosecuted by a "highly-organized, well-funded group of law firms." FN24 In addition to Masry and Brockovich, the memo noted that the "lawsuit will likely be funded in part by the well-known and highly successful plaintiffs' law firm Girardi & Keese, who prosecuted the famous Anderson chrome case against PG & E which is the subject of the Brockovich film." FN25 It noted that "Girardi and its partner law firms have the resources to vigorously and aggressively prosecute any lawsuits filed and have the wherewithal to go to great lengths to bring these lawsuits to a successful conclusion." FN26

FN24. *Id.*

FN25. *Id.*

FN26. *Id.*

Dintzer's memorandum also advised Holly's Board that since "[t]he science of connecting human exposures to chemicals, such as those released from oil and gas production, to serious disease outcomes is complicated and often difficult to explain ..., the plaintiffs' story—very sick plaintiffs exposed to chemicals, fighting large corporations—[would be] attractive to a lay jury." FN27 It noted that there were at least five different causes of action that could be brought and more than seven types of damages that could be sought—including punitive damages and emotional distress damages. Furthermore, the Holly Board learned that "[i]n California, there is no limit to the amount the plaintiffs can collect on personal injury claims .... [and p]unitive damages are only limited by the general factors that apply to such damages and any Constitutional limits." FN28 While there was no estimate of potential liability, as a point of reference, Dintzer's memorandum did note that the Anderson case against PG & E, which was the subject of the *Erin Brockovich* movie, resulted in a $400 million award, which was later reduced to $333 million by settlement.

FN27. *Id.*

FN28. *Id.* at 5.

Dintzer also anticipated the "shark effect" leading to an increase in the costs of defending any potential litigation. The shark effect was defined as the risk, after the settlement of a toxic tort case, that additional lawsuits would be filed against the same defendants, at times by the same law firms who filed the original suit, on behalf of different plaintiffs. Several examples were supplied, including the Anderson litigation, as a way of demonstrating that "[s]ettling cases with certain plaintiffs is no guarantee that the controversy will go away." FN29

FN29. *Id.*

Lastly, the memorandum predicted that the duration of any lawsuit might be prolonged, thus leading to an increase in costs. Furthermore, the Board was advised that "recent changes in California law to the procedures for summary judgment which strongly favor plaintiffs ... make it very difficult to achieve summary judgment." FN30 The memorandum forecast that, even though it might be possible to achieve summary judgment, "extensive and expensive discovery would have to occur before" it would be ripe.FN31 The memorandum finally cautioned that it might be easier for plaintiffs in California to present questionable science to the jury as a way of proving liability "because California has not adopted the *Daubert* standard, which applied to the Federal Rules of Evidence ." FN32

FN30. *Id.* at 6.

FN31. *Id.*

FN32. *Id.*

J. *Holly's Board Approves the Merger Agreement*

***7** After receiving Dintzer's memorandum, Holly's Board "continued to consider and discuss the benefits of the proposed transaction for the Company's stockholders versus the potential risks associated with the transaction in light of the potential California Claim." FN33 "[A]lthough the Board noted that its legal counsel probably would not be able to advise the Board with absolute certainty that Frontier was clearly insulated from any potential liability," FN34 the Board decided "that it was in the best interest of the Company's stockholders to proceed with the proposed transaction now and for the Company to continue to investigate and evaluate the potential California claim." FN35 Thus, the Board ended the meeting by approving the Merger Agreement.

FN33. PX 125 at 5.

FN34. *Id.* at 7.

FN35. *Id.* at 8.

K. *The Merger Agreement*

Before turning to the events following execution of the Merger Agreement, it may be helpful to review the various exit strategies afforded by that agreement. For purposes of this action, there were, in general, three avenues: (1) if a party's representations and warranties in the Merger Agreement were or, in some instances, became inaccurate, including, if threatened litigation would have or would reasonably be expected to have a Material Adverse Effect; (2) if a party exercised its "fiduciary out"; and (3) if the parties mutually agreed to termination.FN36 Recitation of pertinent provisions of the Merger Agreement is unavoidable.

FN36. A fourth strategy, one not expressly sanctioned by the Merger Agreement, might be to delay, but without being charged with causing the delay, until the "drop deal date" passed.

Section 7.1 allows "Termination by Mutual Consent":

> This Agreement may be terminated at any time prior to the Effective Time by the mutual written agreement of Holly and Frontier approved by action of their respective Board of Directors in their respective discretion for any reason, including due to the number of Holly Dissenting Shares exceeding 5% of the Total Holly Common Stock Number or the number of Frontier Dissenting Shares exceeding 5% of the total number of shares of Frontier Common Stock outstanding immediately prior to the Effective Time.FN37

FN37. "Effective Time" means the "date and time when the Mergers become effective." Merger Agreement, Section 1.3(b).

Section 7.2 establishes other ways the Merger Agreement could be terminated by either party, including a failure to close by the "drop dead date" of October 31, 2003, or a failure of one of the parties to obtain the requisite stockholder vote to send the transaction to closing. This provision provides in pertinent part:

Section 7.2 TERMINATION BY FRONTIER OR HOLLY. At any time prior to the Effective Time, this Agreement may be terminated by Holly or Frontier, in either case by action of its Board of Directors, if:

(a) the Mergers shall not have been consummated by October 31, 2003; provided, however, that the right to terminate this Agreement pursuant to this clause (a) shall not be available to any party whose failure or whose affiliates' failure to perform or observe in any material respect any of its obligations under this Agreement in any manner shall have been the principal cause or, or resulted in, the failure of the Mergers to occur on or before such date; or

***8** (b) the Holly Requisite Vote shall not have been obtained at a meeting (including adjournments and postponements) of Holly's stockholders that shall have been duly convened for the purpose of obtaining the Holly Requisite Vote; or

(c) the Frontier Requisite Vote shall not have been obtained at a meeting (including adjournments and postponements) of Frontier's stockholders that shall have been duly convened for the purpose of obtaining the Frontier Requisite Vote....

Sections 7.3 and 7.4 contained comparable provisions authorizing Frontier and Holly to terminate the Merger Agreement, for reasons, such as breach of representations,FN38 without cure within thirty days, and the transaction's "fiduciary out" for those instances when the directors' fiduciary duties would no longer allow them to support the Merger. The similar provisions stated in full:

FN38. The obligation of Holly to complete the Merger was conditioned by Section 6.2(a) which provides in part:

Frontier shall have performed in all material respects its covenants and agreements contained in this Agreement required to be performed on or prior to the Closing Date and the representations and warranties of Frontier contained in this Agreement and in any document delivered in connection herewith (i) to the extent qualified by Frontier Material Adverse Effect or any other materiality qualification shall be true and correct and (ii) to the extent not qualified by Frontier Material Adverse Effect or any other materiality qualification shall be true and correct in all material respects, in each case as of the date of this Agreement and as of the Closing Date (except for representations and warranties made as of a specified date, which need be true and correct only as of the specified date), and Holly shall have received a certificate of Frontier, executed on its behalf by its Chairman of the Board, President and Chief Executive Officer, dated the Closing Date, certifying to such effect.

Frontier's obligation to proceed with the Merger was similarly conditioned by Section 6.3.

Section 7.3 TERMINATION BY HOLLY. At any time prior to the Effective Time, this Agreement may be terminated by Holly, by action of its Board of Directors, if:

(a) (i) there has been a breach by Frontier of any representation, warranty, covenant or agreement set forth in this Agreement or if any representation or warranty of Frontier shall have become untrue, in either case such that the conditions set forth in Section 6.2(a) would not be satisfied and (ii) such breach is not curable, or, if curable, is not cured within 30 days after written notice of such breach is given to Frontier by Holly; provided, however, that the right to terminate this Agreement pursuant to this Section 7.3(a) shall not be available to Holly if it, at such time, is in material breach of any representation, warranty, covenant or agreement set forth in the Agreement such that the conditions set forth in Section 6.3(a) shall not be satisfied;

(b) prior to obtaining the Frontier Requisite Vote, the Board of Directors of Frontier shall have withdrawn, modified, withheld or changed, in a manner adverse to Holly, such Board's approval or recommendation of the Agreement or the transactions contemplated hereby, or recommended a Frontier Superior Proposal, or resolved to do any of the foregoing; or

(c) prior to obtaining the Holly Requisite Vote, Holly is the Withdrawing Party pursuant Section 5.4(b) (it being understood that Holly shall not have the right to terminate this Agreement pursuant to this Section 7.3(c) unless and until Holly shall have paid Frontier all amounts due under Section 7.5(a)).

Section 7.4 TERMINATION BY FRONTIER. At any time prior to the Effective Time, this Agreement may be terminated by Frontier, by action of its Board of Directors, if:

(a) (i) there has been a breach by Holly of any representation, warranty [,] covenant or agreement set forth in this Agreement or if any representation or warranty of Holly shall have become untrue, in either case such that the conditions set forth in Section 6.3(a) would not be satisfied and (ii) such breach is not curable, or, if curable, is not cured within 30 days after written notice of such breach is given by Frontier to Holly; provided, however, that the right to terminate this Agreement pursuant to Section 7.4(a) shall not be available to Frontier if it, at such time, is in material breach of any representation, warranty, covenant or agreement set forth in this Agreement such that the conditions set forth in Section 6.2(a) shall not be satisfied;

***9** (b) prior to obtaining the Holly Requisite Vote, the Board of Directors of Holly shall have withdrawn, modified, withheld or changed, in a manner adverse to Frontier, such Board's approval or recommendation of this Agreement or the transactions contemplated hereby, or recommend a Holly Superior Proposal, or resolved to do any of the foregoing; or

(c) prior to obtaining the Frontier Requisite Vote, Frontier is the Withdrawing Party pursuant to Section 5.4(b) (it being understood that Frontier shall not have the right to terminate this Agreement pursuant to this Section 7.4(c) unless and until Frontier shall have paid Holly all amounts due under Section 7.5(b)).

The term "Withdrawing Party," employed in both Section 7.3 and Section 7.4, is defined in Section 5.4(b) which provides in part:

The Board of Directors of Holly or Frontier, as applicable (the *"Withdrawing Party,"* the other party being the *"Non–Withdrawing Party"*), may at any time prior to obtaining the Holly Requisite Vote or Frontier Requisite Vote, as applicable, (A) withdraw, withhold, modify, or change, in a manner adverse to the Non–Withdrawing Party, any approval or recommendation regarding this Agreement or the transactions contemplated hereby or (B) approve and be prepared to enter into or recommend and declare advisable any Holly Superior Proposal or Frontier Superior Proposal, as the case may be, if its Board of Directors determines in good faith after consultation with its outside legal counsel that the failure to take the action in question would be inconsistent with the fiduciary obligations of such Board of Directors under applicable law. FN39

FN39. Section 5.4(b) obligated Holly (and Frontier), through its Board of Directors, to recommend the Merger Agreement to the shareholders. The language quoted in the text allowed it to back out of the transaction if certain circumstances, including payment of the break-up fee, were first satisfied. Also, the directors had signed Support Agreements committing to support the Merger.

If either party used the fiduciary duty termination provisions to avoid the Merger, Section 7.5 provides that the terminating party would pay the other party $15 million as a break-up fee in addition to reimbursing the other party up to $1 million in expenses incurred in connection with the Merger Agreement. Section 7.5 provides in part:

Section 7.5 EFFECT OF TERMINATION

(a) If this Agreement is terminated

(i) by Holly or Frontier, after the public announcement (made prior to the closing of the polls for the vote of Holly stockholders for the purpose of obtaining the Holly Requisite Vote) of a Holly Acquisition Proposal, pursuant to Section 7.2(b);

(ii) by Frontier pursuant to Section 7.4(b);

(iii) by Holly pursuant Section 7.3(c);

then Holly shall pay Frontier the Holly Termination Amount (as defined below) and, in addition, reimburse Frontier for all expenses incurred by Frontier in connection with this Agreement up to the Reimbursement Maximum Amount (as defined below) prior to or upon termination of this Agreement. All payments under this Section 7.5(a) shall be made in cash by wire transfer to an account designated by Frontier at the time of such termination or, in the case of a termination pursuant to Section 7.3(c), prior to such termination). The term *"Holly Termination Amount"* shall mean $15,000,000. The term *"Reimbursement Maximum Amount"* shall mean $1,000,000. In addition, Holly shall reimburse Frontier for all expenses incurred by Frontier in connection with this Agreement up to the Reimbursement Maximum Amount if this Agreement has been terminated pursuant to Section 7.2(b) even if Frontier is not entitled to any Holly Termination Amount under this Section 7.5(a). Holly acknowledges that the agreements contained in this Section 7.5(a) are an integral part of the transactions contemplated by this Agreement, and that, without these agreements, Frontier would not enter into this Agreement; accordingly, if Holly fails promptly to pay any amount due pursuant to this Section 7.5(a), and, in order to obtain such payment, Frontier commences a suit which results in a judgment against Holly for the payment set forth in this Section 7.5(a), Holly shall pay Frontier its costs and expenses (including attorneys' fees) in connection with such suit, together with interest on the Holly Termination Amount and other amounts to be reimbursed to Frontier under this Section 7.5(a) from the date payment was required to be made until the date of such payment at the prime rate of Union Bank of California, N.A. in effect on the date such payment was required to made plus one percent (1%). If this Agreement is terminated pursuant to a provision that calls for a payment to be made under this Section 7.5(a), it shall not be a defense to Holly's obligation to pay hereunder that this Agreement could have been terminated at an earlier or later time.

***10** Section 7.5(b) is the mirror image of Section 7.5(a), with Holly and Frontier substituted for each other.

Frontier's representations and warranties are set forth in Article IV of the Merger Agreement which provides in part:

Except as set forth in the disclosure letter delivered to Holly concurrently with the execution hereof (the *"Frontier Disclosure Letter"*), ... Frontier represents and warrants to Holly that:

Section 4.8 LITIGATION AND LIABILITIES. Except as set forth on Schedule 4.8 of the Frontier Disclosure Letter, there are no actions, suits or proceedings pending against Frontier or any of its Subsidiaries or, to Frontier's knowledge, threatened against Frontier or any of its Subsidiaries, at law or in equity, or before or by any federal, state or foreign commission, court, board, bureau, agency or instrumentality, other than those that would not have or reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect. There are no outstanding judgments, decrees, injunctions, awards or orders against Frontier or any of its Subsidiaries, other than those that would not have, individually or in the aggregate, a Frontier Material Adverse Effect.

There are no obligations or liabilities of any nature, whether accrued, absolute, contingent or otherwise, of Frontier or any of its Subsidiaries, other than those liabilities and obligations (a) that are disclosed in the Frontier Reports, (b) that have been incurred in the ordinary course of business since December 31, 2002, (c) related to expenses associated with the transactions contemplated by this Agreement or (d) that would not have or reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect.

Section 4.9 ABSENCE OF CERTAIN CHANGES. Since December 31, 2002, Frontier has conducted its business only in the ordinary and usual course of business and during such period there has not been any (i) event, condition, action or occurrence that has had or would reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect; ...

Holly, by Article III, made similar representations, except that Section 3.8 did not carry the same modifications as did Section 4.8, to accommodate the Beverly Hills concerns.

Finally, Section 8.9(d) provides in its entirety:

(d) *"Material Adverse Effect"* with respect to Holly or Frontier shall mean a material adverse effect with respect to (A) the business, assets and liabilities (taken together), results of operations, condition (financial or otherwise) or prospects of a party and its Subsidiaries on a consolidated basis or (B) the ability of the party to consummate the transactions contemplated by this Agreement or fulfill the conditions to closing set forth in Article 6, except to the extent (in the case of either clause (A) or clause (B) above) that such adverse effect results from (i) general economic, regulatory or political conditions or changes therein in the United States or the other countries in which such party operates; (ii) financial or securities market fluctuations or conditions; (iii) changes in, or events or conditions affecting, the petroleum refining industry generally; (iv) the announcement or pendency of the Mergers or compliance with the terms and conditions of Section 5.1 hereof; or (v) stockholder class action or other litigation arising from allegations of a breach of fiduciary duty relating to this Agreement. *"Holly Material Adverse Effect"* and *"Frontier Material Adverse Effect"* mean a Material Adverse Effect with respect to Holly and Frontier, respectively.

L. *Holly Passes on Acquiring the Denver Refinery*

***11** During the negotiations with Frontier, Holly was also pursuing the acquisition of a refinery in Denver, Colorado (the "Denver Refinery") which ConocoPhillips had been required by the FTC to divest. Because of Frontier's substantial presence in the Denver area, Holly's acquisition of the Denver Refinery would have posed significant antitrust concerns if it combined with Frontier. Thus, in anticipation of entering into the Merger Agreement, Holly abandoned its efforts to purchase the Denver Refinery.

M. *Frontier Completes Financing for the Merger*

Frontier needed to finance the cash portion of the merger consideration to be paid to Holly shareholders.[FN40] With Holly's concurrence,[FN41] Frontier proceeded in April to borrow $220 million. The funds were borrowed well before the anticipated closing because of favorable interest rates. When it became apparent that the Merger would not close, Frontier would repay the debt. Its unreimbursed costs associated with the borrowing were approximately in excess of $20 million, including interest.

FN40. The Merger Agreement was not contingent upon financing.

FN41. PX 150.

N. *Two Important Developments*

During the fourteen weeks following execution of the Merger Agreement, two matters, both previously mentioned, would evolve. The Merger, because of one, both, or some combination of the factors, would not happen. The parties are deeply divided as to their relative significance. The first involves Beverly Hills. Not only was litigation commenced, but also, and more importantly, it was learned that Frontier would not be able to rely upon its "corporate separateness" defense because it had guaranteed Wainoco's obligations under the lease for the oil production site at Beverly Hills High School. The second was a new MLP presentation by Lehman Brothers for a public offering of Holly's pipeline assets. Lehman Brothers' analysis suggested that Holly had significantly undervalued those assets and, thus, that Frontier had struck a good, perhaps too good of a, deal.

1. (a) *The Beverly Hills Litigation*

In early April, Norsworthy and Glancy flew to California to meet with Holly's attorneys at Gibson Dunn and to visit the site of oil wells on the campus of Beverly Hills High School.

On April 28, 2003, the Masry law firm filed twenty-three initial notices of claims with the City of Beverly Hills and the Beverly Hills Unified School District on behalf of former students of Beverly Hills High School, employees of the school, and residents living near the school. Those notices contained allegations that emissions from the oil field or production facilities had caused cancers and related health problems. In light of these notices, Gibson Dunn informed Holly of its view that a lawsuit would be filed within the next two months.

On June 9, the Beverly Hills Litigation became a reality with the commencement of an action entitled *Moss et al. v. Venoco, Inc., et al.* (the "*Moss* Complaint") in the Superior Court of the State of California for the County of Los Angeles, Central District.[FN42] The seventy-page complaint was brought on behalf of twenty-one plaintiffs, two of whom were deceased. It alleged that toxic emissions from the oil production facilities had caused an unusually high rate of cancer and Hodgkin's disease among former students of Beverly Hills High School.[FN43] Significantly, and perhaps most importantly from the point of view of Holly, the action was directed not only against Wainoco, but Frontier as well; it alleged that Frontier had contractually guaranteed Wainoco's obligations under the lease of the Beverly Hills oil wells.

FN42. N 50. There are five lawsuits (the "Beverly Hills Litigation").

FN43. Gibson Dunn advised Holly that the venue could be transferred to Central Civil West, which is known to plaintiffs' law firms in Southern California as "the Bank" because of its tendency to provide favorable verdicts.

***12** At this point, Holly decided that it needed a second opinion as to the risks associated with the Beverly Hills Litigation. Thus, on June 11, 2003, Holly retained the firm of Carrington, Coleman, Sloman & Blumenthal, LLP ("Carrington Coleman") to evaluate the Beverly Hills claims and to determine if Frontier, in contrast to a mere subsidiary of Frontier, faced potential liability.

On June 12, the Holly Board met and received a presentation from Gibson Dunn about the Beverly Hills Litigation.[FN44] Gibson Dunn reported that it expected as many as 200 additional plaintiffs to file claims; that it could take two to three years, or more, to prepare the initial case for trial; that it would be hard to exclude adverse expert witnesses; that there would be no cap on punitive damages; and that legal fees could be $200,000 per month or more. Gibson Dunn also advised that while it could not predict the ultimate outcome of the litigation, Frontier's exposure could run into the hundreds of millions of dollars.[FN45] Gibson Dunn nevertheless remained optimistic about Frontier's ability to extricate itself at an early stage from the litigation by use of the corporate separateness defense.

FN44. H 381.

FN45. There is substantial debate as to what figure was actually given. Frontier, looking at drafts of the meeting minutes, claims it is tens of millions of dollars; Holly, using the signed minutes, claims it is in the hundreds of millions. Although not critical to the ultimate decision, the number of potential plaintiffs, the seriousness of the diseases, and the projected monthly fees, tend to support the range sponsored by Holly as the one presented to the Board.

(b) *Frontier as Guarantor and Indemnitor*

Both Frontier and Holly were shocked by the allegation in the *Moss* Complaint—which was factually correct—that Frontier had guaranteed Wainoco's performance and indemnified various Beverly Hills entities. To fully understand their impact, a short history of the Beverly Hills oil wells is necessary. In 1959, the Beverly Hills Unified School District leased the portion of its lands which now contain the oil wells to one Allen Guiberson. This lease contained a provision which called for the lessee to indemnify Beverly Hills Unified School District for any costs it might incur as a result of the lessee's use. FN46 In 1985, this lease was assumed by Wainoco Oil & Gas Company, and guaranteed by its parent Wainoco Oil Corporation, FN47 which is now Frontier. Thus, Frontier has guaranteed Wainoco's performance through the indemnification provision in the 1959 lease. FN48 Waverly Oil Company, Inc. assigned the lease to Wainoco. Chevron USA, Inc. (or its predecessor, Standard Oil Company of California) at one time had held the lease rights. As part of the lease assumption, Wainoco (including the corporate entity now known as Frontier) executed a Consent Agreement which, in substance, made Frontier directly liable to Chevron for performance of the lessee's obligations. FN49 Thus, Frontier may have a direct obligation to indemnify Chevron.

FN46. PX 1 at 17.

FN47. PX 9.

FN48. The Court does not, even if words which may suggest otherwise are used from time to time, determine Frontier's obligations under the various indemnity or guarantee provisions. That question, involving California law, documents evidencing an interest in California real property, and a dispute in California, is better resolved in California. It is sufficient for purposes of this Memorandum Opinion that it is likely, or that it is reasonable to expect, that Frontier will be deemed directly obligated with respect to the claims, whatever their merit, asserted in the Beverly Hills Litigation. That exposure may be mitigated by, for example, cross-indemnities from one or more of the other defendants in those proceedings.

Frontier correctly points out that its indemnification obligations do not affect the "corporate separateness" argument which Gibbs relied upon at the end of March 2003 to persuade Holly to proceed with the Merger Agreement. That "corporate separateness" or "corporate veil-piercing" argument depends upon the status of Frontier and Wainoco as distinct corporate entities. The existence of the indemnification agreements does not affect their relative independence as corporate entities. Gibbs, however, used his corporate separateness argument to demonstrate that Frontier was not liable for the obligations of Wainoco. Because of the indemnification obligation, whether Frontier and Wainoco are separate and distinct corporate entities loses much significance in this context. What mattered for purposes of the Merger Agreement was whether Frontier could keep itself out of the Beverly Hills litigation by virtue of an arms-length relationship with Wainoco; with the indemnities, that goal was frustrated.

FN49. PX 10.

Before the Merger Agreement was signed, Holly had engaged in the typical due diligence effort of a company considering a merger. As part of this inquiry, Holly specifically requested from Frontier any materials relating to indemnities or guarantees, and, in fact, made the following request in its initial due diligence request list:

> *Indemnities, Guarantees and Other Obligations.* Copies of all documents and agreements pursuant to which the Company or any other [Frontier] Entity has any continuing indemnification, guarantee or other obligations to any third party with respect to the disposition of assets. FN50

FN50. PX 54A.

***13** Frontier has suggested that the Wainoco indemnification documents were available to Holly, in the sense that Holly's V & E lawyers were in the same room where they were stored and had access to the board minutes reflecting their approval. Nevertheless, these documents were neither discovered during due diligence nor directly provided by Frontier.[FN51]

FN51. Board minutes, reflecting that the parent (now Frontier) had accepted guaranty and indemnification obligations at Beverly Hills (PX 12) were also among the records available during Holly's due diligence effort.

On the other hand, it is also clear that Frontier's management did not know about the indemnities—or had forgotten about them—when the Merger Agreement was signed. For instance, during the due diligence period, Bechtol had represented that there were "none other than ordinary course." [FN52] Gibbs admitted that he "had personally forgotten about [the] very existence" of the indemnities and was "shocked" by their discovery. [FN53] However, these indemnities were included in an appendix to a memorandum to Frontier from Andrews Kurth on April 23, 2003, but they seemed to have escaped the notice of Frontier's management until approximately two months later.[FN54]

FN52. Tr. at 736.

FN53. Tr. at 95.

FN54. F 174; Tr. at 551–52.

(c) *Due Diligence II: The Indemnities are Discovered*

The fact that Frontier had indemnity obligations to the Beverly Hills Unified School District and Chevron, both named defendants in the Beverly Hills Litigation, came to the attention of Gibbs, Bechtol, and Robert V. Jewell, one of the Andrews Kurth lawyers representing Frontier, by at least June 30, 2003. [FN55] Interestingly, when three of Holly's lawyers from Carrington Coleman, including Ken Carroll, came to Frontier's offices the next day, July 1, 2003, Frontier was not immediately forthcoming with this information. Instead, Holly's lawyers were taken to a meeting room where Gibbs surprised them with an hour-long presentation regarding the corporate separateness defense.[FN56] This prepared presentation was also attended by Edwards, Bechtol, and Jewell, who chimed in with other information at various points, including the Canadian tax ruling which, Frontier claimed, showed the viability of the corporate veil between it and Wainoco.

FN55. Tr. at 91, 527, 841.

FN56. Tr. at 2239–40.

While Carroll's chances to ask questions during the conversation were limited during the presentation, Carroll did ask several questions about various indemnities after Gibbs had finished. For instance, Bechtol confirmed that Wainoco had executed guarantees of the Beverly Hills High School leases when the leasehold interest had been acquired, something which Bechtol had originally indicated in an e-mail to Carroll on June 26. [FN57] After being informed of this, Carroll asked the following question, "Well, in light of that guarantee, does the parent, Wainoco Oil Corporation [Frontier], have a direct obligation to indemnify the school district or the city?" [FN58] The question was answered by a simultaneous "no" from Gibbs, Bechtol, and either Jewell or Edwards.[FN59] After the meeting, Frontier did not immediately produce the indemnity and guaranty documents, but instead Holly's lawyers were told that the ten to twelve boxes in the room contained all of the documents relating to Beverly Hills.[FN60]

FN57. Tr. at 2242–43.

FN58. Tr. at 2243.

FN59. *Id.* Carroll was uncertain if it was Edwards, Jewell, or both, because they were further down the table from him. Tr. at 2243–44.

FN60. Tr. at 771–72.

***14** In these boxes, the Carrington Coleman lawyers would find the following indemnities: the 1978 amendment to the 1959 lease of the oil wells which contained "kind of an oddball indemnification provision which required that the lessee indemnify both the city and the school district with respect to certain ... challenges," FN61 an obligation subsequently undertaken by Wainoco and guaranteed by Frontier; the Wainoco's sale agreement with Venoco in 1995 which contained "cross indemnities or reciprocal indemnities between the buyer and the seller;" FN62 and a consent agreement, signed with Chevron, whereby "Wainoco Oil & Gas had assumed the obligation to the lessee and Frontier ... had guaranteed those obligation to the school district." FN63

FN61. Tr. at 2247.

FN62. Tr. at 2247–48.

FN63. Tr. at 2248.

One thing absent from the boxes was the 1959 lease of the property, although a number of the documents made reference to it. Carroll asked Bechtol for a copy, but he could not immediately produce it. It was sent to Carroll at his office the following day. The contents of the lease contained the very indemnity Gibbs and Bechtol had disclaimed the previous day with their unison "no." As Carroll wrote in an e-mail to two other Carrington Coleman lawyers:

> And finally, I now have the '59 lease. Remember yesterday when I asked if WOC had a direct obligation to indemnify the City or School district and 3 of them answered "NO" in unison? Well, look at paragraph 24 of the '59 lease: "Lessee shall and hereby agrees to indemnify, defend, and hold Lessor harmless from all damages, costs, ... arising out of or in any way connected with ... the conduct of any operations hereunder...." FN64

FN64. H 386.

Discovery of the indemnities was critical for Holly. Dintzer advised the Board that the existence of the indemnities "[c]hanged the whole picture in terms of what Frontier could be facing as this litigation unfolded." FN65 Existence of the indemnities essentially meant that the corporate shield defense was meaningless as Frontier now likely had a direct obligation to pay at least some of the damages and costs that might be incurred.

FN65. Tr. at 1981.

2. *The Lehman Brothers MLP Presentation*

Before entering into the Merger Agreement, Frontier had performed its own analysis of Holly's proposed MLP and had projected a value in the range of $140 million to $150 million. FN66 On April 3, 2003, Gibbs and Edwards attended a meeting with Norsworthy and Clifton at Holly's offices in Dallas during which a presentation was given on the potential benefits of the proposed MLP FN67 by Holly's adviser, Townes Pressler. This slide-show predicted a current value of the MLP assets as $248.3 million. After this presentation, Gibbs told Edwards, "We got a good deal." FN68

FN66. Tr. at 47.

FN67. Tr. at 48, 208, 452.

FN68. Tr. at 52.

Norsworthy was aware, around the time of the Merger Agreement and in the weeks following, that the market was "hot" for MLP assets such as those Holly could offer. FN69 He also recognized that, as interest rates decrease, as they did during the period from March to summer 2003, the MLP would become more valuable. FN70

FN69. Tr. at 1296–97.

FN70. *Id.* at 1298.

***15** On June 23, 2003, Clifton received by e-mail a report, entitled "MLP Presentation" (the "Lehman Brothers MLP Presentation"), from Lehman Brothers. FN71 This report contained both the Frontier and Holly logos in the margins; it does not appear that Lehman Brothers ever sent the report directly to Frontier. The Lehman Brothers MLP Presentation included the following chart, which showed a substantial increase in value from the $248.3 million set forth by Townes Pressler at the beginning of April:

FN71. PX 220; Tr. at 2513.

Sources and Uses of Funds [72]

(*$ in millions*)

	Base Case	Case A
Sources		
IPO Proceeds	$114.60	$160.30
Debt Issuance	100.0	150.0
Total Sources	$214.60	$310.30
Uses		
Cash Distribution to Frontier	$203.70	$295.70
Estimated Transaction Fee	10.9	14.6
Total Uses	$214.6	$310.3
Pre-tax Value to Frontier		
Cash at IPO	$203.7	$295.7
Value of Retained Interest (at 7.19% yield)	142.8	199.9
	$346.5	$495.6
Pre-tax Value:		
Multiple of 2004E EBITDA	11.9x	12.0x
% of Holly Enterprise Value	75.8%	108.5%

FN72. PX 220 at 00373 (footnotes omitted).

In sum, this report predicted a value for the MLP assets of between $346 million and $495 million—more than double what Frontier had thought the value of the MLP effort was when the Merger was negotiated and, under Case A, double what Holly had thought the value was only two months earlier. Furthermore, under Case A, the value of the MLP exceeded the implicit valuation of the Merger by 8.5%. In other words, were this report believed, by completing the Merger and then proceeding with the MLP, Frontier would essentially be acquiring Holly's refineries for free.

The implications of the Lehman Brother's MLP Presentation were not lost on Clifton, who forwarded it to Jim Townsend, Holly's Vice President of Pipelines and Terminals, the following day, noting: “Although, [Lehman Brothers'] # 's maybe somewhat higher than they should be, look how high a value [they have for] the MLP worth post expansion/SLC related terminals/ & exp. Rio Grande & interest.” FN73

FN73. PX 223.

However, Clifton would also note that the Lehman Brothers MLP Presentation contained several errors and assumptions that resulted in overstating the value of the pipeline assets. For instance, he observed that the differences in value between the Base Case and Case A were the result of including in the MLP assets that Holly had acquired in 2003, the projected effects of expanding Holly's New Mexico refinery to increase flow through the pipeline, and an increase in debt. FN74 Lehman Brothers had assumed that the interest expense, or cost of debt, was 7% and the yield to the unit holders, when the units were sold, was 9%; therefore, an increase in debt had the corollary effect of increasing value. FN75 Even the Base Case assumed $100 million in debt which was $50 million more than assumed in the presentation from Townes Pressler. FN76 Furthermore, Lehman Brothers had forgotten to include more than $4.5 million in expenses, related to such matters as corporate overhead, insurance and property tax, all of which would drive the value down by approximately $50 million. FN77

FN74. Tr. at 2514–15.

FN75. *Id.*

FN76. PX 461 at 18; Tr. at 2517.

FN77. Tr. at 2519.

***16** Clifton would eventually make handwritten notations on the Lehman Brothers MLP Presentation to correct for the errors he perceived, as well as to note where Lehman Brother's assumptions differed from those of Townes Pressler or included projected expansions. FN78 Thus, simply taking into account the expenses Lehman Brother forgot to include, while leaving all other assumptions the same, Clifton would recalculate the projections from the Lehman Brothers MLP Presentation as follows: FN79

FN78. H 874.

FN79. *Id.* at HC000883 (footnotes omitted).

Sources and Uses of Funds

(*$ in millions*)

	Base Case	Case A
Sources		
IPO Proceeds	$90.0	$136.0
Debt Issuance	100.0	150.0
Total Sources	$190.0	$286.0
Uses		
Cash Distribution to Frontier	$181.0	$274.0
Estimated Transaction Fee	9.0	12.0
Total Uses	$190.0	$286.0
Pre-tax Value to Frontier		
Cash at IPO	$181.0	$286.0
Value of Retained Interest (at 7.19% yield)	115.0	169.0
	$296.0	$455.0

Pre-tax Value:		
Multiple of 2004E EBITDA	11.9x	12.3x
% of Holly Enterprise Value	65.8%	101.4%

On July 3, 2003, Clifton e-mailed the original version of the Lehman Brothers MLP Presentation to Edwards along with the following message:

> Julie [Edwards]: I don't know whether you & Jim [Gibbs] got a copy of this latest analysis from Lehman. For some reason, they have EBITDA in both cases overstated by $4.4MM (didn't include some o/h & insur, etc.) which would lower enterprise values by roughly $40MM + more or less. Dollars are bigger than Townes presentation due to higher debt @ 7% and IPO assumed yield of 9%. Also case A includes the additional Rio Grande %, SLC terminals & expansion volume effects.[FN80]

FN80. H 534. Clifton was uncertain if he ever actually sent Edwards his handwritten changes to the calculations or if his e-mail was the only way he ever showed her what adjustments needed to be made to the analysis. Tr. at 2518–19.

While the Lehman Brothers MLP Presentation is a critical part of Frontier's repudiation case, I find as a matter of fact that no one on behalf of either Holly or Frontier accepted the projections at face value. For instance, Edwards, even after receipt of the Lehman Brothers MLP Presentation, believed the enterprise value for the MLP to be less than $280 million, and probably in the "mid 200s." [FN81] This is not inconsistent with the testimony of Clifton who put the value in the range of $275 million to $300 million [FN82] and Norsworthy who noted the increase in value from "the mid twos to the upper twos." [FN83]

FN81. Tr. at 455–57.

FN82. Tr. at 2522.

FN83. Tr. at 1299.

O. *The Holly Board Meets on July 9*

The Holly Board met again on July 9 and received a status report on the Beverly Hills Litigation. Gibson Dunn informed the Board that defense costs alone would be substantial: early drafts of the Board's minutes indicate they could be between $25 million and $40 million [FN84] and the final version indicates that a range of $40–$50 million was discussed.[FN85]

FN84. PX 271 at 4.

FN85. PX 264 at 4. Frontier argues that these changes show that the "Board Minutes" are a record created for this litigation. I need not resolve the issue, although the practice of delaying the final form of board minutes, unfortunately and perhaps unnecessarily, raises some doubt about their reliability.

The Board also received a presentation from Fletcher Yarbrough of Carrington Coleman. He was introduced as having been hired to "undertake an independent review of the Beverly Hills situations .... in addition to the analysis being done by Gibson Dunn." [FN86] Yarbrough informed the Board that, based on what he had learned, Frontier was likely to be involved in the Beverly Hills Litigation through trial, and that it had direct contractual obligations to guaranty and indemnify other parties named as defendants in the Beverly Hills Litigation.[FN87] As Yarbrough put it, the existence of the indemnities and guarantees meant that there was no "silver bullet" to protect Frontier from substantial litigation costs and liability.[FN88]

FN86. PX 271 at 6, 8.

FN87. H 387.

FN88. PX 265 at 7, 8.

***17** The Board, as might be expected, did not relish this news. For instance, Norsworthy expressed concern about Frontier stock "with this big, black cloud hanging over it." FN89 Similarly, Clifton "felt pretty uncomfortable personally about [the March 30] deal" and was unwilling to move forward "without something that Frontier could bring to the table to mitigate the concern over Beverly Hills." FN90 Board member Jack P. Reid ("Reid") recalled that he had "greatly increased" concern over the indemnities, but believed that Holly would "probably be able to reach some type of agreement with Frontier" to address these concerns. FN91

FN89. Tr. at 1259.

FN90. Tr. at 2631.

FN91. Tr. at 2114–15.

During the course of the meeting, the Board considered issuing a Material Adverse Effect ("MAE") notice, but it ultimately rejected that course of action in favor of instructing Holly management to report its concerns to Frontier and to engage in a dialogue about those concerns. FN92 While the record is clear that the Holly Board did not change its recommendation or determine that an MAE notice should be sent on July 9, FN93 the record is also clear that, after the July 9 Board Meeting, Holly likely would not proceed to closing on the Merger Agreement in accordance with its express terms. This is not to suggest that Holly had repudiated the Merger Agreement; instead, it still had multiple options available to it, if Frontier did not adequately address its concerns, including declaring an MAE, exercising its fiduciary out, or seeking a mutual termination.

FN92. PX 262 at 15.

FN93. Tr. at 1400–01; 1528–30; 2071–72; 2117–18.

P. *Holly and Frontier Meet on July 9*

Immediately following the July 9 Board meeting, Norsworthy, Glancy, and Clifton flew (in a thunderstorm) from Dallas to Houston to convey the Board's concerns to Frontier. There, they met with Gibbs, Edwards, Bechtol, and Jewell. What happened at this meeting is the subject of some debate. Holly asserts that Frontier management was informed of the Holly Board's concerns and was presented with three options (1) restructuring the deal; (2) declaration of an MAE regarding the Beverly Hills Litigation; or (3) mutual termination. Frontier claims that, while Holly indicated its concerns, it was less than clear as to what options were available to accomplish the closing. The record is clear that at one point either Norsworthy or Glancy mentioned the possibility that the Beverly Hills Litigation could be an MAE to which Jewell responded that he "respectfully disagreed." FN94 Thus, while that exchange was short, lasting less than thirty seconds, the possibility of Holly's declaring an MAE and ending the transaction was expressed to Frontier at the meeting. FN95

FN94. Tr. at 1708–09, 533–34, 1411.

FN95. Neither side sought to discuss the MAE question in greater detail.

Q. *Frontier Decides to Renegotiate the Merger Terms*

Regardless of precisely what was said and what options were presented to Frontier at the July 9 meeting, the effect of it is clear—Frontier was placed on notice that, unless Holly's concerns were in some way assuaged, Holly would not proceed to closing under the Merger Agreement. For instance, Gibbs testified that "Mr. Norsworthy told [Frontier management] that his board would not—was very concerned about Frontier's stock and taking—taking the Frontier stock that we had in the original deal." FN96 In his deposition, he more clearly stated his understanding following the July 9 meeting that "Holly was not going to go forward with the merger based upon the March 30th agreement." FN97 Similarly, Edwards testified that she "understood on July 9 that it was very unlikely, if [Frontier] didn't do something, that Holly was going to proceed to a closing." FN98 Likewise, Bechtol recalled that he left the July 9 meeting thinking "that the business folks were going to need to get together and start trying to work towards some sort of renegotiation." FN99 Jewell perhaps put it most clearly of all by testifying that following the July 9 meeting "the ball was in our court to come up with some ideas .... [and] if we wanted to keep the deal together, we thought we would have to restructure." FN100

FN96. Tr. at 348–49.

FN97. Tr. at 347–49; Gibbs Dep. at 168–69.

FN98. Tr. at 470.

FN99. Tr. at 853.

FN100. Tr. at 537. Gibbs testified that, at the conclusion of the meeting, Norsworthy said, “We still have a deal.” Tr. at 64. Edwards testified that both parties said this, Tr. at 387, and Jewell testified that someone from Holly, probably Norsworthy, said, “We do still have an agreement.” Tr. at 534–35. Holly's witnesses have neither agreed with nor refuted this. Frontier has asked for a specific factual finding that this was in fact said. Whether or not this was said, it was the clear understanding of Frontier's management after the meeting—that the terms of the deal needed to be altered in order for the Merger to occur. Thus, this “we still have a deal” statement, if uttered, would only indicate Holly's desire to find terms for a merger that were satisfactory to both parties. More likely, it reflected Holly's expectation that a solution could be found. This statement, of course, would not have prevented Holly from using any of the exit provisions in the Merger Agreement if its concerns were not met.

***18** The reasons for Frontier's willingness to renegotiate, instead of holding Holly to its deal, were best expressed by Gibbs:

Q. Why didn't you just say to Mr. Norsworthy on July 9, “Hold on, Lamar. You signed a deal, and a deal is a deal and you're going to live by that or else?”

A. You know, *we had transactions put together here that we—you only live once or twice for.* You only get to these where it makes so much sense for your shareholders, their—Holly shareholders, for Wall Street, for the bondholders, for employees. When you put the two companies together, creative form or fashion, helps the balance sheet, creates a real competitive power in the Rocky Mountains in an industry that's dominated by majors.

We wanted to do this transaction—this transaction badly. We knew we had a good deal. We knew we had significant value for our shareholders going forward if this thing got closed. And we knew that we had quite a bit of leeway as far as being able to accommodate and sweeten and still maintain a good trade for our shareholders. And if [the Lehman Brothers MLP Presentation] was correct, had to assume it was, then the difference between the valuation that we had and this number, $250 million.

So yes, we didn't want to lose the deal. We thought it was good for everybody going forward. Wall Street loved it. We had quite a bit of leeway in order to move up both the cash portion and the stock portion that we had. *In the back of my mind was if—if the new valuation, even on an apple-to-apple basis of between $114 to $140 million of additional volume has been discovered here, Holly could at that point in time simply slip us $16 million and walk out into the sunset.* Rather than have that happen, we were willing to go forward with a restructured deal.FN101

FN101. Tr. at 66–67 (emphasis added).

Thus, Frontier's decision to renegotiate was based on both its perception of an increase in MLP value in which it wanted to share and its knowledge that if Holly was not satisfied with the deal, it had an available exit strategy (and a relatively cheap one if the Lehman Brothers MLP Presentation were believed) under the Merger Agreement. This is the back-drop against which the subsequent negotiations took place.

From July 9 to August 5, the parties engaged in protracted negotiations regarding how to restructure the transaction. These negotiations would eventually yield at least four models for a restructuring, all of which would be rejected, by one party or the other, for various reasons.

R. *The Put Proposal*

On July 17, the parties met in Dallas and held a lengthy “brainstorming session” during which several proposals were discussed, including an all-cash deal with upside participation for Holly shareholders, FN102 a "synthetic" put with a financial institution, and a combination of cash, notes, and warrants. FN103 They agreed on a restructuring under which, for a period after closing, Holly shareholders would be able to "put" their shares back to Frontier at a fixed price (the "Put Proposal"). The Put Proposal would have given Holly shareholders protection against Beverly Hills Litigation in that, should the litigation drive the price of Frontier stock down, they could "put" the shares received in the Merger back to the surviving company at a guaranteed minimum price for a limited time following the Merger. FN104 If the Beverly Hills Litigation resolved itself or Frontier stock rose above that price, Holly shareholders could also participate in the appreciation in value. FN105 At the conclusion of the meeting, Frontier directed Andrews Kurth to work out the mechanics of the Put Proposal and to draw up a term sheet.

FN102. Tr. at 72.

FN103. Tr. at 1264–65.

FN104. Tr. at 1266.

FN105. *Id.*

***19** Frontier, however, backed away from the Put Proposal several days later after Gibbs and Edwards discovered that the puts would have to be recorded as Frontier debt. Gibbs did not want to "leverage [Frontier's] balance sheet." FN106 He explained his concerns:

FN106. Tr. at 73.

> This is a very capital-intensive business that also has a very large amount of working capital. A lot of that working capital is financed through trade terms. And even though it's very large, it's very small as far as participants. Once you become overleveraged and illiquid, all that trade credit dries up; and many companies have found themselves in pretty sad situations by overleveraging, getting illiquid and have a commercial trade credit dry up. FN107

FN107. *Id.*

S. *The Canoe Proposal*

Frontier's rejection of the Put Proposal was communicated to Holly, along with another restructuring proposal under which Holly would implement the MLP before the Merger and the proceeds from the MLP placement would be used to finance an all-cash transaction for the Frontier–Holly Merger (the "Canoe Proposal"). FN108 In effect, under the Canoe Proposal, Holly was expected to pay the purchase price for the benefit of Frontier with its own money. This proposal infuriated Norsworthy, who had been expecting a final term sheet on the Put Proposal. In a phone call to Edwards on July 21, Norsworthy rejected the Canoe Proposal, saying, "[W]hy would I need Frontier if I can do that? I can sell my own pipes. I can paddle my own canoe." FN109

FN108. Tr. at 395; 1267–68.

FN109. Tr. at 395.

The following day, after Norsworthy had calmed down, he called Edwards again and proposed a transaction which Glancy and he had formulated. This transaction would involve "moving the boxes" or finding a way to organize the various entities in such a way that Frontier's potential liability would stay with Frontier stockholders and Holly's shareholders would be insulated from any potential exposure. FN110 While Edwards initially thought this was "a good idea" with "some feasibility," it was ultimately not pursued, most likely because of difficulties encountered in assuring the desired result. FN111

FN110. Tr. at 397–98; 1268–69.

FN111. Tr. at 397–98.

T. *The July 29 Proposal*

Another concept was a cash/stock election option—a merger structure under which the stockholders of Holly would have a choice between the original deal and one with more cash and less stock. Clifton faxed this proposal to Edwards on July 29 (the "July 29 Proposal") FN112 after he had reviewed it first with Norsworthy, Paul Stoffel, a Holly director, and Robert

Wheeler) of Credit Suisse First Boston.FN113 This approach essentially converted the transaction from a merger to an acquisition. It eliminated the concept of a shared board and management structure and increased the cash consideration. The pertinent terms were as follows:

FN112. PX 294.

FN113. Tr. at 2643.

Option 1	
Cash	$11.11
FTO Stock	1 Share
CVR	1 CVR

Option 2	
Cash	$18.11
FTO Stock	1/2 Share
CVR	1 CVR

***20** Note: As long as FTO stock value is above $14 per share when election is made, there would be an economical incentive to pick "Option 1."

2. Holly Corporation shareholders can pick one of the two following options subject to a maximum cash outlay from [Frontier ("FTO")] of $275MM (Over-subscription of "Option 2" will be prorated back to "Option 1" on equal basis to keep below maximum cash outlay of $275MM).

3. CVR—Original CVR is modified by adding the following right to the jet fuel claim right:

CVR holders will receive a payment equal to 50% of the "value" receive by FTO from the sale of "Holly Corporation's Pipeline and Terminal" assets to a third party or to a new MLP formed by FTO in excess of $250 MM, but less than $350 MM, plus 40% of the "value" receive by FTO in excess of $350 MM.

In the event that FTO does not sell "Holly Corporation's Pipeline and Terminal" assets to a third party or a newly formed MLP within 18 months from the date of the merger, the CVR holder will receive a payment equal to $4 per share.FN114

FN114. PX 294.

Edwards liked this plan.FN115 From July 29 through August 5, the parties worked hard to adapt the July 29 Proposal into a form that would be acceptable to all involved. Indeed, Edwards recalls "the last half of July as a blur of conversations and different things [they] were trying ... to ... solve the problem." FN116 Similarly, Clifton's desperation to close the deal is reflected in an e-mail sent to Edwards on August 1:

FN115. Tr. at 398.

FN116. Tr. at 394.

I can't stress how important it is to get a proposal ASAP. If we blow another week I don't know if it will stay together. *Again, I'll go anywhere, any time to try to resolve outstanding issues*.... Let's keep it going to see if we can get there. Even I am losing patience. FN117

FN117. F 549 (emphasis added).

U. *The Denver Agreement*

The parties came to an agreement on August 5, 2003 in Denver (the "Denver Agreement"). The meeting was among Holly and Frontier's senior management and financial advisors, but without lawyers. The Denver Agreement differed from the July 29 Proposal: Holly stockholders could elect to receive all stock or all cash; the cash portion of the deal was raised from $172.5 million to $210 million; FN118 Holly shareholders would receive a contingent value right equal, in the aggregate, to 35% of the consideration which Frontier would receive from the MLP to the extent that it exceeded $280 million. Under this deal Holly stockholders could elect to receive $28.25 in Frontier stock, or $27 in cash, subject to a $210 million cash limit. FN119 Assuming full proration, this was an increase of approximately $2 per share for the Holly stockholders over the March 30 deal. FN120

FN118. Tr. at 1451.

FN119. Tr. at 81; PX 319.

FN120. Tr. 84–85; 1451; PX 319.

At the conclusion of the meeting, both sides agreed to take the Denver Agreement back to their respective boards. Norsworthy committed to support the transaction before the Holly Board. FN121 According to George C. Morris, III, Frontier's financial advisor from Petrie Parkman, "[Gibbs] looked across the table to [Norsworthy] and said 'Lamar, do we have a deal? Is this a deal that you'll do?' And [Norsworthy] said 'Yes, that's a deal I'll do.' ' FN122 The parties then called their lawyers to discuss the terms of the deal and to begin the document preparation process. FN123 According to Morris, at the end of the meeting "[e]verybody was feeling very good, because it was a very stressful situation going into this thing, but now everybody felt relieved that we had solved the problem." FN124 That feeling would not last long.

FN121. Tr. at 1443.

FN122. Tr. at 651.

FN123. Tr. at 86–87.

FN124. Tr. at 651.

V. *On the Road to Banff*

***21** The night of August 5, Norsworthy would fly from Denver to Calgary. Upon his arrival, he was driven to Banff—a ride of about two hours. During this ride, Norsworthy began to have second thoughts about the Denver Agreement:

> I was sitting in the back thinking about it. And I don't know why I was so dumb that it didn't occur to me earlier; but the more I though about it, I felt, you know, this thing feels kind of funny, that you've got a deal here where you're inducing stockholders to take Frontier stock and all of the liability of Beverly Hills, if there is any, and you're structuring such a way that the insiders maybe can get all cash and outsiders, who don't know anything about it, are going to end up with Frontier stock, and is this the right kind of thing to do.... FN125

FN125. Tr. at 1275.

Norsworthy's concerns were further compounded by the limited disclosure Frontier had given its stockholders concerning the Beverly Hills Litigation:

> Frontier disclosed very little about what we thought we knew about this thing, the indemnities and everything was closed; and that if we were to proceed with this deal we were talking about, that clearly all this—all this we would have to try to make an effort to disclose all this stuff—as to the stockholders. And by people being focused on this stuff, nobody in their right mind would want to take [Frontier's] stock. They would want to take the cash, and there wouldn't be enough cash to satisfy anybody. If they didn't disclose—well, it was just something we couldn't do. FN126

FN126. Tr. at 1276–77.

Norsworthy had come to realize that by making the Denver Agreement he had shirked his fiduciary responsibilities to his shareholders; he was concerned about his personal liability if the transaction were to close on these terms. He and his associates had intended to take the cash option, in essence, hoping that enough of the other (*i.e.,* less-informed) Holly shareholders would take Frontier stock. If not enough of Holly shares were tendered for stock, then the cash Frontier would make available would not be adequate to assure Norsworthy and the others that they would not be "stuck" with Frontier stock.FN127 The topic of personal liability was again stressed the following day, August 6, in conversations Norsworthy had with Glancy and Robert G. McKenzie, another Holly director. As Norsworthy stated in his deposition, by this point, the Denver Agreement was effectively "DOA." FN128

FN127. Holly's public shareholders would have been able to trade freely their new Frontier stock upon the Merger. The risk that Norsworthy faced (in addition to potential liquidity problems resulting from his status as an insider if he received a substantial portion of the Merger consideration in new Frontier stock) was that the public shareholders who held onto their new Frontier stock would subsequently pursue him and the other Holly insiders who took the all-cash option, in the event that the new Frontier stock fared badly. They, it was feared, would argue that Holly's insiders, buoyed by misleading public disclosures and aided by their own insights, had duped the public shareholders into taking new Frontier stock, thereby allowing Norsworthy and the other Holly insiders to escape with nothing but cash.

FN128. Norsworthy Dep. at 298.

W. *Holly and Its Lawyers Gather*

On August 11, Glancy convened a meeting involving nine different outside lawyers to evaluate Holly's rights under the Merger Agreement. The lawyers discussed declaring an MAE and the effect of issuing a press release relating to an MAE.FN129 A draft MAE notice letter and a draft press release were prepared shortly thereafter.FN130

FN129. Tr. at 1724.

FN130. Tr. at 1724–25.

X. *The All–Cash Proposal*

On August 12, the Holly Board gathered to consider the Denver Agreement. It also received an update on the Beverly Hills Litigation, which by this time had expanded to three separate lawsuits on behalf of over 400 plaintiffs. Gibson Dunn reiterated that the litigation was serious and predicted defense costs in the range of $40 million to $50 million simply to prepare the first case for trial with ultimate exposure potentially in the range of $500 million to $1 billion.FN131

FN131. H 55 at 381.

***22** Norsworthy, after his drive from Calgary to Banff, did not endorse the Denver Agreement, and the Holly Board, not surprisingly, rejected it. The Board continued to have concerns about a transaction involving Frontier stock and instead determined to ask Frontier to accept an all-cash proposal. Holly's Board was advised that Frontier could finance an all-cash transaction, but the Board also authorized Holly management to help finance such a transaction.

Immediately following the August 12 board meeting, Norsworthy, Clifton, Holly director Stoffel, and advisor Vestor Hughes called Gibbs and informed him of the Holly Board's rejection of the Denver Agreement and proposed an all-cash transaction of $28 per share. Holly also advised Gibbs that Holly would provide bridge financing for the transaction and no longer expected to participate in the upside of the MLP. Gibbs testified that:

> I told them that we had a discussion in the past about taking all cash. We had pretty much eliminated that as an option. I had told Paul Stoffel that on a telephone conversation with him a week before. And *I didn't think that this was something we could do.* We had already considered it and determined that, *but we would look at it and get back in touch with them.* FN132

FN132. Tr. at 101–02 (emphasis added).

Gibbs would then consult with Edwards and Frontier's bankers about the all-cash proposal. Edwards testified that hearing that the Denver Agreement had been rejected "was like being kicked in the stomach." FN133 Between August 12 and 19, Edwards and Clifton would have numerous discussions about the latest proposal; Edwards would run multiple models on it, but her response to Clifton would be that "it would be really risky and imprudent to overleverage Frontier" to close the transaction.FN134

FN133. Tr. at 411.

FN134. Tr. at 411–12.

Gibbs testified that the proposal would make Frontier "75 percent debt" which was "awfully dangerous." FN135 At some point he called Stoffel and communicated his concern about taking the debt required for the transaction because "of the impact on [Frontier's] balance sheet and liquidity and the perception it would create in the debt markets, equity markets, and the oil markets." FN136

FN135. Tr. at 104.

FN136. *Id.*

Y. *Frontier and Its Lawyers Develop a Strategy*

Other than his conversation with Stoffel, Gibbs would have no communication with Holly. He would instead be taking the first steps which would lead to this litigation. On August 18, Gibbs met with Richard Caldwell of Andrews Kurth to begin planning to sue Holly. At this meeting Gibbs heard the word "repudiation" applied to this matter for the first time.FN137 Caldwell provided Gibbs with a script of questions to ask Norsworthy when they next talked. This script would be used the following day.

FN137. Tr. at 163.

Z. *The August 19 Phone Call*

Holly had heard nothing from Gibbs regarding the all-cash proposal since making it on August 12. Thus, on August 18 Holly contacted Frontier and arranged a telephone call with Gibbs for the following day. On August 19, the phone call between Gibbs and Norsworthy took place (the "August 19 Phone Call"). Edwards was with Gibbs in his office in Houston and Norsworthy was with Clifton in Dallas. This phone call is the crux of Frontier's claim that Holly repudiated the Merger Agreement. Gibbs took notes of this conversation as it transpired, then recopied these notes into a final form (the "Transcript"), FN138 and discarded the original. The full text of his recopied version of the Transcript is as follows:

FN138. PX 355.

HOLLY PHONE CALL—8/19/02
2:00 p.m. CDT

1.

Attendees (assumed)

Holly—Lamar Norsworthy

Matt Clifton

Frontier—JRG [Jim Gibbs]

JHE [Julie Edwards]

***23** 1. After a few cordial addresses got right to business

2. JRG—"what's up"

3. Lamar—reiterated that Holly wanted an all cash deal and not agreed to deal.

4. JRG—explained that this was discussed with Paul (Stoffel) last week and that it was impossible for us to do an all cash deal. I explained again why we could not do it and drew the analogy to Tesoro's experience

during the last 2 years.

5. I asked then what he proposed—nothing substantive came out.

6. I then explained that [Frontier's] position was that “we liked the signed and agreed to deal, thought that we still had an agreement and it and its terms were still effective, [Frontier] would abide by its terms and expected Holly to do likewise, expected final comments from the SEC on Thursday, Friday or Monday—would be preparing to go effective and mailing proxy shortly.

7. Lamar then stated that “his Board was not prepared to recommend the transaction to their shareholders.”

8. I then asked Lamar and asked him to listen carefully “Is your Board no longer willing to do or support our signed deal on its existing terms?”

He clearly, unambiguously, distinctly and unequivocally responded “No [they are not] FN139

FN139. The last part of this, “[they are not],” was not said by Norsworthy but was added by Gibbs to the “Transcript” for “clarification.”

9. I repeated this for the second time.”

10. I asked Lamar then what amended terms would they support? Lamar responded “all cash”

11. I told him that was not possible.

12. I asked Lamar if we could provide insurance for the suit would this board support the existing deal. He responded that if the insurance was provided by a big well funded insurance company like AIG and the terms it contained were acceptable they might consider it.

When asked what terms and conditions were acceptable, he responded whatever claims and forever terms.

This is clearly impossible to provide. There was no reason to continue.

13. The meeting then concluded.

As Gibbs testified, this is not a complete or accurate transcription of what was said; statements that he considered “unimportant” were not recorded. FN140 The Transcript clearly shows the influence of a meeting with a lawyer.

FN140. Tr. at 170–171.

While much of the conversation between Gibbs and Caldwell was cloaked in privilege, FN141 Gibbs did testify that he received the questions on line 8 and 10 of the “Transcript” from Caldwell. FN142 Furthermore, Gibbs also received the words characterizing Norsworthy's answer, “clearly, unambiguously, and unequivocally” from Caldwell, before the statement was given. FN143 In fact, Gibbs had this characterization already written down on a separate sheet of paper. FN144 Gibbs explained his “choice” of words:

FN141. The Court draws no inference from the exercise of the attorney-client privilege. Both Frontier and Holly asserted their privilege from time-to-time during this proceeding.

FN142. Tr. at 166.

FN143. Tr. at 167–68.

FN144. Tr. at 168.

Q. As a straight-talking, boot-wearing Texan who does not speak legalese, is this how you talk? Clearly, unambiguously, distinctly, and unequivocally, is that an example of the manner in which you speak?

A. No.

Q. Well, pray tell, why is it written in that fashion?

A. That was information that I got from my attorneys. FN145

FN145. Gibbs Dep. at 202–03.

***24** Norsworthy's recollection of the phone call, while essentially similar, does contain some differences. For instance, Norsworthy testified that Gibbs asked him, " 'Are you prepared to proceed with the transaction we executed on ...'—whatever it was—'... March the 30th." ' FN146 Norsworthy agreed with Gibbs that he answered "no." FN147 Norsworthy testified that he discussed the Board's continued reluctance to take Frontier stock with "the Brockovich problem hanging over them." FN148 Norsworthy also recalled that Gibbs asked if he would be willing to talk to Frontier's outside counsel about the Beverly Hills Litigation.FN149

FN146. Tr. at 1288.

FN147. *Id.*

FN148. Tr. at 1288.

FN149. Tr. at 1289. Edwards also recalled this portion of the conversation. Tr. at 487.

His version of the insurance discussion was also quite different:

> A. At some point in time [Gibbs] asked me would insurance solve the problem. And I said, "well if there is a triple A rated company, and it would take care of the Beverly Hills situation, I'm sure that would solve it."
>
> Q. How did he react to that?
>
> ....
>
> A. His question was: "What if it was something less than that?"
>
> Q. How did you react?
>
> A. My answer was, like it usually is, "we just have to look at it, Jim." FN150

FN150. Tr. at 1288–89

Importantly, Norsworthy also stated that he would have Holly's lawyers at V & E contact Frontier's Andrews Kurth lawyers "to figure out what [to] do next." FN151 That Norsworthy indicated the lawyers should talk to each other, which is not in the Gibbs' Transcript, was confirmed by Edwards.FN152

FN151. Tr. at 1290.

FN152. Tr. at 489. Interestingly, Edwards, who testified that she was sitting within five or six feet of Gibbs during the August 19 Phone Call, did "not recall" seeing him take notes during it. Tr. at 487.

AA. *Frontier Claims Repudiation and Files Suit*

On August 20, 2003, the day after the phone call, Frontier filed this action. Shortly after the complaint was filed, but before Holly had learned of it, Clifton sent Edwards the following e-mail:

> Julie: Wheeler called me this morning and said that you had told him [Frontier] got insurance re: the Ca case. If this is so we should have a discussion on the coverage etc to see if this mitigates the Board's concerns. Stoffel's has called numerous times this morning and would be quite anxious to review any coverage you could obtain.FN153

FN153. PX 359.

Edwards responded by calling Clifton and letting him know that "it [was] too late" because a lawsuit had been filed.FN154 She also forwarded him a copy of the Complaint within nine minutes of his e-mail.FN155

FN154. Tr. at 2553, 492.

FN155. H 872A.

Around the same time Edwards was informing Clifton about the suit, Gibbs was leaving the following voicemail for Norsworthy:

> Lamar this is Jim, Jim Gibbs. I'm sorry I didn't get a chance to talk to you but I tried. At any rate what I was trying to do was give you a heads up and tell you what was happening. As you know we've been[,] really been[,] working diligently to try to come up

with some type of alternative or amendment to our existing agreement that would satisfy you and certain of your directors so that we could get this transaction going. But yesterday in our conversation you clearly and unequivocally stated that the Holly Board of Directors were not willing to proceed with or support the merger under its existing terms. So that essentially represented a repudiation of our agreement. That leaves us no alternative and we have already filed in the last 10 minutes a lawsuit in Delaware court to protect our shareholders' interest. That's about the only thing we could do. I tell you that this is the first time in 22 years that we've ever filed a lawsuit and I hate that it's going to be between Frontier and Holly. I really have grown to appreciate the staff at Holly and you and Lamar ... you and Matt particularly. Really enjoyed you two guys. I'm certainly sorry that we couldn't get together to come up something that would work. I'm still a big proponent for this merger. I think it would represent a hell of a company. That I'm sorry that we just can't get your directors comfortable with the transaction. So.... Give me a buzz if you have any questions. Again I wanted to give you a heads up, heads up. This will hit the wire in about probably 10 or 15 minutes. I suspect the New York Stock Exchange will stop trading on our stock. You all might act accordingly. Talk to you later. Thank you.[FN156]

FN156. PX 361A.

BB. *Holly Gives Its MAE Notice*

***25** On August 21, 2003, Holly sent Frontier a letter [FN157] in which it asserted that Hilly had breached its representations in Section 4 .8 and Section 4.9 [FN158] of the Merger Agreement. In essence, Holly claimed that the Beverly Hills Litigation would have a Frontier MAE.

FN157. PX 365.

FN158. Section 4.9 of the Merger Agreement is set forth *infra* note 220.

CC. *Frontier Abandons the Merger Effort*

After filing suit, Frontier stopped taking the actions necessary to implement the Merger Agreement. For instance, it refused to proceed with the preparation of the financial information required by securities laws [FN159] and declined to respond to an SEC comment letter. [FN160]

FN159. F 789.

FN160. F 958.

DD. *Frontier Procures Insurance for Beverly Hills*

On September 30, 2003, Frontier was able to obtain insurance for the Beverly Hills Litigation from an AIG affiliate. Under the terms of the insurance agreement, Frontier would be covered for five years from any bodily injury, property damage, or potential contractual indemnity claims for all amounts up to $120 million in defense costs and liability payments.[FN161] For this coverage, Frontier had to pay a risk transfer premium of $5.75 million and place $19.5 million in a commutation account, in addition to various fees and costs.[FN162] The insurance coverage was layered. For the first $40 million of covered claims Frontier did not have any co-insurance requirement, although the first $19.5 million in costs would be taken out of the commutation account. Between $40 million and $41.5 million Frontier would be responsible for all payments, and from $41 .5 million to $120 million Frontier would incur the first 3% of the claims. After $120 million, of course, Frontier would be uninsured. On each anniversary of the policy, Frontier could commute the account, or cancel the insurance, and be refunded the unused portion of the commutation account, as well as a portion of the risk transfer premium.[FN163]

FN161. PX 406.

FN162. Tr. at 1087.

FN163. Tr. at 1088–89.

EE. *Holly Offers Its Pipeline Assets*

On March 15, 2004, Holly issued the S–1 for its MLP transaction. It projected a unit price of $22.25, for, according to Frontier, approximately $335 million in value.[FN164] When the offering closed in July 2004, the unit price was $23.50.[FN165] Holly notes that the market value of such MLP transactions generally increased between March 2003, when the Merger Agreement was executed, and Holly's closing on its MLP transaction.[FN166]

FN164. Frontier's Mot. to Reopen Ev., at Ex. B, 2.

FN165. Frontier's Mot. to Take Judicial Notice, at ¶ 3.

FN166. The parties have debated how to compare the value of the MLP transaction closed in July 2004 to the various values ascribed by the participants after the Merger Agreement. The assets to be included and the debt to be assumed, which would vary from projection to projection, would have had a significant impact. One can debate minority discounts and control premiums. Developments in the financial markets, such as lower interest rates, also would come into play. Fortunately it is not necessary to resolve this fascinating debate with any precision. The increase in value that could be achieved through an MLP offering of Holly's pipeline and terminal assets exceeded significantly the $16 million payment to Frontier that would accompany Holly's exercise of its fiduciary out. Frontier assumed, before the Merger, that an MLP would generate perhaps $150 million, but it realized, in early April 2003, that $250 million might be the more accurate number. By July 2003, Holly (depending upon which Holly representative) viewed the value as somewhat less than $300 million. During the ensuing six months or so, it would grow to more than, on a roughly equivalent basis, $330 million.

II. CONTENTIONS

A. *Frontier's Perspective*

Frontier first asserts that Norsworthy's statements during the August 19 Phone Call demonstrated that Holly repudiated the Merger Agreement. That allowed Frontier to declare a breach of the Merger Agreement and to sue for contract damages. Because of the favorable deal that it had negotiated, the increase in value associated with Holly's pipeline assets, and the more than $20 million spent by Frontier in support of the Merger, Frontier claims a right to recover in excess of $160 million.

In addition to its repudiation claim, Frontier contends that Holly breached the covenant of good faith and fair dealing implicit in every contract governed by Delaware law. According to Frontier, the Lehman Brothers MLP Presentation in June persuaded Norsworthy, who may already otherwise have reached the same conclusion, that he had made a very bad bargain. Holly used the Beverly Hills Litigation as a pretext for renegotiating the Merger Agreement and to drag out the process; the objective was to delay until the "drop dead" date at the end of October and, thus, to avoid all potential exposure.

***26** Finally, Frontier asserts that the Holly Board's decision, as early as July 9, not to proceed to closing entitles it in accordance with the Merger Agreement, and especially in a court of equity, to an award of the break-up fee.

B. *Holly's Perspective*

Holly takes the position that the August 19 Phone Call cannot form the basis for a repudiation claim because there was no clear and unequivocal expression of intent not to comply with the Merger Agreement. Norsworthy told Gibbs that there would be no deal, but the "deal" was the exchange of one Holly share for one Frontier share, $11.11, and a CVR. Frontier, however, is not suing for breach of that "deal." Instead, Frontier is suing for breach of the Merger Agreement and the Merger Agreement, even as of the August 19 Phone Call, entitled Holly to exit either by declaring an MAE or other breach of warranty or by exercising its right to a fiduciary out. Norsworthy, Holly claims, informed Gibbs that it was "up to the lawyers," thus conveying the notion that it was time to evaluate the various exit strategies. In short, Holly did not refuse to perform its duties under the Merger Agreement.

Holly also argues that Frontier breached its representations and warranties in the Merger Agreement with respect to the then-threatened Beverly Hills Litigation and the existence of a Frontier guarantee of its subsidiary's obligations. Specifically, it asserts that the threatened litigation would have or would reasonably be expected to have (or that Frontier must and cannot prove otherwise) an MAE.

Holly points out that a wrongful repudiation is also a breach of contract. That, in addition to Frontier's misrepresentations, authorizes Holly to recover damages that it has incurred. Holly's damage claims focus on the lost opportunity to acquire to Conoco/Phillip's refinery in Denver, its loss of favorable small refiner status with respect to its sale of aviation fuel, and the substantial costs that it incurred as it pursued closing under the Merger Agreement.

Holly, furthermore, has a different view of the efforts to renegotiate. It concedes that, as of the July 9 meeting in Houston, it was not likely to close under the express terms of the Merger Agreement. This reluctance resulted from growing concerns over Frontier's potential exposure in the Beverly Hills Litigation and the accompanying risks involved in acceptance of Frontier stock. Far from breaching the covenant of good faith and fair dealing, Holly made reasonable and well-intentioned attempts to salvage the transaction.[FN167]

FN167. Both parties have applied for an award of attorneys' fees. Because those applications have not been fully developed, the Court defers decision of that aspect of this proceeding.

III. ANALYSIS

A. *Principles of Contract*

This case is about a contract.[FN168] "[T]he Court first looks to the express terms of the contract to see 'whether the parties' intent can be discerned' from those terms. If the terms of the contract are clear on their face, the Court will give those terms the meaning that 'would be ascribed to [them] by a reasonable third party.' '[FN169] If, however, the contract is "reasonably or fairly susceptible of different interpretations or may have two or more different meanings,"[FN170] it is ambiguous, and the Court will resort to extrinsic evidence to ascertain the "reasonable shared expectations of the parties at the time of contracting."[FN171] The extrinsic evidence may include "the overt statements and acts of the parties, the business context, prior dealings between the parties, and other business customs and usage in the industry."[FN172] In addition, the Court must strive to "interpret contractual provisions in a way that gives effect to every term of the instrument, and that, if possible, reconciles all of the provisions of the instrument when read as a whole."[FN173]

FN168. The Merger Agreement is to "be governed by and construed in accordance with the laws of the State of Delaware." Merger Agreement, Section 8.6 (original in capitals).

FN169. *BAE Sys. N. Am., Inc. v. Lockheed Martin Corp.,* 2004 WL 1739522, at *4 (Del.Ch. Aug.3, 2004) (quoting *Comrie v. Enterasys Networks, Inc.,* 837 A.2d 1, 13 (Del.Ch.2003) & *True N. Communications, Inc. v. Publicis, S.A.,* 711 A.2d 34, 38 (Del.Ch.1997), *aff'd,* 705 A.2d 244 (Del.1997)) (footnotes omitted).

FN170. *Rhone–Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.,* 616 A.2d 1192, 1196 (Del.1992).

FN171. *Comrie,* 837 A.2d at 13.

FN172. *In re Explorer Pipeline Co.,* 781 A.2d 705, 714 (Del.Ch.2001) (quoting *Bell Atl. Meridian Sys. v. Octel Communications Corp.,* 1995 WL 707916, at *6 (Del.Ch. Nov.28, 1995)); *see also Cincinnati SMSA, L.P. v. Cincinnati Bell Cellular Sys. Co.,* 708 A.2d 989, 993 (Del.1998).

FN173. *Council of Dorset Condominium Apartments v. Gordon,* 801 A.2d 1, 7 (Del.2002).

B. *Did Holly Repudiate the Merger Agreement?*

***27** An "unequivocal statement by a promisor that he will not perform his promise" is the essential underpinning for a repudiation claim.[FN174] Repudiation occurs upon "an outright refusal by a party to perform a contract or its conditions." FN175 A party may be treated as having repudiated his contract if he announces his refusal to perform under the contract "unless terms different from the contract are met." FN176

FN174. *Carteret Bancorp, Inc. v. The Home Group, Inc.,* 1988 WL 3010, at *5 (Del.Ch. June 13, 1988) (citing FARNSWORTH ON CONTRACTS § 8.20, at 630 (1982)). The unequivocal statement must be "positive and unconditional." *Id.* at *6 (citing WILLISTON ON CONTRACTS § 1322 (3d ed.1968)).

FN175. *CitiSteel USA, Inc. v. Connell Ltd. P'ship,* 758 A.2d 928, 931 (Del.2000); *see PAMI–LEMB I, Inc. v. EMB–NHC, L.L.C.,* 857 A.2d 998, 1014 (Del.Ch.2004).

FN176. *CitiSteel,* 758 A.2d at 931.

The Merger Agreement, of course, was not an ordinary contract. Before the Merger could occur, the shareholders of Holly had to approve it. The directors of Holly were under continuing fiduciary duties to the shareholders to evaluate the proposed transaction. FN177 The Merger Agreement accommodated those duties by allowing, under certain circumstances, the board of directors to withdraw or change its recommendation to the shareholders that they vote for the Merger. FN178 The presence of a "fiduciary out" does not preclude a finding of repudiation. FN179 It does, however, establish a specific context in which the conduct of the players must be assessed. FN180

FN177. *See Omnicare, Inc. v. NCS Healthcare, Inc.,* 818 A.2d 914, 932–35 (Del.2003).

FN178. Merger Agreement, Section 5.4. The recommendation to approve the Merger could be withdrawn, withheld, modified, or changed if the board of directors determined in "good faith after consultation with its outside legal counsel that the failure to the take the action in question would be inconsistent with the fiduciary obligations of such Board of Directors under applicable law."

FN179. *See, e.g., Consolidated Edison, Inc. v. Northeast Utils.,* 249 F.Supp.2d 387 (S.D.N.Y.2003).

FN180. For example, a statement by a promisor who has a contractual out that he will not perform under the contract because of the contractual out will not automatically be "repudiation." Otherwise, any affirmative reference to the contractual out would be a repudiation, and such an approach would defeat the purposes behind such protective provisions.

Holly's repudiation of the Merger Agreement, if it occurred, occurred during the August 19 Phone Call. Holly arranged for the call because it was seeking Frontier's response to the all-cash offer of August 12. Given Frontier's previous concerns about more debt, Holly had more than an inkling of the answer it would receive. Gibbs, in contrast, arrived at the call with an entirely different agenda. His purpose was to induce Norsworthy to repudiate the Merger Agreement. FN181 With the prior guidance of counsel, he sought to induce Norsworthy to tell him "unambiguous, distinctly and unequivocally" that Holly would not go forward. Gibbs knew that he had out-negotiated Norsworthy. He also knew that changes in market conditions, including the significant appreciation in the value of an MLP offering, had made his good deal even better. He believed that Holly was worth 100 million more than the Merger price reflected. What he could not abide was the thought that Holly would simply walk away (through exercise of the fiduciary out) for $16 million, an amount less than Frontier's costs already occurred in borrowing the cash necessary for the Merger. FN182

FN181. Early in the conversation, Gibbs informed Norsworthy that Frontier would not pursue an all-cash acquisition. His position was consistent with the concerns that he had previously expressed about burdening Frontier with additional debt of the magnitude necessary for an all-cash acquisition.

FN182. As Gibbs, in describing the reasons for pursuing a negotiated resolution after the July 9 meeting, put it, “Holly could ... simply slip us $16 million and walk out into the sunset.” What Gibbs failed to appreciate was that if the transaction was too good (from Frontier's perspective), especially because of the uncertainty arising from the Beverly Hills Litigation, Holly's Board, properly acting with the best interests of the shareholders in mind would likely—and perhaps necessarily—invoke the fiduciary out provision (assuming that it did not pursue a more aggressive strategy involving declaration of an MAE or asserting that it had been misled to enter into the Merger Agreement because of the failure to disclose the Beverly Hills guarantees).

Norsworthy did tell Gibbs that the Holly Board was no longer willing to support the deal on its existing terms. The answer could not have been a surprise to Gibbs. After all, as of the July 9 meeting, everyone understood that the “deal” of one Frontier share, $11.11 and a CVR was not going to happen.

Ultimately, Frontier has failed to prove that Holly, through Norsworthy or its other representatives, made “an unequivocal statement” that would “it would not perform [its] promise.” The “deal” to which Norsworthy referred was not the Merger Agreement; instead, it was, in accordance with the way the parties had discussed this matter for the preceding six weeks or so, the deal of one Frontier share, $11.11, and a CVR.

***28** The lack of clarity and precision here is the result, in large part, of actions taken by Frontier. Gibbs, or Frontier's counsel, “wrote the script.” Norsworthy did not say that Holly was going to ignore the terms of the Merger Agreement.FN183 Moreover, the questions, as written in the Transcript, are directed to whether the Holly Board would recommend the Merger to the shareholders. Revisiting the commitment to recommend the Merger was not merely something that the Merger Agreement allowed the Holly Board to do; it was the duty of the Holly Board to review the transaction to confirm that a favorable recommendation would continue to be consistent with its fiduciary duties. In that light, merely stating that the Board was no longer recommending a transaction (particularly in the same conversation in which a pending offer from Holly was rejected) cannot, in this context, be considered a repudiation of the Merger Agreement, entitling Frontier to damages.FN184

FN183. Tr. at 489 (Edwards).

FN184. A phone call is a somewhat strange (perhaps calculated) way to close off a contract involving several hundreds of millions of dollars and which had been negotiated and monitored by a number of talented and informed lawyers. The Restatement provides the following guidance as to the nature of a demand for adequate assurances: “A party who demands assurances must do so in accordance with his duty of good faith and fair dealing in the enforcement of the contract.... Whether a particular demand for assurance conforms to that duty will depend on the circumstances. The demand need not be in writing. Although a written demand is usually preferable to an oral one, if time is of particular importance the additional time required for a written demand might necessitate an oral one. RESTATEMENT (SECOND) OF CONTRACTS, § 251, cmt. d. Thus, as Frontier points out, written notice is not absolutely required. However, a written demand is “preferable,” especially for a transaction of the complexity and sophistication of the one anticipated by the Merger Agreement. Frontier seeks to excuse its decision not to make a written demand for assurances by arguing that time was of “particular importance” because of the impending release of the S–4 as part of the process of securing shareholder approval of the Merger. Frontier, understandably, did not want to see the proxy statement released to the public, only to learn after-the-fact that Holly was going to abandon the Merger. Frontier's argument fails to acknowledge three significant considerations. First, although the imminence of the proxy process was mentioned by Gibbs during the August 19 Phone Call, that call had been arranged by Holly, not by Frontier. Second, and more importantly, Frontier had known for several weeks that Holly was not likely to go forward on the original terms (and Frontier had not responded to the all-cash offer made by Holly a week earlier) and, thus, to the extent that the proxy statement issuance date created a temporal exigency, it was largely of Frontier's own making. Third, Frontier still had a few days before it reached what it considered to be the crucial point. Thus, there was sufficient time to make the demand in writing. Holly certainly could not have professed surprise at such an inquiry, and Frontier would have been entitled to expect a prompt response.

This conclusion is bolstered by Edwards' testimony, which also confirms Norsworthy's view that there was more to do under the Merger Agreement:

Q: And so Mr. Norsworthy [after the August 19 Phone Call] was going to have the lawyers talk to each other to figure out what to do next. Right?

A: Yes.

Q: Because you guys were parties to a merger agreement. Right?

A: Yes. We had a contract.

Q: Right. You had a contract. That contract had rights and it had obligations. Correct?

A: Yes.

Q: The lawyers were going to figure out what to do next in view of those rights and obligations. Weren't they?

A: I don't know what they were going to do next. They were going to do something next. FN185

FN185. Tr. at 491. Norsworthy, according to Gibbs' testimony (Tr. at 108–09, 115–117) and the Transcript, referred to the "signed deal." The only "signed deal" was the Merger Agreement. The deal of one Frontier share, $11.11 and a CVR was not a separately signed agreement: it was simply the merger consideration that would flow to Holly shareholders upon consummation of the Merger Agreement. In light of the lengthy, personal contacts among the principals, a technical reading of a necessarily imprecise recollection cannot support the conclusion that Norsworthy was expressing the intention that Holly would refuse to act in compliance with the Merger Agreement.

By declaring a repudiation the following day, Frontier deprived Holly of the opportunity that it had under the Merger Agreement to exercise its right to a fiduciary out, or, possibly, to declare an MAE based on the Beverly Hills circumstances. FN186

FN186. At about the time that Frontier was filing this action, Clifton sent Edwards an e-mail (PX 359) that addressed insurance coverage for the potential Beverly Hills liability. This reflects either Clifton's understanding that Holly had not repudiated, and was still a participating party to, the Merger Agreement, or extreme disingenuousness on the part of Clifton. As a factual matter, the latter explanation is rejected.

C. *Did Holly Breach Its Covenant of Good Faith and Fair Dealing?*

The covenant of good faith and fair dealing, implied in every Delaware contract, arises from "fundamental notions of fairness." FN187 It "is a judicial convention designed to protect the spirit of an agreement when, without violating an express term of the agreement, one side uses oppressive or underhanded tactics to deny the other side the fruits of the parties' bargain." FN188 The Court, of course, may not substitute its notions of fairness for the terms of the agreement reached by the parties. Indeed, the implied covenant may only be invoked where it is "*clear* from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of [their agreement] had they thought to negotiate with respect to that matter." FN189 "[W]here the subject at issue is expressly covered by the contract, ... the implied duty to perform in good faith does not come into play." FN190 Finally, imposing an obligation on a contracting party through the covenant of good faith and fair dealing "is a cautious enterprise" FN191 and instances "should be rare." FN192

FN187. *Williams Natural Gas Co. v. Amoco Prod. Co.,* 923 F.2d 847, 1991 WL 5838 (Del. Ch. Apr. 16, 1991).

FN188. *Chamison v. HealthTrust, Inc.—The Hosp. Co.,* 735 A.2d 912, 920 (Del.Ch.1999), *aff'd,* 748 A.2d 407 (Del.2000) (TABLE); *see also PAMI–LEMB I, Inc.,* 857 A.2d at 1016; RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

FN189. *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.,* 708 A.2d 989, 992 (Del.1998) (emphasis in original).

FN190. *Dave Greytak Enters., Inc. v. Mazda Motors of Am., Inc.,* 622 A.2d 14, 23 (Del.Ch.1992), *aff'd,* 609 A.2d 668 (Del.1992) (TABLE).

FN191. *Aspen Advisors LLC v. United Artists Theatre Co.,* 861 A.2d 1251, 1259 (Del.2004).

FN192. *Cincinnati SMSA,* 708 A.2d at 992.

***29** The covenant of good faith and fair dealing is, by its very nature, context-specific. The directors of publicly traded companies pursuing a merger are frequently buffeted by conflicting forces. The Holly–Frontier Merger presented unusually difficult problems, especially for the Holly directors. They, of course, were required, as a matter of fiduciary duty, to continue their assessment of whether to recommend the Merger to Holly's shareholders. The directors had learned of Frontier's potential liability in the Beverly Hills Litigation and had seen the scope of that litigation increase significantly. Also, they had come to realize that they had approved a transaction which had not maximized value for the shareholders.

Frontier's assertion that Holly engaged in underhanded tactics can best be understood as based on two overlapping theories. One is that, in general, Holly was not candid. The other is that all the activity and hand-wringing over the Beverly Hills Litigation was nothing more than a pretext to escape from the Merger Agreement and to avoid the break-up fee that would be incurred through exercise of the fiduciary out.

Frontier starts with the Lehman Brothers MLP Presentation which was submitted to Holly on or about June 23, 2003. FN193 The presentation informed Holly that an MLP transaction could generate between \$346.5 million and \$495.6 million. Contrasting that with the \$248 million estimate discussed immediately after the Merger, Frontier argues that this provided the impetus for Holly's subsequent conduct. Or, as Norsworthy later put it, "I got skinned." FN194

FN193. Lehman Brothers had worked with Holly on a possible MLP transaction during the January–February 2003 lull in the negotiations with Frontier. Following execution of the Merger Agreement, Holly and Lehman Brothers continued discussions about a public offering of the pipeline assets. Such an offering after the Merger seemed likely. During these discussions and presentations (*see, e.g.,* a June 5, 2003 memorandum, PX 396A), Holly was shown that the pipeline assets were increasing in value. It does appear, however, that the scope of the increase had not earlier been portrayed as dramatically as in the June 23, 2003, document. Lehman Brothers did not forward the Lehman Brothers MLP Presentation to Frontier, but, shortly after receiving it, Clifton forwarded it to Edwards and explained to her why he believed that Lehman Brothers had been overly optimistic. Thus, Holly did not hide the news from Frontier. Moreover, Edwards, both savvy and knowledgeable in these matters, did not fully believe the numbers either. It should also be noted that Lehman Brothers' projections were higher than the prior valuations of the pipeline assets in part because additional assets were included and additional debt was to be assumed by the new entity. Nevertheless, all involved took the following from the Lehman Brothers MLP Presentation: Holly, in entering into the Merger Agreement, had understated significantly the value of its pipeline assets.

FN194. Tr. at 77 (Gibbs).

Frontier would have the Court find that the July 9 meeting in Houston, where Holly advised Frontier that renegotiation was in order, was prompted by concerns about the value of the pipeline assets and other factors indicating that Holly had been far too generous in its negotiations leading to the Merger Agreement. Isolating Holly's actions from the developments in Beverly Hills is not so easy.

Norsworthy and Glancy had visited the Beverly Hills site and conferred with Gibson Dunn in early April. In late April, the Masry firm had given notice of claim to the governmental defendants of impending litigation. Holly did little more, as it was in a holding pattern, until the first of the suits was filed on June 9. The complaint alleged, contrary to the representations of Frontier and to the genuine surprise of both Holly and Frontier, that Frontier, by virtue of its guarantee of Wainoco's obligations, was directly liable to the plaintiffs; indeed, Frontier was named as a defendant. Two days later, on June 11, Holly hired Carrington Coleman.[FN195] It would be almost two weeks later, June 23, when Clifton would receive Lehman Brother's MLP presentation.

FN195. Two Carrington Coleman lawyers, Yarbrough who led the effort and Carroll who did the work, testified at trial. Both were highly credible. Neither understood nor perceived the firm's assignment to be anything other than what it purported to be: an assessment of Frontier's liability in the Beverly Hills Litigation, with emphasis on the “corporate separateness” defense.

When Carrington Coleman was retained, Holly had not received the documents establishing Frontier's liability for the conduct of its subsidiary at the Beverly Hills site.[FN196] A few days before, the first Beverly Hills complaint had alleged Frontier's involvement, but there was uncertainty, if not skepticism, in the response of both Frontier and Holly to the allegation.

FN196. Of course, Holly had asked for the documents as part of its due diligence and, at least arguably, Frontier was required by the Merger Agreement to supply them. The critical documents may have been available for a V & E associate during the course of the due diligence preceding the Merger Agreement. The associate either did not review the documents or did not appreciate the significance of the documents; for current purposes, it is sufficient, and undisputed, that V & E did not inform Holly about Frontier's obligations at the Beverly Hills site (and that the senior V & E lawyers supporting Holly on the Merger Agreement had no knowledge either).

***30** As Carrington Coleman pursued its efforts to ascertain Frontier's exposure in the Beverly Hills Litigation, it met with Frontier on July 1. For a party that now complains about Holly's lack of candor, that was not a good meeting for Frontier. Gibbs spent the first hour defending the “corporate separateness” defense even though the documents refuting the value of that defense—by now known to Frontier's representatives—were in boxes no more than several feet away. Carroll, and his colleagues, eventually worked through the boxes and found the pertinent documents. As Dintzer of Gibson Dunn explained it, finding the indemnities “changed the whole picture in terms of what Frontier could be facing as the litigation unfolded.”[FN197] At the July 9 meeting of Holly's Board, following Carrington Coleman's explanation of the troubling new developments increasing the potential exposure of Frontier in the Beverly Hills Litigation, the directors instructed Norsworthy, as he had expected, to meet with Frontier and to share their concerns about Beverly Hills. At that point it was clear that the directors would not continue to support the transaction on the basis of one Frontier share, $11.11, and a CVR, unless some arrangement were made to protect against the potential exposure from the Beverly Hills Litigation. Yet, Holly's Board never formally determined to change its recommendation.

FN197. Tr. at 1981.

Frontier complains that Holly failed to convey its concerns candidly. During the July 9 meeting with Frontier after the Holly Board meeting, Norsworthy may have reassured Gibbs with a comment along the lines of, “we still have a deal,” but no one at the meeting, including Gibbs, could have had any reason to believe that the Merger would proceed in accordance with the specific terms negotiated in March.FN198 In short, Holly did not mislead Frontier at the July 9 meeting about the need to adjust the terms under which the Merger would close.

FN198. *See supra* Part I.P (quoting testimony of Frontier representatives).

Of course, that Frontier had been informed that a change of terms would be required does not necessarily lead to the conclusion that it been fairly informed of what changes would be needed or the real reasons behind the request. In the ensuing weeks, several approaches to address Holly's concerns would be considered in some detail. Significantly, these efforts all focused on protecting Holly's shareholders from exposure to Frontier's Beverly Hills liability. No substantial increase in share price was sought. Holly agreed to the Put Proposal, but Frontier withdrew its support when it realized the adverse impact it would have had on its balance sheet. Frontier suggested that a cash transaction could be achieved if Holly undertook the MLP—the Canoe Proposal. Holly rejected that concept because it saw no reason why it should assume the burdens and risks associated with the MLP solely for the benefit of Frontier. Norsworthy and Edwards considered “moving the boxes,” again a solution that would enhance the position of the Holly shareholders, but only in the larger sense of protecting them from the downside that might result from the Beverly Hills Litigation. The Denver Agreement, a cash/stock proposal, added a little value to the transaction, but its primary consequence would have been to afford Norsworthy and his associates the opportunity to cash out their Holly interests with the expectation that other Holly shareholders would take away the Frontier stock. This solution collapsed, not because of value, but because Norsworthy came to realize that he could not pawn off the Frontier stock on Holly shareholders without either disclosing his true aspiration (cash, not Frontier stock) or violating his fiduciary duties. Finally, Holly proposed an all-cash transaction of $28 for each Holly share, only a slight increase in the effective merger consideration and without any upside for Holly shareholders under either an MLP or the aviation fuel claim that was the basis for the CVR. Again, there is no suggestion that Holly was seeking to increase consideration materially; Holly even offered to help finance the additional cash requirements for an all-cash transaction.FN199

FN199. Frontier accurately points out that all-cash consideration had been discussed and that Gibbs had expressed great reluctance to agree to such a transaction because of the negative impact on Frontier's balance sheet. Thus, it is likely that Holly expected Frontier to reject the all-cash offer even though Gibbs did agree to consider it. That much is true. If, however, the value of Holly—because of favorable economic conditions, the escalation in consideration to be obtained through an MLP, the “good deal” that Frontier had negotiated, or some other factor—had increased as substantially as Frontier now advocates (after all it is the enhancement in value that leads, in its view, to Holly's “ultimate” motivation), then one cannot help wondering why Frontier did not rethink its aversion to an all-cash transaction and, what it now suggests, the minimal risk associated with turning the MLP assets into a sizeable pile of cash, in addition to the interest to be retained. It should be noted, on the other hand, that the retained interest, representing approximately half of the value ascribed to MLP offering would be illiquid. Also, Frontier would have likely needed the consent of the lender of the cash portion of the merger consideration to pursue such an effort and that consent might have come at a cost.

***31** The Court, thus, concludes that Holly pursued the post-July 9 negotiations in a good faith effort to find a way to meet the concerns that it had identified.[FN200] Holly had shared the Lehman Brothers MLP Presentation with Frontier. As soon as the Holly Board met after having been informed of Frontier's indemnities at Beverly Hills, it advised Frontier of its concerns. All subsequent negotiations focused on finding a way around Beverly Hills issues.

FN200. Norsworthy reached the Denver Agreement in good faith with respect to Frontier. When he recognized its implications, he abandoned it, in a way reminiscent of Gibbs' abandonment of the Put Proposal. Whether Norsworthy's initial support for the Denver Agreement was in good faith with respect to other stakeholders, such as Holly's public shareholders, is a question not germane to this proceeding.

Frontier, nevertheless, complains that Holly's Board never disclosed that it was, in effect, withdrawing its recommendation of the Merger and that it continued to hold out the possibility of closing the Merger. Yet, Frontier wanted the opportunity to save the transaction. Frontier's position would suggest that once a board with responsibility for determining whether to exercise a fiduciary out decides that the transaction cannot go forward under the precise contract terms, it must act forthwith to terminate the agreement. No good reason has been offered for why parties should not try to resolve the differences and, more importantly, why a party must exercise its exit rights without offering the other party at least the opportunity to salvage the transaction. If the concept of Holly's seeking to renegotiate the Merger Agreement is so offensive, Frontier must confront the question which it cannot answer: why then did Frontier engage in the negotiations? [FN201] Again, Frontier's angst stems from the nature of an agreement that allowed multiple exit strategies. As conditions change, frequently without the responsibility of either party to the transaction, the need to reevaluate the Board's recommendation to complete the Merger proceeds apace. When the Holly Board learned of Frontier's potential direct exposure in the Beverly Hills Litigation, it had to evaluate whether it should declare an MAE or whether it should use its fiduciary out to protect the interests of the shareholders who would be receiving Frontier's stock if the Merger closed. Perhaps, Holly would have declared an MAE (as it did after this litigation was filed). Perhaps Holly's Board would have concluded that the facts would not support declaring an MAE (or that it did not want the litigation that such a declaration might bring forth). Perhaps Holly's Board would have concluded that the risks of the Beverly Hills Litigation were large enough to withdraw, in accordance with its fiduciary duties, its recommendation to merge. Frontier, by peremptorily declaring a repudiation, denied the Holly Board that opportunity (and the Holly shareholders the benefit of that opportunity). Indeed, the Holly Board was confronted with a difficult question. It had begun discussions with counsel over what course to follow if Frontier did not take the August 12 all-cash offer. Frontier relieved Holly's directors of that burden.[FN202]

FN201. All of this is not to suggest that the Holly directors were oblivious to the run-up in value of the Holly enterprise. Multiple motivations are not uncommon in the human experience. Frontier has failed to persuade the Court that all of this was nothing more than a charade to avoid the fiduciary out payment (or the public embarrassment of admitting that an improvident merger had been recommended).

FN202. Of course, if Frontier had accepted the all-cash proposal at $28 per share and then Holly's Board had reneged, this might have been a very different case.

In sum, Holly was reasonably candid with Frontier; it did not deny Frontier “by arbitrary and unreasonable conduct ... the fruits of the [Merger Agreement].” Holly still had the opportunity to invoke one or more of its various exit strategies, exit strategies to which Frontier had agreed and accepted through the Merger Agreement. On the facts before the Court, Frontier has not proven that Holly breached its implied covenant of good faith and fair dealing.FN203

FN203. Frontier, by the middle of August was faced with a quandary. The October "drop dead date" was approaching. It may have been that Holly was trying to delay away payment of the break-up fee. Perhaps, Holly was planning to deliver a an MAE or other default notice that would not have afforded Frontier the thirty-day cure period. On the other hand, the drop dead date provision required that the party invoking it not have caused the delay. Frontier could have selected a more formal and more precise method for ascertaining Holly's intent than that provided by the August 19 Phone Call. It did not, and the decision on how to go about making the demand for assurances was not inadvertent. Frontier decided to go after broad contract damages as if Holly had breached the Merger Agreement. Structuring it as a repudiation must have been the most appealing strategy. Thus, this action resulted.

***32** Holly, by its counterclaim, seeks damages from Frontier because of (1) wrongful repudiation FN204 and (2) Frontier's breach of its representations and warranties in the Merger Agreement.

FN204. To the extent that Frontier meets this contention by asserting its conduct was justified by the change in attitude of Holly's Directors to the Merger, that argument is addressed at Part III.H, *infra.*

D. *Did Frontier Breach the Merger Agreement By Declaring that Holly Had Repudiated and By Filing this Action?*

As Holly argues, a wrongful repudiation is a breach of contract and entitles the injured party to damages as if (or because) a total breach occurred. Holly's damage claims fall into three categories: (1) loss of the opportunity to acquire the Denver Refinery; (2) loss of the small refiner exemption for the sale of jet aviation fuel; and (3) its costs incurred in supporting the Merger after entry into the Merger Agreement.

A party who is the victim of a wrongful repudiation is ordinarily entitled to damages for breach of contract because, in the absence of repudiation, the party would have performed under the contract and would have received the benefits of its bargain. This case, again, is not ordinary. As set forth above, after Frontier concluded, wrongly it turns out, that Holly had repudiated the Merger Agreement, and then Frontier proceeded with this action, Frontier ceased its efforts to complete the transaction. Under the circumstances, that constitutes a repudiation, or breach, of the Merger Agreement by Frontier. Thus, Frontier is liable to Holly for the damages caused by its wrongful repudiation. However, before August 20, 2003, Holly had already decided that the Merger would not happen on the terms negotiated in March. Either the terms would be renegotiated or Holly would be forced to choose an exit strategy. Under no foreseeable circumstances would Holly get the benefit of its bargain. Thus, the harms about which Holly complains were not caused by Frontier's breach. If, for example, Holly had exercised its fiduciary out, all of the damages which it has identified would still have been incurred and there would have been no basis for obtaining relief from Frontier.FN205

FN205. Thus, Holly is only entitled to an award of nominal damages of $1.00.

Exercise of its fiduciary out, however, was not Holly's only potential course of action. Even before Frontier's intervening acts, Holly was evaluating whether it could avail itself of an exit strategy based on misrepresentations which it believed Frontier made in the Merger Agreement.FN206 Holly relies upon two provisions of the Merger Agreement. The first, Section 4.8, is Frontier's representation that there existed no "Material Adverse Effect." This turns on whether the Beverly Hills Litigation does or would reasonably expect to have an MAE. The second, Section 4.19, is Frontier's representation that there were no material and undisclosed contractual obligations. This implicates Frontier's indemnifications and guarantees regarding the

Beverly Hills site. I turn first to the question of whether the Beverly Hills Litigation would have (or reasonably be expected to have) an MAE.

FN206. By declaring without a sufficient basis that Holly had repudiated the Merger Agreement, Frontier could not cut off Holly's claim that Frontier had breached its warranties in the Merger Agreement. Thus, Holly's misrepresentation claims survived Frontier's failed attempt to hold Holly in breach.

E. *Did Frontier Breach Its Representation that the Beverly Hills Litigation Would Not Have and Would Not Reasonably Be Expected to Have a Material Adverse Effect?*

***33** Frontier warranted in Section 4.8 of the Merger Agreement:

> Except as set forth on Schedule 4.8 of the Frontier Disclosure Letter, there are no actions, suits or proceedings ..., to Frontier's knowledge, threatened against Frontier or any of its Subsidiaries, ..., other than those that would not have or reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect.FN207

FN207. Under Section 6.2 of the Merger Agreement ("Conditions to Obligation of Holly to Effect the Mergers"), Frontier's representations and warranties had to be "true and correct ... as of the date of [the Merger] Agreement and as of the Closing Date (except for representations and warranties made as of a specified date, which need be true and correct only as of the specified date)." Thus, it was a condition to Holly's closing obligation that Frontier's representation that no MAE existed remain accurate, even as intervening events occurred.

Learning of the threatened litigation involving Frontier's subsidiary at the Beverly Hills site in March 2003 had been a major impediment to Holly's execution of the Merger Agreement. Gibbs and Edwards both downplayed the risks, but, within a short time span, the parties had agreed on how to handle the Beverly Hills matter. As set forth in Schedule 4.8 to the Merger Agreement:

> For avoidance of doubt and only for the limited purpose of this Agreement, Frontier agrees with, and for the sole benefit of, Holly that this potential litigation will be considered as "threatened" (as such term is used in Section 4.8 of the Agreement) and that the disclosure of the existence of this "threatened" litigation herein is not an exception to Section 4.8, 4.9 or 4.13 of the Agreement and despite being known by Holly, will have no effect with respect to, or have any limitation on, any rights of Holly pursuant to the Agreement.

From the parties' handling of the disclosure of the potential for litigation involving Beverly Hills, two guiding principles emerge: (1) the Beverly Hills Litigation is "threatened litigation" and, thus, within the scope of the representation of Section 4.8; and (2) Frontier's disclosure (or listing on Schedule 4.8) of this threatened litigation did not create an exception to Frontier's responsibility for its warranties under Section 4.8 or otherwise limit Holly's rights under the Merger Agreement. FN208 Although acknowledging the threatened litigation at Beverly Hills, Frontier, nonetheless, assured Holly that there were no threatened legal proceedings "other than those that would not have or reasonably be expected to have ... a Frontier Material Adverse Effect." Thus, in substance, Frontier represented to Holly that the Beverly Hills Litigation *would not have* an MAE and *would not reasonably be expected to have* an MAE. FN209 The test—"would have" or "would reasonably be expected to have"—is an objective one.FN210

FN208. Accordingly, even though the threatened Beverly Hills Litigation is "disclosed" on Schedule 4.8, it is not "disclosed" for purposes of Section 4.8.

FN209. The parties used "would," not "could" or "might." "Would" connotes a greater degree (although quantification is difficult) of likelihood than "could" or "might," which would have suggested a stronger element of speculation (or a lesser probability of adverse consequences).

FN210. I do not doubt that Gibbs and Edwards both sincerely believed, when the Merger Agreement was executed, that the threatened Beverly Hills Litigation was of little moment to Frontier. Similarly, I do not doubt that Norsworthy, in light of his unhappy and then recent experience with the Longhorn Litigation, would have considered the threatened Beverly Hills Litigation material if he had been aware of Frontier's indemnification obligation running to the benefit of Wainoco. Of course, the good faith views of Gibbs and Edwards, if wrong, would not preclude a finding that Frontier breached the warranty of Section 4.8. The point is the obvious: the honestly held subjective beliefs of even the most knowledgeable and experienced individuals are, to an unavoidable extent, the product of individual experience and perceived self-interest. This is but one of the many reasons counseling in favor of an objective standard.

For purposes of ascertaining whether the parties intended for a problem such as the Beverly Hills Litigation to be treated as an MAE, the words chosen by the parties provide a starting point:

> *"Material Adverse Effect"* with respect to Holly or Frontier shall mean a material adverse effect with respect to (A) the business, assets and liabilities (taken together), results of operations, conditions (financial or otherwise) or prospects of a party and its Subsidiaries on a consolidated basis.... FN211

FN211. Merger Agreement, Section 8.9(d). The parties excluded from the scope of the MAE provision those adverse effects that may result from general economic, regulatory, or political conditions or changes, financial market fluctuations, and changes in the petroleum refining industry generally.

It would be neither original nor perceptive to observe that defining a "Material Adverse Effect" as a "material adverse effect" is not especially helpful. Moreover, the definition chosen by the parties emphasizes the need for forward-looking analysis; that is especially true because the parties, through the drafting changes designed to assuage Holly's concerns about the threatened Beverly Hills Litigation added the "would not reasonably be expected to have" an MAE standard to the scope of inquiry regarding threatened litigation and the term "prospects" to the list of "the business, assets and liabilities ... results of operations [and] condition" in the definition of an MAE.

***34** The parties chose to use the term "Material Adverse Effect" and it is the Court's function to discern what they intended. They could have simply agreed that there was no threatened litigation which was or would be material. Because they did not choose that concept, it is reasonable to infer that something more is involved. The notion of an MAE is imprecise and varies both with the context of the transaction and its parties and with the words chosen by the parties. The drafters of the Merger Agreement had the benefit of the analysis in *In re IBP, Inc. Shareholders Litigation* (*"IBP"*) FN212 which considered whether the acquiring party in a merger transaction could successfully invoke an MAE provision to escape the agreed-upon combination:

FN212. 789 A.2d 14 (Del.Ch.2001).

> Practical reasons lead me to conclude that a New York court would incline toward the view that a buyer ought to have to make a strong showing to invoke a Material Adverse Effect exception to its obligation to close. Merger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a Material Adverse Effect condition is a broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term per-

spective of a reasonable acquiror.FN213

FN213. *Id.* at 68 (applying New York law) (footnote omitted).

Although *IBP* involved application of New York law, I see no reason why the law of Delaware should prescribe a different perspective. Because Section 4.8, and not Section 4.9 which addresses changed circumstances, is involved, it may be more useful to consider the standard drawn from *IBP* as one designed to protect a merger partner from the existence of unknown (or undisclosed) factors that would justify an exit from the transaction.

Before attempting to ascertain whether the Beverly Hills Litigation should be treated as an MAE, the threshold question of who bears the burdens of proof and persuasion must be first addressed.FN214 Holly argues that Frontier agreed to bear the burdens because of structural aspects of the warranty. Frontier generally warranted that there was no threatened litigation. That precise warranty (as both parties knew) was not accurate. That warranty, however, was subject to an exception: an exception for threatened litigation that would not (or would not reasonably be expected to) have an MAE. Holly contends that it only must show that there is, in fact, threatened litigation known to Frontier; then it becomes Frontier's burden to demonstrate that it is entitled to the exception, that is, the threatened litigation would not be an MAE.

FN214. This issue arises in the context of Holly's counterclaim: Holly seeks an affirmative award because of an alleged misrepresentation. It would also have arisen if the Court had concluded that Holly had repudiated or otherwise breached the Merger Agreement, in the context of Holly's affirmative defense that Frontier's misrepresentation excused any subsequent breach by Holly.

Frontier relies primarily upon *IBP* for the premise that “a defendant seeking to avoid performance of a contract because of the plaintiff's breach of warranty must assert that breach as an affirmative defense.” FN215 If a defendant seeking to avoid a contract bears the burden, it follows that the same defendant pursuing an affirmative claim, based on the breach of warranty, would also be charged with the burden as well.FN216 The opinion in *IBP*, of course, was issued well-before the Merger Agreement was negotiated. The parties could have expressly allocated the burdens as a matter of contract, but they did not do so.

FN215. 789 A.2d at 53; *see also Hollinger Int'l, Inc. v. Black,* 844 A.2d 1022, 1090 (Del.Ch.2004) (applying New York law).

FN216. At issue in *IBP* was a warranty which recited in pertinent part: “Except as set forth in Schedule 5.11 ..., there are no liabilities of the Company ... and there is no existing condition, situation or set of circumstances which could reasonably be expected to result in such a liability, other than: ... (d) other liabilities which individually or in the aggregate do not and could not reasonably be expected to have a Material Adverse Effect.” 789 A.2d at 39–40 (emphasis in original removed). Thus, the warranty in *IBP* used the same “other than” transition from the promise that there was no liability to the qualifying standard of whether any liability (existing in contradiction of the representation) could have a Material Adverse Effect.

***35** The Court's function is to ascertain the intent of the parties. To obtain relief for a breach of warranty, one would expect to be required to demonstrate an entitlement to that relief. That Frontier may have breached a warranty—no threatened litigation—accomplishes nothing by itself. Unless the threatened litigation has (or could reasonably be expected to have) an MAE, Holly has no claim. That is because breach of the warranty, if it is with respect to incidental litigation, is of no moment.FN217 In sum, the Court concludes that the expectation of the parties, as reflected in the Merger Agreement and as informed by the case law, was that the burden of demonstrating that the Beverly Hills Litigation would have (or would not reasonably be expected to have) an MAE falls on Holly.FN218

FN217. Holly looks to cases involving insurance coverage for support. *See, e.g., Judge v. State Farm Ins. Cos.,* 1993 WL 1611307, at *4 (Del.Super. May 3, 1993). Insurance cases reflect important public policy considerations not present here. Moreover, the insurance cases generally deal with exclusions. The insured has the coverage unless there is reason, as set forth in the policy or arising as a matter of law, for the insurer to avoid its obligation. The insured, thus, has a right that may be taken away; if all that happened under the Merger Agreement was the failure of Frontier to disclose threatened litigation, Holly, without more (*i.e.,* its showing of an MAE) has nothing.

FN218. Sometimes a court is able to deflect the import of allocating burdens by opining that, regardless of who has the burden, the outcome would be the same. This case is not so convenient.

Frontier argues that threatened litigation can never constitute an MAE because litigation results are inherently speculative.FN219 This argument ignores that threatened litigation can be so certain, the outcome so predictable, and the likely consequences (*i.e.,* "prospects") so negative, that an observer could readily conclude that the impact that one would reasonably expect to result from the litigation would be material and adverse. Predicting the outcome of unfiled (or even filed) litigation may be difficult and conclusions must be drawn with care; those considerations, however, neither require nor prudently allow for the absolute rule espoused by Frontier, particularly in light of the parties' drafting efforts to accommodate the then-threatened Beverly Hills Litigation.

FN219. Post Trial Br. of Frontier, at 39 ("[C]ourts do not find lawsuits to constitute MAEs because of the speculative nature of the litigation."). If that is the case, one wonders why Frontier entered into an agreement which required disclosure of threatened litigation unless it would not have an MAE. *But cf. S.C. Johnson & Son, Inc. v. Dowbrands, Inc.,* 167 F.Supp.2d 657, 670 (D.Del.2001).

The Beverly Hills Litigation poses serious risks for Frontier. Defense costs will be substantial; the risk of adverse results exists; and it is likely that, given the nature of the alleged health effects, if plaintiffs prevail on the merits of their claims, damage awards will be large. Whether this all reaches "Material Adverse Effect" under the terms of the Merger Agreement, however, mandates a more thorough review of the details.FN220

FN220. Holly at one time asserted that Frontier had beached its representations in Section 4.9 of the Merger Agreement which provides in part:

> ABSENCE OF CERTAIN CHANGES. Since December 31, 2002, Frontier has conducted its business only in the ordinary and usual course of business and during such period there has not been any (i) event, condition, action or occurrence that has had or would reasonably be expected to have, individually or in the aggregate, a Frontier Material Adverse Effect.

> Holly has since abandoned any claim under Section 4.9.

Holly focuses on the nature of the Beverly Hills forum and not on the merits of the actions there. Much of its argument is premised on its impressions of California law and procedure as plaintiff-friendly for mass toxic tort claims. This ranges from reporting that plaintiffs' lawyers affectionately refer to the venue as "the Bank" to noting that California has not adopted the *Daubert* standard which authorizes an expanded role for the trial judge as a gatekeeper with respect to so-called "junk science" expert testimony. Holly also foresees an antibusiness jury pool that would be sympathetic to the plaintiffs. The choice of a forum, of course, may be a factor in assessing the probable outcome of any litigation. Yet, Holly has not demonstrated, and I would suspect that is because it cannot, that Frontier would not receive a fair trial in California.

Significantly, Holly devotes little effort to developing the merits of the plaintiffs' case against Frontier. FN221 It produced no data or studies suggesting that individuals with long-term exposure to petroleum suffer a higher incidence of the cancers suffered by the plaintiffs in the Beverly Hills Litigation. It offered no expert testimony as to how current scientific and medical knowledge supports its position. FN222 It did perform a "back of the envelope" calculation to the effect that the cancer rate among the Beverly Hills High School community was higher than that of the general populace, but the process had no validation and no rigorous review. FN223

FN221. Perhaps Holly was reluctant to advance a scientific, including epidemiological, basis (assuming that one exists) to support, on the substantive merits of the dispute, its view that the litigation poses great risk to Frontier. It might not be in Holly's self-interest, as a participant in the petroleum industry, to champion the cause of linking exposure to petroleum (or petroleum products) to cancer.

FN222. Holly sought to bolster its claims regarding Frontier's exposure, both in terms of adverse outcome and in terms of defense costs, in the Beverly Hills Litigation through the testimony of Steven L. Hoch, an experienced environmental and toxic tort practitioner in California. Indeed, Hoch represented the defendant in the lawsuit upon which *Erin Brockovich* was based.

> Hoch initially expressed the opinion that it would be reasonable to expect that Frontier's ultimate liability in the Beverly Hills Litigation could exceed $100 million. Tr. at 2361. At its core, his opinion relied upon an "ingrained fear of people" about chemicals. Tr. at 2363. Hoch may be right in his assessment that the initial reaction of jurors will be to identify with the plaintiffs because of this "ingrained fear." Nonetheless, Holly, in this proceeding, still must demonstrate a basis in fact (*i.e.*, in science) for a causal connection between Wainoco's activities at the Beverly Hills site and the cancers suffered by the plaintiffs who are asserting their claims in the Beverly Hills Litigation. More importantly, Hoch later significantly qualified his testimony:
>
> Q: It's correct that you would not tell a client [*i.e.*, Frontier] at this point that it would be reasonable to expect $100 million in liability, given what you know about this case right now? That's right, isn't it?
>
> A: That's right.
>
> Tr. at 2374. Moreover, he had also testified in his deposition that he was unable even to say that it is "likely that [Frontier] will be held liable." Tr. at 2375.

FN223. Dintzer, as responsible as anyone for persuading Holly's Board that the Beverly Hills Litigation could be a serious problem for Frontier, had come around by August 2003 to the point where he could tell Glancy that he was optimistic that Frontier could ultimately extricate itself from the litigation. Tr. at 1652.

***36** Holly is correct that the Beverly Hills litigation could be catastrophic for Frontier. It is not possible to rule out judgments running into the hundreds of millions of dollars. Holly has not, however, demonstrated (or even seriously tried to demonstrate) the likelihood of the event. It suggests that any jury trial carries a ten percent chance of losing. That contention is little more than an acknowledgement that the system is not perfect. More importantly, it is more in the nature of random speculation. It is possible, in the right case, for a party in a position comparable to Holly's, to come forward with factual and opinion testimony that would provide a court with the basis to make a reasonable and an informed judgment of the probability of an outcome on the merits. Holly simply has not provided that foundation. FN224

FN224. In assessing whether the risk of litigation (as contrasted with the cost of litigation) may have a Material Adverse Effect, the mere existence of a lawsuit cannot be determinative. There must be some showing that there is a basis in law and in fact for the serious adverse consequences prophesied by the party claiming the MAE. It could turn out that the plaintiffs in the Beverly Hills Litigation have a sound case, both as a matter of fact and as a matter of law. After all, the first claims regarding tobacco use or asbestos exposure may have been met with skepticism. It is not, however, for the Court to speculate. It is for the Court, instead, to evaluate the evidence presented to it. Holly, other than proclaiming that bad things can happen in mass toxic tort litigation in California, has not come forth with substantive arguments (as opposed to procedural concerns which may impact the cost of litigation) supporting its claim that Frontier was subject to a cognizable risk on the merits. Indeed, Holly has not presented sufficient evidence to require the Court to seek to describe that level of such proof necessary to sustain an MAE claim in this context.

Alternatively, Holly projects the costs of defense against the claims in the Beverly Hills Litigation and argues that the burdens of litigation would have an MAE. Estimating the cost of litigation, as a general matter, is difficult; it is even more difficult for mass toxic tort litigation. Many plaintiffs, numerous experts, and uncertain science may all add to the complexity of anticipating the staffing needs for a responsible defense. Of course, various case management techniques may work to contain costs.

At the July 9 meeting of the Holly Board, Dintzer of Gibson Dunn estimated defense costs, depending upon which version of the board minutes one accepts, ranging from $25 million to $40 million, or from $40 million to $50 million. This contrasts with an earlier estimate (but one based on essentially the same factors and anticipated developments) of perhaps $200,000 per month. If one assumes four years of litigation, that approaches is $10 million. As Frontier put it, Dintzer never tried a toxic tort case to completion; he was both soliciting business and providing estimates that, if low, might have made him look bad; and his firm's rates, as a national firm, are substantially above those of local, but experienced and talented, insurance defense firms. FN225

FN225. Hoch, Holly's toxic tort practice expert, estimated that total defense costs would be in a range between $40 million and $50 million. This was based on his assumption that the proceedings would take five years (Tr. at 2403) and his views as to the staffing that would be required. He distinguished his estimate of $40 million to $50 million for the full effort from Dintzer's estimate of $40 million to $50 million, by indicating that he understood Dintzer's estimate to be simply through the first of a series of trials (and thus leaving open the resolution of the claims of other plaintiffs). He anticipated that a fairly small number of individual claims would be litigated; those results would form a template for resolving other claims. Again, while Hoch's projections are entitled to some weight, the assumptions that drive his costs above the range of $20 million to $25 million are questionable, both in terms of rates and staffing. *See* Tr. at 2406–08 (addressing cost savings that can be achieved through prudent use of bellwethers). Also, certain defense costs (especially expert witness costs) may be divided among the defendants because, for example, as to the causal connection between the drilling and processing activities at the Beverly Hills site and the cancers suffered by the plaintiffs, the defendants share a common defense. Hoch implicitly acknowledges that potential (Tr. at 2397), but does not adequately incorporate the benefits. (Interestingly, Hoch represented the only defendant in the litigation recounted in *Erin Brockovich*, a case with 648 plaintiffs and ultimate liability of $333 million, but his firm's fees were less than $10 million. Tr. at 2418–22).

Frontier, through its expert, Stephen Jones, a California practitioner with extensive experience in trying toxic tort cases in California, provided an estimate of defense costs in the range of $11 million to $13 million. Jones assumed an hourly rate roughly half of that charged by Gibson Dunn. Moreover, he differed substantially on staffing requirements—both with respect to lawyers and consulting experts.FN226

FN226. In the early stages of assessing the risks of the Beverly Hills Litigation (and through August 20, 2003), Holly was represented by Gibson Dunn and Frontier was represented by Irell & Manella, another national firm with comparable billing rates. In fact, neither of these firms ended up with the job of defending Frontier. Instead, an insurance defense firm, with a lower hourly rate, was selected. As Holly observes, the difference between the billing rates of a national firm and the billing rates of a local insurance defense firm could account for a difference of more than $5 million in the cost estimates.

The purpose here is to reach a reasonable estimate; it is inherently inexact. Frontier's Jones underestimates somewhat the staffing requirements. Holly's projections turn to speculation as they rise above $25 million. Holly's estimate of $25 million would fall below $20 million if the defense is not handled by a national firm. In sum, the evidence leads to a conclusion that a reasonable estimate for Frontier's defense costs is in the range of $15 million to $20 million.

***37** With that range as a reference, the question becomes one of whether meeting it would have (or reasonably be expected to have) an MAE. Holly relies on testimony from Frontier's comptroller to the effect that $10 million would have been material to Frontier in 2002 FN227 and testimony from a Frontier director that tens of millions of dollars in defense costs would have made the litigation material.FN228 It also points out that Edwards was unable to characterize projected defense costs of that magnitude as not material.FN229 Of course, whether those witnesses were considering materiality in an accounting sense or an MAE sense (or if they considered them the same) is not clear.

FN227. Zupan Dep. at 86.

FN228. Schafer Dep. at 73.

FN229. Tr. at 439.

The question of whether a particular "problem" would have an MAE has both quantitative and qualitative aspects. In any given year, particularly in light of the cyclical nature of Frontier's business, the burden of paying defense costs, such as those projected here, could be difficult. Holly, however, has not shown that Frontier could not pay them or that their payment would have had a significant effect if viewed over a longer term. The forward-looking basis for evaluating an MAE as chosen by Holly and Frontier does not allow the Court to look at just one year (assuming, as one may here, that the short-term consequences would not significantly interfere with the carrying on of the business). Instead, given Frontier's enterprise value,FN230 it is reasonable to conclude that Frontier could absorb the projected defense costs without experiencing an MAE. More importantly, Holly has not proved that the defense costs would have, or would reasonably be expected to have, a Frontier MAE.

FN230. By the discounted cash flow analysis of Frontier's valuation expert, the net present value of Frontier on a going-forward, stand-alone basis (*i.e.*, without Holly) was approximately $338 million. PX 419 ¶ 45.

Thus, Holly has not met its burden of proving by a preponderance of the evidence that the Beverly Hills Litigation, because of the risk of adverse results, because of the costs of defense, or because of both considerations taken together, does have, would have, or would reasonably be expected to have a Frontier MAE. FN231

FN231. Other factors, upon which the Court does not rely, may tend to support this conclusion. Some are set forth for a better understanding of the circumstances surrounding the failed transaction:

1. Venoco indemnified the Frontier interests at Beverly Hills. The scope of the indemnification (as with Wainoco's cross-indemnification) and Venoco's ability to pay are open to debate.

2. Frontier (and Wainoco) had historical insurance coverage from the mid–1980s that may have contained more insured-friendly pollution exclusion clauses. Any expectation of substantial assistance from the historical policies may be optimistic.

3. Frontier's actual defense costs through the end of 2003 were slightly over $1 million.

4. Frontier was able to borrow the funds needed to close the Merger. Presumably, a lender of $220 million would have contemplated whether the Beverly Hills Litigation would impair Frontier's ability to repay the loan (at least on a post-merger basis).

5. Holly, on August 21, 2003, delivered a notice to Frontier (PX 365) declaring that the Beverly Hills Litigation constituted an MAE. More precisely, it asserted that Frontier had breached its warranties in Section 4.8 and Section 4.9 (but with no reference to Section 4.19) of the Merger Agreement. If this had been done in the absence of Frontier's filing of this lawsuit, Frontier, under the Merger Agreement, would have had thirty days in which to cure the default. Presumably, one cure opportunity would have been through insurance. Frontier was able to obtain coverage from an AIG affiliate at the end of September 2003. It did not obtain the coverage before the expiration of thirty days following delivery of Holly's MAE notice, but, had it chosen to do so, it could have. The policy, with a five-year term, provides limits of $120 million covering all claims asserted in the various cases filed in the Beverly Hills Litigation. In addition to claims for personal injury and property damage, it also covers the contractual indemnity claims. Frontier incurred a premium of $5.75 million that is earned over the life of the policy and paid $19.5 million into a commutation account that will fund certain costs. One could view the acquisition of this insurance as evidence that the payment of $25 million was within Frontier's ability to pay; that the defense cost issue was under control; and that a sophisticated party took on the risks associated with the Beverly Hills Litigation after due inquiry. (The insurer's risk assessor stated, “We had determined that a likely exposure, including defense costs, was somewhere south of $20 million.” (Winick Dep. at 118; PX 392)). Of course, if the worse case scenario evolves, the difference between Frontier's exposure and its insurance coverage will be devastating.

F. *Did Frontier Breach Its Warranty as to the Absence of Material Contracts?*

Holly also asserts that Frontier breached its contractual warranties when, in the Merger Agreement executed on March 30, 2003, it failed to disclose those documents evidencing Frontier's indemnification obligations involving Wainoco's activities at the Beverly Hills site. By Section 4.19 of the Merger Agreement, Frontier warranted, in relevant part:

> [A]s of the date hereof, there are no contracts or leases that are material to the business, properties, assets, financial condition or results of operations of Frontier and its Subsidiaries taken as a whole.

Unlike Frontier's forward-looking warranty regarding MAEs, this warranty is to be measured “as of the date [of the Merger Agreement].” FN232 Significantly, although the parties expressly used the term “prospects” to emphasize the forward-looking nature of the MAE warranty, no such term was employed with respect to Frontier's warranty with respect to outstanding contractual obligations.

FN232. Frontier's representations and warranties had to be “true and correct” as of both the date of the Merger Agreement and the Closing Date, "(except for representations and warranties made as of a specified date [such as those in Section 4.19], which need to be true and correct only as of the specified date)." Merger Agreement, Section 6.2(a).

***38** The documents evidencing potential Frontier liability for Wainoco's operations at Beverly Hills would be material to Frontier's financial conditions at the time of the Merger Agreement if the litigation risks associated with that threatened litigation were sufficiently foreseeable and sufficiently large. In other words, the failure to disclose the Wainoco indemnification obligations would have constituted a breach of Section 4.19 if (1) they demonstrated that Frontier would be directly liable in the threatened Beverly Hills Litigation, and (2) the potential adverse consequences of the threatened Beverly Hills Litigation, as measured as of the date of the Merger Agreement either by the risk of an adverse outcome and its potential magnitude or the cost of defense, would have been material to Frontier.

Accordingly, the Court again confronts a question of whether the threatened Beverly Hills Litigation could fairly be considered material to Frontier (assuming its liability at the site) as of the date of the Merger Agreement. FN233 The materiality of an indemnification or a guarantee can only be measured objectively with reference to the underlying obligation. In the context of the Merger Agreement, the concept of "Material Adverse Effect" and "material" are analytically distinct, even though their application may be influenced by the same factors. For example, the Merger Agreement requires an assessment of whether threatened litigation would be an MAE, thereby suggesting the parties' common understanding that threatened litigation at least could be an MAE. Holly and Frontier did not modify the terms of Section 4.19 (unlike Section 4.8, with Schedule 4.8) to address specifically the potential impact of the then-threatened Beverly Hills Litigation. A fact is generally thought to be "material" if it is "a substantial likelihood that the ... fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." FN234

FN233. Holly is charged with the burdens of proof and persuasion under Section 4.19. The language of Section 4.19 is even clearer than that of Section 4.8 (as discussed above). The warranty of Section 4.19 is syntactically straightforward: "There are no contracts ... that are material ..." Thus, the burden is on Holly to demonstrate the materiality and the inaccuracy of the representation.

FN234. *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976).

As a general matter, the consequences of threatened litigation are speculative and hard to quantify and, thus, courts are hesitant to find threatened litigation material. FN235 Because of the concentrated efforts of the parties in the days leading up to execution of the Merger Agreement to grasp the potential consequences of the Beverly Hills Litigation, it is difficult to dismiss Holly's claim under Section 4.19 out-of-hand simply because all that is at issue was then-threatened litigation. However, even in this somewhat unusual context, the Court cannot conclude that Frontier's failure to disclose those contractual obligations linking it directly to the Beverly Hills site can fairly be classified as "material" within the meaning of Section 4.19. As discussed above, the cost of the litigation itself cannot fairly be labeled material and there is a lack of a scientifically-recognized causal connection between site operations and the various cancers suffered by the plaintiffs (at least on this record). Also, while not preclusive, the litigation had not been filed, and, thus, any view of its likely consequences necessarily was somewhat speculative. In short, the risk that Frontier would be found liable at Beverly Hills, and to what extent based on what was otherwise known as of March 30, 2003, was too uncertain to be material within the meaning of Section 4.19. FN236

FN235. *See, e.g., Gen. Elec. Co. v. Cathcart,* 980 F.2d 927, 935 (3d Cir.1992).

FN236. This is a claim for breach of an express contractual warranty, not for inducement to enter into the Merger Agreement through misrepresentation. Holly framed this aspect of this proceeding to be one of "declaring that Frontier breached Section 4 .19 of the Merger Agreement." Joint Pretrial Order, Section IV(B)(5). Thus, it is viewed from the perspective of the objective third-party observer considering whether the contracts at issue were material to Frontier.

It might be different if the question, instead, were: was the representation that there were no contracts linking Frontier directly to Beverly Hills (and, thus, impairing Frontier's corporate separateness argument) material to Holly? If Frontier had not persuaded Holly that Frontier's potential liability in Beverly Hills was precluded (or substantially minimized) by the corporate separateness argument, Holly would not have entered into the Merger Agreement. Bechtol, on behalf of Frontier, conceded as much: "If Holly had thought that Frontier could avoid exposure in the Beverly Hills litigation by asserting corporate separateness ... the guarantees [would] be pretty important to it." Tr. at 816. Thus, the absence of such a contractual obligation may have been material to Holly in reaching its decision to enter into the Merger Agreement. The warranty of Section 4.19, however, is not measured against Holly's subjective expectations; the parties did not draft it that way and the Court may not rewrite it.

G. *Some Thoughts on Holly's Efforts to Prove Damages*

***39** A few words about Holly's damages claim may, nonetheless, be appropriate. The proper measure of damages for breach of contract is an amount sufficient to restore the injured party "to the position [it] would have been in had the breach not occurred." FN237 A prevailing party must prove its damages by preponderance of the evidence; absolute precision is not required but the proof may not be speculative either.

FN237. *Del. Limousine Serv., Inc. v. Royal Limousine Serv., Inc.*, 1991 WL 53449, at *3 (Del.Super.Apr.5, 1991).

Holly failed to prove that it suffered any damages because of its failure to acquire the Denver Refinery. First, although it perhaps could have later rekindled its efforts, Holly's directors voted not to pursue that acquisition on March 7, 2003, some three weeks before execution of the Merger Agreement. FN238 Thus, there could not have been any reliance on the warranties of the Merger Agreement because those warranties had not yet been made by Frontier. Second, the evidence of agreement with ConocoPhillips is unpersuasive. FN239 It is clear that Holly and ConocoPhillips were close to an agreement, but that is all. Finally, Holly's proof of loss—presumably the difference between the purchase price (never established) of the Denver Refinery and the value to Holly with its synergistic benefits—was also insufficient. Even though damages need not be proven with absolute precision, Holly failed to provide the Court with a reasonable basis for any such calculation.

FN238. PX 44. That decision was motivated by the anticipated agreement with Frontier. Holly's ownership of the Denver Refinery would have spawned antitrust concerns upon a merger with Frontier which already operated in the Denver market.

FN239. No testimony (or other evidence) from Conoco/Phillips was offered.

As to its loss of small refiner status and the impact on revenues from the sale of aviation fuel, Holly concedes that its expert used the wrong basis for calculating damages. The expert used contracted volumes, but, historically and for the period in question, Holly never reached those volumes. FN240 Recognizing its problems, Holly asked the Court to assign a conservative, but nonetheless speculative, number. The Court declines Holly's invitation to guess. FN241

FN240. Actual volumes are not in the record.

FN241. It is not that proof was not available (or even not readily available). It is that Holly did not present it.

Finally, Holly seeks reimbursement of $2,063,504.43 for out-of-pocket expenses incurred in pursuing the Merger, after execution of the Merger Agreement, but excluding litigation costs.[FN242] Frontier does not challenge the amount and those costs all appear to have been reasonably foreseeable under the circumstances; if Holly had prevailed on one or both of its misrepresentation claims, it would have been entitled to an award of these damages accordingly.

FN242. N 55; *see also* Tr. at 1602–03.

H. *Frontier's Claim for an Award of the Break-up Fee* [FN243]

FN243. This may seem a strange place (*i.e.*, at the end of a memorandum opinion) to consider a plaintiff's claim. Frontier's first two claims—repudiation and breach of the covenant of good faith and fair dealing—could be addressed without reaching Holly's arguments under Sections 4.8 and 4.19. Frontier's third argument—a blend of contract and equity—could not fully be explored without first resolving Holly's allegations of misrepresentation.

Frontier separately argues that, if it is not entitled to the benefit of its bargain, then it should at least be awarded the break-up fee of $15 million, in addition to $1 million in expenses.[FN244] Under Section 7.4(b) of the Merger Agreement, Frontier could terminate the Merger Agreement if, before the Holly stockholders' vote on the Merger, "the Board of Directors of Holly shall have withdrawn, modified, withheld or changed, in a manner adverse to Frontier, such Board's approval or recommendation of [the Merger] Agreement or the transactions contemplated thereby."[FN245] If Frontier terminated the Merger Agreement "pursuant to Section 7.4(b)," then, by Section 7.5(a)(ii), Holly would be obligated to pay Frontier the break-up fee. Accordingly, if Holly's Board withdrew (or modified) its support for the Merger Agreement, Frontier could have terminated the Merger Agreement and collected $16 million. By the time of the July meeting, a majority of the members of the Holly Board (indeed, all but possibly one) had concluded not to continue supporting the deal with the terms negotiated at the end of March 2003. Thus, Frontier contends, it follows, under Section 7.5(a)(ii), that it is entitled to the break-up fee. This argument fails.

FN244. It is undisputed that both Frontier and Holly incurred well over $1 million in qualifying expenses.

FN245. By Section 5.4(b), Holly, through its Board of Directors, agreed to "recommend approval" of the Merger to the stockholders. By authorizing the Merger Agreement, the Board had "approved" it. The directors were also subject to their Support Agreements.

***40** First, the Holly Board never took formal action with respect to withdrawing or otherwise modifying its recommendation to the shareholders. No determination was made, as anticipated by Section 5 .4(b), as to whether the directors' fiduciary duties required the Board to act. From Glancy's notes, it appears that the Holly Board may have come close; his notes reflect that the Board instructed Norsworthy to seek different terms. However, that direction, while it may foreshadow a change in recommendation, does not amount to a change in recommendation or a formal board decision to that effect.[FN246]

FN246. This is but one factor in the analysis. A formal resolution by the Board is not necessarily required. Indeed, with a recalcitrant merger partner, it may be unreasonable to expect or require formal action. On the other hand, the parties chose the term "Board of Directors" but, instead, could have used the term "Directors," thereby suggesting a more individualized consideration.

Second, Frontier fails to acknowledge that the members of the Holly Board could have decided not to go forward with the Merger and never reached the fiduciary out issues. Perhaps, although unlikely, a voluntary termination could have been negotiated. Perhaps a breach of warranty claim could have been asserted. Because the Merger Agreement afforded a number of exit strategies, the conclusion by the members of the Board, especially without collective action, not to proceed with the transaction on the then-existing terms does not automatically force the process into the one channel that leads to payment of the break-up fee.[FN247]

> FN247. There is admittedly a timing problem here because, otherwise, an unfair opportunity for delay may occur. The answer for a party in Frontier's position may be a more focused demand for assurances. Also, the issue here is complicated by the presence of significant questions regarding the accuracy of Frontier's representations and warranties.
>
> There is also a question of whether Holly would have had the opportunity to cure if the withdrawal of support had not been in compliance with the Merger Agreement (*e.g.*, exercise of a fiduciary out without the guidance of outside counsel).

Finally, Frontier's right to seek the break-up fee is conditioned upon termination of the Merger Agreement "by Frontier pursuant to Section 7.4(b)." Frontier has not proven that it terminated the Merger Agreement under the auspices of Section 7.4(b). Indeed, no such allegation appears in its complaint filed on August 20, 2003, a complaint which does not purport to seek recovery of the break-up fee.[FN248]

> FN248. Instead, the complaint sought an award of "substantial damages" for repudiation and for breach of the covenant of good faith and fair dealing. It is clear that Frontier did not consider the break-up fee as the equivalent of "substantial damages."

Frontier's efforts to obtain payment of the break-up fee are, at least up to a point, not without equitable appeal. Holly, although it is concededly a close question, could not (or, at least, it did not here) prove that Frontier breached its warranties under Section 4.8 or 4.19 of the Merger Agreement. Holly, however, at least from early July 2003, was not going forward with the Merger under the express terms of the Merger Agreement. Because of the escalation in (or recognition of) the value of its pipeline assets, a difference far in excess of $16 million, Holly would have, and, at least arguably, should have, escaped from the Merger Agreement and paid the break-up fee. (That is, Holly recognized that if it guessed incorrectly as to whether the Beverly Hills Litigation would be perceived by a judicial officer as having an MAE, it could be found liable for perhaps $150 million; that would have provided Holly with an incentive to pay the break-up fee.) All of that may be accurate, but Frontier, in August 2003, was not content to accept or to seek the break-up fee. It wanted the benefit of its bargain. By its very conduct, it terminated the Merger Agreement under which it might otherwise have obtained the break-up fee. The fiduciary out is designed to allow for an orderly disentanglement of merger partners when the directors' fiduciary duties require it. Frontier, by orchestrating the August 19 Phone Call and by launching this litigation, disrupted that process. Frontier made its choices; one consequence of those choices is that it now has no claim to the break-up fee.

IV. CONCLUSION

***41** For the foregoing reasons, the Court concludes as follows:

1. Holly did not repudiate the Merger Agreement;

2. Holly did not breach its implied covenant of good faith and fair dealing under the Merger Agreement;

3. Frontier breached the Merger Agreement by declaring a repudiation by Holly;

4. Holly suffered no damages as a result of Frontier's breach of the Merger Agreement and, thus, is entitled only to an award of nominal damages;

5. Frontier did not breach Section 4.8 of the Merger Agreement;

6. Frontier did not breach Section 4.19 of the Merger Agreement; and

7. Holly is not obligated to pay Frontier the break-

up fee.

Counsel are requested to confer and to submit an appropriate order to implement this memorandum opinion.[FN249]

FN249. As noted above, the Court has deferred resolution of any application for an award of attorneys' fees or, for that matter, costs.

Del.Ch.,2005.
Frontier Oil v. Holly Corp.
Not Reported in A.2d, 2005 WL 1039027 (Del.Ch.), 30 Del. J. Corp. L. 993

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EXHIBIT 3

Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
John A. GENTILE, Victoria S. Cashman, Bradley T. Martin, John Knight, and Dyad Partners, LLC, Plaintiffs,
v.
Pasquale David ROSSETTE, Douglas W. Bachelor, Defendants.

C.A. No. 20213-VCN.
Submitted: June 16, 2009.
Decided: May 28, 2010.

Robert J. Katzenstein, Esquire, David A. Jenkins, Esquire, Michele C. Gott, Esquire, and Robert K. Beste, III, Esquire of Smith Katzenstein & Furlow LLP, Wilmington, DE, and John L. Reed, Esquire of Edwards Angell Palmer & Dodge LLP, Wilmington, DE, Attorneys for Plaintiffs.

Jesse A. Finkelstein, Esquire, Raymond J. DiCamillo, Esquire, and Elizabeth Tucker Sudderth, Esquire of Richards, Layton & Finger, P.A ., Wilmington, DE, and Sean T. Carnathan, Esquire and Rebecca A. Binder, Esquire of O'Connor, Carnathan and Mack LLC, Burlington, MA, Attorneys for Defendants.

MEMORANDUM OPINION

NOBLE, Vice Chancellor.

I. INTRODUCTION

***1** SinglePoint Financial, Inc. ("SinglePoint" or the "Company") attempted to develop software and was a commercial failure. Founded in 1996, it was part of the technology boom at the turn of the last century. Without the continual, substantial financial support of Defendant P. David Rossette, its majority shareholder, the firm would have ceased to exist on any number of occasions. Because of Rossette's investment of his life savings, SinglePoint lasted long enough to be acquired by Cofiniti, Inc. ("Cofiniti") in a stock-for-stock merger (the "Merger") in the fall of 2000. Although the market for SinglePoint stock was thin-nonexistent might be more accurate-its valuation generally was seen as hovering around $0.50 per share. Cofiniti-depending upon which contemporaneous valuation of its stock one uses-may have paid in effect either roughly $0.91 or $2.46 per share for SinglePoint. Unfortunately, within several months of Cofiniti's acquisition of SinglePoint, reality also caught up with Cofiniti and it filed for bankruptcy. Its shares, including those received by SinglePoint's former shareholders, became worthless.

It is from this background that this case arose. Six months before the Merger-well before Cofiniti was even on the horizon-the SinglePoint board, consisting of Rossette and Defendant Douglas W. Bachelor, decided to improve the Company's balance sheet. Rossette, who was owed substantial sums as the result of his loans to sustain SinglePoint, converted much of his debt into common stock at a conversion rate of $0.05 per share (the "Debt Conversion"). That number contrasted sharply with a debt conversion price negotiated only several months before of $0.50 per share. As a result of the conversion of debt into equity, Rossette's equity share in SinglePoint increased from 61% to 95%. The Plaintiffs, former minority shareholders of SinglePoint, challenge that transaction as an improper dilution of their voting and economic rights.

In addition, the Plaintiffs challenge an option (the "Put Option") given to Rossette as part of the Merger-an option that was not extended to any other SinglePoint shareholder. In short, Rossette received the right to sell one year after the Merger (or upon the earlier happening of some especially fortuitous event) a portion of the Cofiniti shares that he received in the course of the Merger back to Cofiniti for the effective price at which those shares had been publicly valued for purposes of the Merger (although likely substantially above Cofiniti's reasonable market price at that time). Rossette asserts that this option was offered to him because Cofiniti, at the last moment, changed the terms of the proposed transaction and refused to assume the obligation to pay immediately the substantial debt owed to him by SinglePoint. He took this offer, not because he wanted it, but in order to save the transaction. The Plaintiffs now challenge the special treatment accorded to Rossette. Of course, with Cofiniti's demise, the challenged option became worthless.

***2** In this post-trial memorandum opinion, the Court determines whether Rossette and Bachelor violated their fiduciary duties to other SinglePoint stockholders by approving the Debt Conversion or the Put Option. Along the way, a characterization of Rossette's conduct-was he greedily excluding minority shareholders because he believed that great success for SinglePoint was just around the corner, or was he himself a victim, misled and perhaps deceived by others who were not pouring most of their personal wealth into that failing company known as SinglePoint-will be considered. Some rumination upon the outcome of the fair price and process dynamic also cannot be avoided. The Plaintiffs can fairly be characterized as asking the Court to engage in alchemy-creating real economic value out of an entity which, with the benefit of hindsight, had little value at any moment in time.

Ultimately, the Court concludes that the Put Option was fair to SinglePoint's shareholders. It was minor consolation for Rossette's loss of what, at the time, appeared to be a material improvement of his chances to be repaid the money that he had lent to SinglePoint-a right upon which he could insist as a creditor. The Debt Conversion, however, must be viewed differently. At the time of the conversion-and without the benefit of hindsight that clearly shows the futility of the venture-Rossette implemented an unfair process that resulted in a conversion rate that simply cannot be justified. Determining a “proper” conversion rate is a worse than uncertain undertaking. Thus, the Court will use several less-than-ideal inputs to arrive at an approximate fair value.

II. FACTUAL BACKGROUND

A. *Context*

To understand this dispute, one must return to the technology boom of the last century. With the clarity of retrospection, one could conclude that SinglePoint was well-nigh worthless. It represented a pipe dream; it carried the value of a chance; at best, it was a long shot. Those involved with the Company greatly erred in their assessment of its potential. But the conduct of a fiduciary must be assessed in context. That conduct demonstrates that Rossette believed that there was value to be had from SinglePoint and that he acted to maximize that value for himself. Moreover, the market-at least as evidenced by the acts of a third-party acquirer-placed value on SinglePoint. The Court must resist the temptation to dismiss all of this as the product of unfounded speculative fervor and instead consider fair price and process without the benefit of tech bubble hindsight.

B. *The Parties*

Plaintiff John A. Gentile was a founder and former executive and director of the Company.[FN1] He owned stock in SinglePoint throughout its pertinent history. After the Debt Conversion, the transfers by Gentile of some shares to Plaintiffs Victoria S. Cashman, Bradley T. Martin, John Knight, and Dyad Partners, LLC were recorded on the Company's books.[FN2]

FN1. Gentile's service as a director and officer of the Company ended in July 1999.

FN2. Although Gentile sold shares to the other Plaintiffs before the Debt Conversion, the transfers were not shown on the records of the Company until June 2000, after the Debt Conversion. Because the Court has not been asked to weigh in on the issue, it will not differentiate among the Plaintiffs based on when they owned stock in the Company or for purposes of calculating any damages.

Rossette became a director of the Company in 1996, a few months after its incorporation. He continued to serve on its board until the Cofiniti acquisition and was its primary-indeed, almost exclusive-source of cash investment. Bachelor served the Company as a director from the beginning and was an employee deeply involved in its software development efforts. From July 26, 1999, until the Merger in October 2000, Rossette and Bachelor were the only directors of SinglePoint.

C. *The Company*

***3** The Company was formed in 1996 to perform technology and computer services.FN3 Its early development was not well-focused, but it settled in early 1999 on a business model through which it would provide enterprise applications to financial services firms, such as Standard & Poor's ("S & P").FN4

FN3. When formed, the Company's name was New Horizon Technology, Inc .; in late 1996, its name was changed to OpTeamaSoft, Inc.; in 1999, it became SinglePoint.

FN4. Although the Company performed software work for others, that business did not develop into a reliable source of revenue.

Rossette was the Company's sole cash investor because, at the time, he saw financial opportunity in developing and controlling a technology company.FN5

FN5. As Rossette put it in August 1999, "If we pull this off in the next 24 months (and we will) you can buy your own golf course and catch up on lost time." JTX 82; Tr. 37.

D. *The S & P Project*

The closest that the Company came to sustainable profitability was through a relationship with S & P. The path with S & P was rocky and uneven. There were times of optimism; there was plenty of disappointment. It seems that S & P was never quite as committed to SinglePoint as Rossette (and others at SinglePoint) believed that it was. Although S & P would not abandon SinglePoint, it did not provide the degree of support that SinglePoint ultimately would require if it were to have a chance to succeed.

In late 1998, discussions began that would eventually lead the Company to attempt to develop software that would serve the specific needs of S & P's (and perhaps other financial service firms') customers.

An S & P representative described their shared objectives:

We had a relationship with [the Company] to provide software and related services to our advisor network's customers. We were working with them to develop the ability to put our research and our investment advice on that same platform.

And it would link the back office individual customers' accounts and asset information, allow them to then reference our research and go out and market and promote that to advisors, brokers and those networks.FN6

FN6. JTX E (Johnson Dep.) at 13.

In April 1999, the Company hired Thomas A. Loch to develop the S & P business. Six months later, he was promoted to Company President.

By January 2000, the project with S & P appeared to be progressing. A revenue sharing arrangement and the potential for S & P to invest in the Company were described at the time by an S & P executive:

[The Company] has developed the Advisor Insight Planning and Portfolio modules that are part of the Advisor Insight Product [an S & P web-based application]. The commercial terms for these components have been negotiated as a revenue sharing agreement whereby we [S & P] retain 70% of the revenue from these modules and [the Company] receives a royalty of 30%. The commercial terms provide us with the software we require for the product, protects our interests in the software, and limits our financial exposure as the payment is based on the success of the product. We did not have to advance funds for development.

The proposal for the equity investment is based on paying $500,000 to [the Company] as an advance on royalty. This payment would give us a right for ninety days to evaluate whether we wish to move forward with an equity investment in the [C]ompany.FN7

FN7. JTX 114.

As late as November 1999, Rossette (and others at the Company) had anticipated a rollout of the Company's primary software product by early 2000. Near the end of January 2000, the Company had again refocused:

> ***4** Since the last report to the Board in October, the [C]ompany has changed focus from enterprise applications to packaged sales to the professional financial advisor.FN8

FN8. JTX 120.

On February 18, 2000, the Company and S & P formalized S & P's option to acquire a 20% stake in SinglePoint.FN9 S & P would also advance the Company $500,000 in anticipation of royalties. In March 2000, S & P and the Company entered into a licensing agreement which would allow the Company to supply the software to deliver S & P's content to its customers. FN10 S & P, thereafter, persevered with its interest in the Company and in June 2000 agreed to offer to provide "bridge financing" to assist with the Company's financial problems at that time.

FN9. JTX 124. S & P acquired the option to purchase a 17.5% interest in the Company for $2 million and to acquire an additional 2.5% interest for $500,000. *Id.* As explained by Rossette in an email to Radebaugh, "Jim, right now [S & P representatives] and S & P have agreed to a price of $2.12/share." JTX 125. There is no reason to believe that S & P would have ever exercised its option without successful development of the software. Thus, the price implied in the S & P option agreement offers little guidance as to fair value. Perhaps it would have been an indication of the fair value of the Company stock after the product had been proven successful or as an indication of value when release of the software was imminent. Those circumstances never occurred.

FN10. JTX 130.

Although the evolving S & P relationship may have supported a somewhat optimistic view of the Company's future, there was another side to the story-one that fell well short of satisfying.FN11 In late 1999, as no formal contract with S & P appeared immediately forthcoming, the Company asked S & P to reimburse it some $1.5 million for software development costs already incurred. Despite the Company's firm belief that it was entitled to such payment, S & P refused. Rossette (who had not previously been directly involved with executives at S & P) asked to meet with the supervisor of the Company's principal contact at S & P.FN12 In meetings with S & P executive Dan Connell in late December 1999 and January 2000, Connell expressed surprise that such money could be owed, and advised Rossette that neither he nor anyone below him had any authority to authorize such a large expenditure and that there was no way that he could retroactively obtain approval of a project of that scope and size.FN13 Nevertheless, Connell committed to work with the Company to come up with a means to provide some compensation to the Company for its effort. During this time, proposals involving S & P's taking an equity stake in the Company, loaning the Company money, or advancing the Company monies against future royalties owed, or some combination of these, were raised and discussed. By the end of January, the Company was informed that S & P would neither be making an equity investment nor would it pay the money that the Company thought it was owed.FN14

FN11. Cofiniti would later struggle with S & P's apparent resistance to a robust commitment to the software development project as well. As a former member of Cofiniti's management put it:

> We could not get Standard & Poor's to commit. We couldn't get them to commit to purchasing our product. We could not get them to commit to purchasing SinglePoint's product. We could not get them to commit to additional development funding with us of any significance. We could not-we could not get them to commit to anything. It-it appeared that they wanted a relationship leveraged on their name with the hope of potential sales with us as it appeared that they had

with SinglePoint.

JTX O (Martin Dep.) at 31.

FN12. Rossette had left the primary responsibility for interacting with S & P to Loch, who already had preexisting working relationships with S & P employees. Loch's primary role was to make the business relationship with S & P a success. During the summer and fall of 1999, Rossette and Loch touched base frequently on the progress of the S & P relationship. Loch consistently conveyed good news, while reiterating that "[w]e can't push them ... there's no way to try to exert our influence upon them, but it's going along ." Tr. 163. Rossette described these reports as "generally an upbeat, I'm-going-to-have-it-done-shortly kind of a conversation." *Id.* Rossette relied on Loch's positive updates in continuing to fund the Company, fully anticipating that he would be reimbursed once a contract with S & P was signed. In an October 23, 1999, board meeting, Loch promised that, in the subsequent two weeks, the Company would have a signed contract with S & P and that the Company would have its first revenue generating customer; forecasting ultimate sales of $472,500 by the end of the year. JTX 94. Rossette only injected himself into the relationship with S & P some time thereafter after neither promise came to fruition: "[w]e weren't getting any contract, we weren't getting any money, there weren't any sales." Tr. 166.

FN13. After the initial meeting revealed a reality with S & P that materially diverged from that which Loch had optimistically described, Rossette immediately called Loch to tell him that he was very disappointed and that Loch "had some explaining to do." Tr. 172.

FN14. Rossette testified that when he sought to collect the monies owed after being informed that S & P would not be making an equity investment in the Company, he was told by S & P executives, "I don't know how you're going to do that. There's not a contract between us. You've got a long road to hoe. I'm sorry you're in the position, but let me help you the best I can." Tr. 199.

Concurrently with these discussions, in mid-January 2000, Rossette was finding out from S & P that the original agreement to have S & P host the product in their massive data center was no longer possible and that the Company would have to find some way to host it, at considerable expense. The Company was also told that the product needed to be reviewed by a compliance committee, which ultimately flagged serious regulatory compliance issues that would cost more than $1 million to adjust, and that S & P would not bear that expense. S & P also objected to its content being presented on a screen alongside third-party content providers, which seriously hampered the product's marketability. Finally, S & P increased its capacity needs ten-fold from the specifications initially provided to the Company; the scaling effort was expected to require a $1 million (or greater) fix.[FN15]

FN15. *See, e.g.,* Tr. 169-201 (detailing disputes over past-due payments, which party would host the application, scaling, and regulatory compliance issues, as well as disagreement over compatibility with third-party information).

***5** By the end of January 2000, as a result of these problems materializing, Rossette told Bachelor that he had had enough and wanted to move on.[FN16] He had run out of money and could no longer meet the Company's considerable cash needs. Ultimately, however, Bachelor convinced him that "there may be something salvageable" and that he should hang in and help the Company get sellable.[FN17] It was at this point that they began discussing the Debt Conversion.[FN18]

FN16. Rossette testified, "I told him that I didn't see, without the S & P investment, given our current overhead, exactly what was going to be the future of the business. I couldn't-I couldn't figure it out.... I said, 'I've been filling the gap now for four years and I don't really know how to do it for you going forward.' I didn't have the personal resources myself to do it." Tr. 202.

FN17. Tr. 203. Rossette testified, "I was doubtful. I mean, I was no longer a believer. And I think the only thing that helped change my opinion was [Bachelor's] personal appeal and his fighting spirit that we'd come too far, we were too close, if I would just hang in there with him we could get there.... He discussed the employees [who] were going to lose everything they had, their jobs, that most of them had stuck around to this point because of my promises. And he just made the appeal, you know, 'Hang in there. Help me get there .' " Tr. 204.

FN18. Rossette's conduct was consistently inconsistent. For example, even though he now claims that he recognized this period of SinglePoint's history as dire, he approved (and personally guaranteed) the leasing for a five-year term of substantial additional office space, with a monthly rental of $6,812, in January 2000. JTX 116. His after-the-fact explanation was that the Company had committed to its employees that they would no longer have to work from home after the first of the year and had already been in the process of negotiating a lease for several months. Tr. 180-81. SinglePoint management had also determined not to reveal the Company's mounting problems with S & P to rank-and-file employees in an effort to keep morale up. Tr. 205.

E. *The Debt Conversion*

Throughout this period, the Company had not been profitable. It had rented additional office space in anticipation of growing to meet the S & P market. Software development costs were significant. Revenues were paltry. The Company survived only because of Rossette's continuing financial support.

The Company's balance sheet reflected a staggering (for an entity of its size) amount of debt-virtually all of it owed to Rossette. By perhaps as early as February 2000, Rossette and others contemplated converting that debt to equity. Reducing the debt on the Company's balance sheet would facilitate future business, the possibility of other investment, and, perhaps, even a sale of the entity. Thus, the Company's management concluded that Rossette's debt should be converted to equity. On March 27, 2000, Rossette and the Company entered into the Debt Conversion Agreement.[FN19] Debt of $2,220,951 was converted into shares of the Company at a price of $0.05 per share. With the Debt Conversion and an accompanying increase in the number of authorized shares of Company stock, Rossette's holdings in the Company increased from 3,612,775 shares (or approximately 61% of the Company's equity) to 48,031,795 shares (or approximately 95% of the Company's equity).

FN19. JTX 141.

The fairness of the per share rate at which Rossette's debt was converted into shares of SinglePoint stock forms the core of this case. Thus, the Court turns to a brief history of the various prices attributed to the Company stock. The history of the pricing of the shares is important because the Plaintiffs bolster their unfair pricing claims by comparing the price reflected in the Debt Conversion Agreement to the other valuations that Rossette endorsed, both before and after the Debt Conversion. In all comparable instances, the price was substantially more than the Debt Conversion rate.

F. *History of Company Valuation*

In April 1997, the Company adopted a stock option plan, which required that exercise prices be no less than the fair market value of the Company's shares at the time of the grant.[FN20] In January 1999, the Company's board (with Rossette and Bachelor among its members) set the exercise price at $0.50 per share.[FN21]

FN20. Thus, the exercise price itself does not necessarily reflect fair market value of the underlying shares, but it does suggest a ceiling for share value. JTX 11 ¶¶ 3.3(c), 3.3(d) & 6.1.

FN21. None of the efforts to set a price was sophisticated. The record does not suggest any detailed study or analysis. Because of the absence of any market for the Company's stock, there was no external indicator-however inefficient-for any guidance, either. In the absence of any better basis, the views of the Company's insiders are generally among the best accessible indicators of value-even though subjective and not backed by any recognized analytical methodology.

In June 1997, Rossette and the Company entered into a Stock Purchase Agreement which allowed Rossette to convert his debt to equity at a rate of $1.33 of debt per share.FN22 In November 1997, the conversion rate was reduced to $0.75 of debt per share; FN23 that conversion rate was reaffirmed in a debt conversion agreement in January 1999.FN24 In October 1999, Rossette and Bachelor, constituting the Company's board of directors, approved an amended loan agreement which allowed Rossette to convert his debt at $0.50 per share. FN25

FN22. JTX 14. It also required him to purchase 500,000 shares for $1.00 per share and allowed him to purchase an additional 250,000 shares for $0.65 per share.

FN23. JTX 16.

FN24. JTX 56.

FN25. JTX 91. During 1998, Rossette and the Company entered into two stock purchase agreements by which he agreed to buy Company stock at $0.50 per share. JTX 19; JTX 30.

***6** On February 17, 2000, James Radebaugh, the Company's secretary, asked Rossette if the option price should be increased. He wrote, "I believe it is time to move this up, the question is how much?" FN26 Rossette responded by recommending an option price of $0.75 per share and by observing that "we are being more than fair." FN27 Less than a week later, Radebaugh informed the Company's employees of the change: "[T]he price of option shares in SinglePoint [has been] raised from $.50 to $.75. This change reflects [the] positive progress of the [C]ompany and the increase in shareholder value." FN28

FN26. JTX 125.

FN27. *Id.*

FN28. JTX 128. The adjustment was made retroactive to January 1 and was formally approved by SinglePoint's directors in March 2000. JTX 131. Radebaugh testified that the $0.75 per share price was "not an anticipated future value of the Company. I would say it was a hope." JTX D (Radebaugh Dep.) at 76.

G. *Stock Valuation and the Debt Conversion*

The Debt Conversion that lies at the heart of this litigation was under consideration by early February 2000. Rossette was focused on a nickel per share as a conversion rate.FN29 Rossette now says that he was relying upon the advice of counsel and an opinion from The Harman Group Corporate Finance, Inc. (the "Harman Group"), which he had retained.FN30 The Harman Group provided a fairness opinion supporting $0.05 as a conversion rate. At the same time as the Debt Conversion, Rossette renegotiated the loan agreement; for the $1,000,000 remaining as unsecured debt (not subject to the Debt Conversion Agreement) and a new $500,000 line of credit, Rossette agreed to convert at $0.50 per share.

FN29. It is unlikely-the evidence is, at best, shaky-that there was any real negotiation of this number. No consistent description of the process by which this number was reached has been forthcoming. In trial testimony, Rossette suggested that Bachelor had "negotiated him up" to $0.05 per share from $0.01 per share. *See infra* note 40.

FN30. Rossette understood that the lawyer who represented him also represented the Company. The lawyer did not testify; it is not clear just where the lawyer's loyalty would lie under these circumstances.

The Plaintiffs seek to make much of the engagement letter between Rossette and the Harman Group. The Harman Group's function was defined as "advis [ing] Mr. Rossette on the fairness to Mr. Rossette, from a financial point of view, of the proposed exchange of [Company] ... Common Stock for [Company] debt...." JTX 123 at 1. The relevant question, of course, is fairness to the Company and its shareholders, not Rossette. Whether the letter is the product of the Harman Group's fundamental misunderstanding of what needed to be done or whether it is simply the product of careless drafting is unclear. Because of this uncertainty, the Court is reluctant to ascribe much weight to the language used in the engagement letter. Rossette appears to have been under the impression that what was fair to him, by definition, would also be fair to the Company and its stockholders. JTX C (Rossette Dep.) at 156-57.

The Plaintiffs also complain that Rossette paid for the Harman Group's fairness opinion. That begs the question of, if not Rossette, then just who was going to pay for it? Would the Plaintiffs have been mollified if Rossette had written his check to the Company which, in turn, had then paid the Harman Group?

H. *The Merger*

By late June 2000, Rossette was discussing a merger of the Company with Cofiniti, a privately-held competitor that was attempting to develop a software platform similar to the one that the Company was creating for S & P. The Merger was consummated in October 2000. In the information statement seeking stockholder approval, the shares of Cofiniti were said to have a value of $5, FN31 making the imputed value of a Company share $2.46.FN32 Neither Rossette nor Bachelor could reconcile this imputed value with their valuation of the Company for purposes of the Debt Conversion six months earlier. FN33 It is difficult to discern how the Company's financial condition materially changed between March and September 2000. Bachelor said that it was significantly worse off by that point. Rossette was ambivalent. Despite an occasional rosy communication, it is reasonable to infer that, overall, not much had changed even though the debt levels had been reduced (because of the Debt Conversion Agreement) and costs had been reduced, primarily through layoffs. On the other hand, time-or, more accurately, Rossette's willingness and ability to pay-was running out for SinglePoint. Without the Merger, it is unlikely that the Company would have survived much beyond the fall of 2000.

FN31. Cofiniti would fail not long after the Merger. It seems unlikely that the $5 per share valuation was reasonable. At the same time, the Cofiniti board was internally valuing Cofiniti stock at approximately $1.86 per share. JTX O (Martin Dep.) at 49 & Ex. 2. In hindsight, this value was also likely overly optimistic.

FN32. The information statement expressly reported: "In the merger, each share of [Company] common stock will be exchanged for approximately 0.4921568 shares of Cofiniti common stock. The value to [Company] stockholders is approximately $2.46 per share based on the exchange ratio provided in the merger agreement and a value of $5.00 per share for Cofiniti common stock as negotiated by the parties." JTX 194 at A1522.

FN33. Care, however, must be used in any comparison of the Company's share price between the Debt Conversion and the Merger. For example, in order to facilitate the Debt Conversion, the number of authorized and issued shares of the Company needed to be increased. After the Debt Conversion, there was a one-for-ten reverse stock split. It is a mildly interesting exercise to calculate market capitalization under the various scenarios. Although of little help in a valuation effort because of the unreliability of the share price inputs, it does give some sense of how divergent the results of seemingly rational calculations can be. After the Debt Conversion, if $0.05 per share were the market price, the market capitalization of the Company would have been little more than $2.5 million ($0.05 per share x 50,323,586 shares). If the Debt Conversion had been carried out at $0.50 per share and that was the market price, the market capitalization would have been approximately $5.1 million ($0.50 per share x 10,346,468 shares). If $5 is accepted as a fair price for a share of Cofiniti as of the Merger, then one could run numbers that, if believed, would suggest a market capitalization in excess of $14 million ($5 per share x 0 .492 exchange ratio x 5,761,789 shares). Or, if one accepts $1.86 per share as the proper value for a Cofiniti share, the effective market capitalization would come to approximately $5.3 million ($1.86 per share x 0.492 exchange ratio x 5,761,789 shares). The salient point, if there is one, is that, there is no easy way to reconcile these numbers.

Thus, unless considered in the context of the Debt Conversion or the Merger, the insiders' recorded view of the value of the Company's stock was generally between $0.50 and something less than $0.75 per share. FN34 This, of course, is not a perfect measure, but it plays a role in trying to discern the fair value of Company stock as of the date of the Debt Conversion. Valuation of start-up companies with no real product and no consistent income stream is difficult. The Court will later turn to the expert valuation testimony sponsored by both sides.

FN34. The Court may not ignore the valuations that management ascribed to the stock, regardless of whether it trusts those numbers. Skepticism about the accuracy of internal valuations goes to the weight which the Court gives such evidence.

***7** Despite what the experts may say, it is significant that Rossette's conduct, except with respect to the Debt Conversion Agreement and the Merger, was consistent with a valuation of approximately $0.50 per share, or perhaps slightly higher. The Merger consideration-especially in the absence of a major improvement leading up to the Merger-perhaps suggests an even higher valuation, but the Court is so skeptical about the Cofiniti value upon which the implicit merger consideration was based that it is reluctant to put much faith in any number derived from what seems to have been Cofiniti's self-appointed value.FN35

FN35. The Cofiniti deal appears to have been the best that Rossette could find. Even if Cofiniti had overvalued itself, the Merger was as good of an opportunity as he was going to get to salvage some shareholder value. Of course, with Cofiniti's demise amidst the bursting of the Internet and technology bubble, the Merger did not work out well for Rossette.

III. CONTENTIONS

The Plaintiffs contend that not only were the Debt Conversion and the Put Option unfair to them but also the burden to prove that they were entirely fair should be imposed upon the Defendants. They seek damages measured by the sum of the value of the excess shares issued to Rossette as a result of the unreasonably low conversion rate, plus the value of the Put Option. The Plaintiffs also ask that their attorneys' fees be shifted to Rossette because of what they characterize as his bad faith conduct before and during this litigation.

The Defendants suggest that, without Rossette's unflagging financial assistance, there never would have been a SinglePoint which could have had the Debt Conversion or the Merger with Cofiniti. Furthermore, they observe that fiduciary duties are contextual and care must be taken not to expect too much from the directors of such a small and financially fragile company. They rely upon the approvals by Bachelor, as a loyal and knowledgeable director, to prevent any shifting of the entire fairness burden to them. They also argue that the Company was in so much trouble by the spring of 2000 that the price and process of the Debt Conversion were, in fact, entirely fair. Moreover, they note that the Put Option left Rossette in a worse financial position than if the Merger had gone through as initially negotiated, which would have entitled Rossette to the immediate repayment of his debt. In short, the events giving rise to the Put Option presented Rossette with a net negative. Finally, they rely upon the Company charter's exculpatory provision, adopted under 8 *Del. C.* § 102(b)(7), to relieve them of any liability for money damages.

IV. ANALYSIS

A. *The Debt Conversion*

1. *Rossette as Controlling Shareholder and Entire Fairness*

Rossette was the Company's controlling shareholder, both before the Debt Conversion, when he held approximately 61% of the common stock, and after the Debt Conversion, when he held approximately 95% of the common stock. Although the Company's balance sheet improved as a result of the Debt Conversion, Rossette was able to orchestrate the pricing component for his benefit. This is a classic example of self-dealing by a controlling shareholder.

The Defendants offer that it should be the Plaintiffs' burden to prove the unfairness of the Debt Conversion because Bachelor, as one member of a two-person board, was independent and received no benefit from that transaction. They emphasize that SinglePoint was a small company with very limited resources and that expectations must be adjusted to accommodate that reality.[FN36]

FN36. A board that is evenly divided between conflicted and non-conflicted members is not considered independent and disinterested. *See Amazon. com, Inc. v. Hoffman,* 2009 WL 2031789, at *3 n. 17 (Del. Ch. June 30, 2009); *In re Oracle Corp. Deriv. Litig.,* 824 A.2d 917, 944 (Del. Ch.2003); *Beneville v. York,* 769 A.2d 80, 82 (Del. Ch.2000). One member of a board may, in appropriate circumstances and under proper conditions, be designated a special committee for purposes of assessing the propriety of a proposed transaction. Nevertheless, "[t]he court necessarily places more trust in a multiple-member committee than in a committee where a single member works free of the oversight provided by at least one colleague. But, in those rare circumstances when a special committee is comprised of only one director, Delaware courts have required the sole member, 'like Caesar's wife, to be above reproach.' " *Gesoff v. IIC Indus., Inc .,* 906 A.2d 1130, 1146 (Del. Ch.2006). Here, there is no assertion that Bachelor was ever impaneled as a single-member special committee for purposes of considering either the Debt Conversion or the Merger and Put Option.

***8** Bachelor had no experience as a director. He was intensely familiar with the Company's technical matters and was aware of its financial difficulties. However, he had no firm basis for determining what a fair conversion price would have been. More importantly, he had no help. He received no independent legal or financial guidance.

A "fairness opinion" that inspired confidence might have bolstered Bachelor's capacity to validate the transaction. Given his technical knowledge, a credible source of valuation assistance, especially within the context of a small entity in financial distress, might have sufficed. Unfortunately, the Harman Group's analysis adds little to the mix. First, its report was not completed by the time Bachelor was called on to approve the Debt Conversion. A draft report had been provided to him, but that is hardly an effective substitute for the final and complete analysis. Second, the Harman Group did not receive complete and accurate financial records from the Company and, thus, its analysis suffered because of lack of full information. Third, there is no indication that Bachelor ever met with representatives of the Harman Group to review its work. Indeed, no one from the Harman Group even attended the meeting at which the Debt Conversion was approved.[FN37] In short, the Harman Group's effort did not materially aid Bachelor; certainly, it did not enable him to be an independent counterweight to the objectives of the controlling shareholder.[FN38]

FN37. This review of relevant factors does not even address the report's self-defined focus:

whether the Debt Conversion was fair to Rossette. It is not for the Court to rewrite the report, but the Court is reluctant to give much weight to what may simply have been a poor choice of words. *See supra* note 30.

FN38. In reaching this conclusion, the Court reconfirms a decision that it reached during the summary judgment process. *See Gentile v. Rossette,* 2005 WL 2810683, at *8 (Del. Ch. Oct. 20, 2005), *rev'd on other grounds,* 906 A.2d 91 (Del.2006).

Thus, under these circumstances, the burden of justifying the Debt Conversion falls upon the Defendants under the entire fairness standard.

> The concept of entire fairness has two components: fair dealing and fair price. Fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock." In making a determination as to the entire fairness of a transaction, the Court does not focus on one component over the other, but examines all aspects of the issue as a whole.[FN39]

FN39. *Boyer v. Wilmington Materials, Inc.,* 754 A.2d 881, 898-99 (Del. Ch.1999) (internal citations omitted).

2. *The Process*

The process of the Debt Conversion was unfair for the same reasons underpinning the Court's conclusion that Bachelor, as the second director, could not cleanse the taint of Rossette's self-interested conduct. Rossette set the conversion rate with limited or no pushback from Bachelor, who was in no position to bargain effectively on behalf of the minority stockholders. Although the Company's financial condition may have afforded Bachelor little leverage, the lack of any independent assistance-legal or financial-precluded a material effort on behalf of the constituency he represented.[FN40] Furthermore, as set forth above, the so-called fairness opinion obtained by Rossette is not a substitute for a thoughtful and helpful analysis.

FN40. There is some limited evidence that Rossette initially proposed a penny per share conversion rate and that Bachelor successfully urged Rossette to increase his offer. No documents support that version, and the story only first emerged in the Defendants' Pre-Trial Memorandum, later "confirmed" by Rossette at trial. Defs.' Pre-Trial Mem. at 23; Tr. 70, 205-10. This testimony is at odds with Rossette's earlier deposition testimony, wherein he was asked whether the $0.05 figure was one that was arrived at through negotiations (the questioner raising a hypothetical $0.01 starting point), to which Rossette stated that he did not recall. JTX C (Rossette Dep.) at 129-30. Rossette explained his later recall of the contours of the negotiations as a product of his having spent more time thinking back on the conversations of that period. Tr. 71-72. Even if one accepts the trial testimony that Bachelor induced Rossette to increase the conversion rate, nothing suggests that any serious negotiations ever occurred. Merely pointing out that a penny per share conversion rate would not work-for any of several reasons-and then acquiescing in the next number floated by Rossette hardly can be viewed as adequate negotiation within the purview of fair process.

3. *The Price*

***9** From a tainted process, one should not be surprised if a tainted price emerges. The Plaintiffs support their challenge to the reasonableness of the Debt Conversion ratio by relying upon their valuation expert, Rebecca A. Kirk, who initially offered a per share value of $1.30. As this Court has recognized, however, "methods of valuation ... are only as good as the inputs to the models."[FN41] Here, the reliability of Kirk's core opinion has been substantially undermined by her use of the Company's books, which, it turns out, were materially inaccurate. She seemed to have accepted the view that the Company's outlook was improving in the early months of 2000. Kirk started with a per share price of $0.75 as of March 10, 2000, when the option price was reset. She then multiplied that by the number of shares outstanding to determine an equity value, subtracted cash equivalents and added total debt to reach an enterprise value of $7,776,000.FN42 She determined twelve-months trailing revenue to be $420,000. This led to a revenue multiple of 18.49. She next calculated the Company's twelve-months trailing revenue as of the date of the Debt Conversion seventeen days later to be $787,000. She applied the revenue multiple from the March 10 data to arrive at an enterprise value of $14,500,000 as of March 27. From that, she calculated a per share value of $1.30 as of the date of the Debt Conversion.

FN41. *Neal v. Ala. By-Products Corp.,* 1990 WL 109243, at *9 (Del. Ch. Aug. 1, 1990).

FN42. The numbers are rounded.

There are at least three problems with Kirk's approach, assuming that one accepts the methodology she employed. First, there is no basis, at least in the Court's judgment, for utilizing $0.75 per share as fair value as of March 10, 2000. It was a number that had been set for the option exercise price, which could not be less than fair value; there was no necessity that it be equal to anyone's understanding of fair value. Second, in the interim, Rossette had caused a substantial loan that he had made to be booked as revenue. That resulted in a massive increase in the "revenue" on SinglePoint's books. Of course, there was, in fact, no material increase in actual revenue during the seventeen-day span. Third, and most importantly, the notion that the per share value of a company experiencing the fiscal distress of SinglePoint would increase from $0.75 to $1.30 in a period of seventeen days, a 73% increase, defies common sense, logic, and the facts of this matter. To sponsor such an improbable increase in value does little but undermine any confidence the Court might have in Kirk's opinions.

Kirk, perhaps because of her growing doubts about the reliability of her initial efforts, also looked to the Merger and its implicit valuation of SinglePoint and worked back from that number, considering Company and market changes, to derive an alternative valuation. Data after the valuation date must be used with care. Yet, the Merger was negotiated at arms length with a third party, and the Company's financial condition had not improved in the interim. Thus, the Cofiniti transaction should serve at least as something of a check. The usefulness, however, of the Cofiniti transaction several months after the Debt Conversion is limited. One can find two potential valuations of Cofiniti as of September 2000: the $5 per share number trumpeted to the Company's shareholders, and the $1.86 per share internal valuation supposedly supported by Cofiniti's management.FN43 There is no credible reason to give any credit to the $5 per share valuation.FN44 The lower value-Cofiniti at $1.86 per share, suggesting an implicit valuation of the Company's stock at approximately $0.90 per share-seems somewhat more likely to reflect the actual judgment of Cofiniti's management, although this number also is not particularly meaningful.FN45 Ordinarily, the management of an entity is presumed to understand the entity's financial condition as well as, if not better than, anyone else. Cofiniti management's public valuation should not be ignored, but, in light of Cofiniti's subsequent demise, it is not a number in which one can place much faith, either.

FN43. As Stephen Martin of Cofiniti described the relationship between these two numbers:

> [W]e felt that ... our stock was worth about $1.85 a share ... at the time.... We did not feel that ... the relationship ... with SinglePoint and Cofiniti would have immediate value in the market place, and we had a very difficult time establishing the value. We pulled a ... number of $5 a share out of the air, very candidly, with the thought that if in the next year or so, given all the investment we would have to make in our technology ... that that was a reasonable number, and it was ... not scientific. It was simply something we

established.... We just simply didn't know ... what it was worth. We-we talked about a $5 to $7 number. But the $5 was pulled out of the air and $7 was also pulled out of the air, and we ... had no idea-simply had no idea.

JTX O (Martin Dep.) at 49-50.

FN44. Cofiniti had every incentive to inflate the public valuation of the Company because it both made its prospects appear better and reduced the number of shares to be paid out to SinglePoint shareholders. While this had the effect of increasing the nominal value of Rossette's Put Option, the conditions placed upon the exercise of the option helped to mitigate the possibility that Cofiniti might be overpaying. As Martin explained:

We thought our stock was worth about $1.85 at the date of the transaction. If we exchanged the debt, or the exchange rate, if you will, at $5 a share, ... we felt ... if a year went by and we established a $5 share, that-that they and we would have a chance to ride the same rollercoaster up in terms of valuation.... [I]f it didn't occur, then the value wouldn't be there. In other words, if we didn't grow because of what we did, the value wouldn't be there.... If it didn't go up and the value wasn't there; well, I guess I would just say there would be no-there would be no risk to us.... [W]e felt ... that between the time the transaction occurred and a year from then, or earlier if certain things happened, that-that $5 would be much, much easier to pay then as opposed to at the date of transaction because of the cash we would have to put in the transaction. So we felt that was a pretty good trade-off.

JTX O (Martin Dep.) at 51-52.

FN45. Cofiniti eventually came to view the Merger as the acquisition of "some people and some code," along with an increasingly dubious relationship with S & P, instead of as the acquisition of a going concern. As Cofiniti management realized the precariousness of the Company's financial situation and its limited options, they knew that it "would be much less expensive." JTX O (Martin Dep.) at 26-27, 33-34.

***10** It is also true that the broader technical market measured by NASDAQ averages had peaked at just about the time of the Debt Conversion. By September 2000, it had declined by more than 20%. That, at least as a matter of logic and if applicable to SinglePoint, would suggest that SinglePoint's stock price would have been higher (as was the broader NASDAQ market) in March. Moreover, Bachelor believed that the Company's financial condition had worsened between the Debt Conversion and the Merger. Whether he held this view because Rossette was no longer able by September to continue subsidizing the Company's operations, or whether the Company had genuinely experienced a deterioration otherwise, is not clear.

Nevertheless, Kirk can fairly opine that the negative developments both within SinglePoint and in the market for technology stocks generally during the period from March to September 2000 suggest that SinglePoint may have been worth more at the time of the Debt Conversion than at the time of the Merger. Yet, this analysis depends upon two broad considerations. First, one should accept the Cofiniti price, as disclosed to SinglePoint stockholders during the course of the Merger, as a reasonable indicator of value. As a general matter, arms-length negotiations yield numbers upon which courts routinely rely. The idea that Cofiniti stock was then worth $5 per share (suggesting a SinglePoint price of $2.46 per share), however, is impossible to accept.[FN46] Although it is unusual not to employ a negotiated and publicly reported number as a fair marker for value, to accept that the stock of SinglePoint was worth anything approaching the numbers derived from the apparently unreliable numbers used during the Merger process would be unreasonable.

FN46. Indeed, the internal valuation by Cofiniti management of $1.86 per share, suggesting an implicit valuation of SinglePoint at $0.90 per share, is even cause for some skepticism.

Second, this is also an example-albeit perhaps an extreme one-of the problem of using data that arose after the valuation date. Analogizing anything about SinglePoint to the broad technology market, given SinglePoint's unique circumstances and abject reliance upon Rossette's continued infusion of cash to keep it in business, renders any significant reliance on such inputs unreliable. This is not to say, however, that some consideration of post-Debt Conversion events would be improper. For SinglePoint, however, they are simply another set of factors to be included as part of an overall assessment of fair value as of the time of the Debt Conversion.

The most persuasive evidence offered by the Plaintiffs that the Company's stock was worth considerably more than the $0.05 per share conversion rate is Rossette's persistent willingness-even though admittedly marked at times by grave doubts-to pour his ultimately limited resources into the Company. He did so almost to the point of impoverishment. As the controlling shareholder and one, by the fall of 1999, closely involved with the Company's operations, his apparent perception of the Company's value must be given weight. He may now say, in substance, that the Company was worthless and on a path to oblivion, but his conduct at that time cannot be squared with his current perception of value.[FN47] In 1999, he acknowledged the fair value of the Company to be $0.50 per share.[FN48] Indeed, with respect to the balance of the debt not addressed by the Debt Conversion, he agreed again to a $0.50 per share conversion price. For him to continue infusing the Company with money would have been rational only if he believed that it would survive and eventually prosper. The S & P relationship was the only viable pathway for the Company. It was far from a “sure thing,” but, in the spirit of the tech boom, it was viewed by Rossette as having a chance for a substantial upside. There is no other plausible explanation for Rossette's ongoing support of the Company in the face of continuing unhappy accounting statements. This perception of Rossette's motives persuades the Court that a nickel per share was not a fair conversion rate, but it does not provide a quantitative basis for a value determination.

FN47. Rossette contends that he was compelled to invest in the Company, first doing so to help a friend and continuing in an attempt to salvage his original investment. Tr. 121-25. The Plaintiffs suggest that Rossette worked to preclude outside investment in order to recoup all of the potential gains for himself. Evidence that Rossette fought off outside investment is, at best, dubious. Still, the reality of Rossette's motivation for financing SinglePoint-particularly during its final stages-is likely somewhere between the two explanations presented by the parties. Rossette appears to have vacillated along with the Company's “fortunes.”

FN48. JTX 55.

***11** The Defendants' valuation expert, Frank C. Torchio, presented a plausible analytical approach that yields a value of $0.09 per share. He began with two reasonable assumptions: that the shares were each worth $0.50 in November 1999 and that the Company's prospects were not all that much better or worse by the time of the Debt Conversion-in other words, that the enterprise value remained, more or less, constant. He attributed the material difference in shareholder value between November 1999 and March 2000 to the significant amount of new debt owed to Rossette. If that new debt, incurred over the five-month period (together with a few other adjustments), is subtracted from the enterprise value using the November price of $0.50 per share, that would equate to a value per share of $0.09 as of the time of the Debt Conversion. This is a suitable lower bound for the range of potential values of SinglePoint stock at the time of the Debt Conversion.[FN49]

FN49. Torchio pursued another valuation effort that yielded a value consistent with the Debt Conversion rate. *See* JTX 216 at 13. He started with the Merger consideration-accepting $1.86 per share as a value for Cofiniti-and calculated back to a fair value as of the Debt Conversion.

He discounted the Merger consideration to the date of the Debt Conversion and then made a few adjustments, primarily dealing with the Company's debt and contingent liabilities. That effort presented him with a per share price of $0.75, assuming that the Company was a viable entity and that its solvency travails could be resolved. He then assessed the Company's prospects for survival. (In one model, he applied an illiquidity discount. However, both the Company and Cofiniti were thinly traded; the stock of both companies suffered from a lack of liquidity. The liquidity shortcomings of Cofiniti were presumably factored into its price, as well. Thus, by applying an illiquidity discount to a comparative value based upon a similarly illiquid market for Cofiniti, Torchio, in essence, applied two liquidity discounts.) Torchio was then confronted with the question of how to assess the risk that SinglePoint would fail. That risk was substantial. The only source of ongoing funding was Rossette, and his wealth was not unlimited. As a means of establishing the probability of failure, Torchio calculated a "cash burn ratio" defined as the Company's cash balance divided by its EBITDA (taken as a negative). That yielded roughly a 5% chance of survival. When multiplied by the $0.75 price, he ascertained a fair value of $0.04, or approximately the $0.05 of the Debt Conversion. This methodology, at best, supplies only a very imprecise estimate of the likelihood of survival. Although perhaps deserving of some consideration, this methodology fails to account for Rossette's ongoing-if not unequivocal-substantial, personal support for the enterprise.

As for the upper bound, courts frequently pay particular attention to management's assessment of an enterprise's value, especially shortly before the start of the chain of events leading to the transaction at issue.FN50 In February 2000, less than two months before the Debt Conversion, Rossette agreed to increase the option price for Company stock from $0.50 to $0.75 per share. That option price did not purport to define fair value; the price simply could not be set at less than fair market value. This, especially in light of the Company's financial travails, sets an upper limit on the possible range of fair value for the SinglePoint stock.FN51

FN50. *See, e.g., Cede & Co. v. Technicolor, Inc.,* 2003 WL 23700218, at *7 (Del. Ch. Dec. 31, 2003), *aff'd in part and rev'd in part on other grounds,* 884 A.2d 26 (Del.2005) ("Contemporary pre-merger management projections are particularly useful in the appraisal context because management projections, by definition, are not tainted by post-merger hindsight and are usually created by an impartial body. In stark contrast, *post hoc,* litigation-driven forecasts have an 'untenably high' probability of containing 'hindsight bias and other cognitive distortions.' "). *See also Doft & Co. v. Travelocity.com Inc.,* 2004 WL 1152338, at *5 (Del. Ch. May 20, 2004) ("Delaware law clearly prefers valuations based on contemporaneously prepared management projections because management ordinarily has the best first-hand knowledge of a company's operations."). Here, however, there is little evidence that management employed anything beyond general intuition in determining the option prices employed.

FN51. The Court has generally rejected the unduly rosy assumptions and methodologies employed by Plaintiffs' expert. No significant improvement in the Company's prospects occurred in the interim from when the revised option price was set. The use of improperly booked revenues by Kirk to justify an optimistic uptick in price has been rejected. Furthermore, the S & P option price cannot be viewed as a valuation metric. The option simply offered S & P the opportunity to protect the product that the Company was developing for it in the event that such effort was about to be successful and an undesired (and probably unexpected) suitor for the Company appeared.

Thus, the Court works within a range from roughly $0.10 per share, based on Torchio's analysis, to something less than $0.75 per share. That, of course, is a wide range, but, given the uncertainty and the absence of a useful financial history, it is a start.[FN52] The value of SinglePoint, if there was value, came almost entirely from the S & P relationship. In a sense, it was the value of a chance. Although there was a ways to go, some progress had been made in developing the platform for S & P and, given S & P's market potential, successful development of the software would have been a lucrative accomplishment. The progress in that project was, at best, bumpy, and it was likely that Rossette, himself not a programmer, had an unduly optimistic view of the Company's prospects. The best evidence, however, is that Rossette-an officer of the Company and its controlling shareholder, one who should be expected to know the value of his enterprise-kept injecting his own-rapidly dwindling-funds. Unless he believed in SinglePoint's future,[FN53] this would have been a course of conduct approaching the irrational, and the Court does not consider Rossette, with his extensive business background, irrational.[FN54]

FN52. Both experts, properly in the Court's view, did not to use the discounted cash flow method because of the shortage of useful data. Although Kirk valiantly attempted to draw upon data involving comparable companies (or a more general, industry-based source), the results of that effort offer little useful guidance because SinglePoint was in an unusual, if not unique, position. It was surviving only because of Rossette's assistance, it had little predictable and consistent income, Rossette was about to run out of money, and there was no reasonable expectation that anyone else would emerge to support the enterprise. That particular amalgam of limiting factors leaves little room for any confidence in any attempt to compare SinglePoint with any other enterprise, or even to assess it within the context of some precisely defined market.

FN53. If SinglePoint had value as an entity going forward, it would have been well in excess of a nickel per share.

FN54. It is somewhat ironic that Rossette's own conduct is an important factor in assessing the fair value of the Company during the last few months before the Debt Conversion.

There simply is no reliable way to “calculate” a “fair value” for SinglePoint at the time of the Debt Conversion. One should start with the $0.50 per share value of November 1999 (and recall that this was the per share value most frequently employed during a large portion of the Company's brief existence) and then consider the few moments of hope, recognize the desperate financial circumstances, accept the chance-perhaps a small one-of developing a viable product for S & P, take a brief glance at the Merger's effective price based on the value assigned to Cofiniti (one that seems to bear little resemblance to reality), and acknowledge that the difficulty in calculating such a number sometimes may cut against the fiduciary who has not faithfully discharged his duties.[FN55] The Court is persuaded that fair value for SinglePoint at the time of the Debt Conversion was something less than $0.50 per share: that is, a number in the mid-range between $0.10 per share and something a little less than $0.75 per share is as accurate as one can be. For these reasons, on balance, the Court finds that the fair value of SinglePoint stock at the time of the Debt Conversion was $0.40 per share.[FN56]

FN55. *See, e.g., Eastman Kodak Co. v. Southern Photo Materials Co.,* 273 U.S. 359, 379 (1927) (“[A] defendant whose wrongful conduct has rendered difficult the ascertainment of the precise damages suffered by the plaintiff is not entitled to complain that they cannot be measured with the same exactness and precision as would otherwise be possible.”); *Centrix HR, LLC v. On-Site Staff Mgmt., Inc.,* 349 Fed. Appx. 769, 775 (3d Cir.2009) (“In cases where a defendant's wrongful conduct renders an exact calculation of damages difficult, ... courts will not permit a defendant to profit from its misconduct by allowing the defendant to avoid damages based on the plaintiff's failure to provide precise evidence of damages.”).

FN56. The outcome here may seem at odds with the conclusions in the appraisal action. *See Gentile v. SinglePoint Fin., Inc.,* 2003 WL 1240504, at *7 (Del. Ch. Mar. 5, 2003). The appraisal proceeding, however, involved an unopposed, default valuation, and, accordingly, is entitled to no weight in this context.

***12** With this finding, it follows that the price component of the Debt Conversion also was not fair; consequently, the Court must conclude that price and process fairness was absent from the overall transaction.

4. *The Calculation of Damages*

The Court, having concluded that the Debt Conversion was not fair to the minority stockholders as a matter of price and process, now turns to a calculation of damages. The framework for a remedy in this case has been provided: “The only available remedy would be damages, equal to the fair value of the shares representing the overpayment by [the Company] in the debt conversion.” FN57 With a fair price and process valuation of $0.40 per share established for the Company at the time of the Debt Conversion, the damages suffered by the Plaintiffs may be calculated in accordance with the following table: FN58

FN57. *Gentile,* 906 A.2d at 103.

FN58. The approach taken here follows the general methodology of Torchio. *See* JTX 216 (demonstrative) at 33.

Debt Conversion at $0.40 Per Share:

Shares Outstanding Before Debt Conversion	5,904,566
Pre-Conversion Share Value	*$0.40*
Pre-Conversion Equity Value	$2,361,826
Debt Conversion Rate	$0.40
Shares Required for Debt Conversion	*5,552,378*
Debt Converted	$2,220,951
Pre-Conversion Equity Value	$2,361,826
Value of Debt Converted to Equity	*$2,220,951*
Post-Conversion Equity Value	$4,582,777
Shares Outstanding Before Debt Conversion	5,904,566
Shares Issued for Debt Conversion	*5,552,378*
Shares Outstanding After Debt Conversion	11,456,944
Post-Conversion Share Value	$0.40
Shares Held by the Plaintiffs	*1,000,000*
Value of the Plaintiffs' Shares When Debt Converted	*$400,000*

Debt Conversion at $0.05 Per Share:

Post-Conversion Equity Value	$4,582,777
Shares Outstanding After Debt Conversion	
@ $0.05 per Share	*50,323,586*

Implied Share Price	$0.091
Shares Held by the Plaintiffs	*1,000,000*
Value of the Plaintiffs' Shares	*$91,000*
Damages:	
Value of the Plaintiffs' Shares When Debt Converted at $0.40 per share	$400,000
Value of the Plaintiffs' Shares When Debt Converted at $0.05 per share	*($91,000)*
Damages	*$309,000*

5. *Bachelor's Liability for Money Damages*

Bachelor has invoked the provisions of the Company's charter that would exculpate him from liability for money damages caused by his breach of fiduciary duty as long as he acted neither disloyally nor in bad faith. By Article 7 of the Company's Certificate of Incorporation, "[n]o director shall be personally liable to the Corporation or its stockholders for any monetary damages for breach of fiduciary duty by such director as a director." FN59 This provision was adopted under the auspices of 8 *Del. C.* § 102(b)(7) which, of course, does not allow for the exculpation of liability for money damages if there was a breach of the duty of loyalty or if the director's conduct was not in good faith.FN60

FN59. JTX 208.

FN60. *See, e.g., Globis Partners L.P. v. Plumtree Software, Inc.,* 2007 WL 4292024, *15 (Del. Ch. Nov. 30, 2007).

***13** Bachelor is entitled to the protection of this exculpatory provision. He received no personal benefit from the Debt Conversion. Indeed, as the holder of the largest block of Company stock other than Rossette, its dilutive effects affected him more than anyone else. He thought for himself and attempted to do the best that he could in difficult circumstances. His ability to discharge his duties effectively was crimped by his lack of experience as a director and the lack of resources to advise him separately and independently of Rossette. At most, Bachelor breached his fiduciary duty of care. He has demonstrated that otherwise he acted loyally and in good faith.FN61 Accordingly, he may not be held liable for any money damages.FN62

FN61. *See, e.g., Union Illinois v. Korte,* 2001 WL 1526303, at *12 (Del. Ch. Nov. 28, 2001).

FN62. Rossette also seeks to avoid liability for money damages by relying upon the exculpatory provision of the Company's charter. As a controlling shareholder who used his position to direct the Debt Conversion, with its unfair price and process, for his personal benefit, his liability was accompanied by, and indeed the result of, a breach of his fiduciary duty of loyalty. Thus, the § 102(b)(7) provision affords him no relief.

B. *The Put Option*

With the continuing support of Rossette's loans, the Company was able to stay alive following the Debt Conversion despite its lack of sales and failure to complete the software for S & P. Rossette, with the help of a college friend, interested Cofiniti in acquiring the Company. After a few weeks of negotiations, the parties agreed on a term sheet. The term sheet provided that the Company's stockholders would collectively receive 2,200,000 shares of Cofiniti; it also recognized that Cofiniti would accept responsibility for the immediate payment of the Company's indebtedness to Rossette. Cofiniti eventually came to recognize the Company's precarious financial condition and sought to take advantage of its plight. After Rossette thought that the terms of the acquisition had been set and after he had signed his shareholder's agreement to sell, Cofiniti's board revised the conditions of the transaction. It balked at the immediate obligation to repay the debt owed to Rossette. Instead, it insisted that he accept deferred payment and continue to personally guarantee various Company obligations.FN63 In an effort to assuage Rossette's frustration and concerns regarding the loss of the right to immediate payment, Cofiniti offered the Put Option.FN64

FN63. Among other obligations, Rossette remained the sole guarantor of the Company's two office leases and its debt to LeaseNet, Inc., as well as the sole indemnifying party to litigation with Gentile in Rhode Island and the sole guarantor of post-closing costs related to the Merger that were not absorbed by Cofiniti. JTX C (Rossette Dep.) at 184.

FN64. JTX 188.

The Put Option, in theory, guaranteed Rossette the right to sell (or "put") 360,000 shares of Cofiniti stock to Cofiniti after one year or upon the realization of certain other benchmarks FN65 at a price of $5 per share, the price formally used for Cofiniti at the time of the Merger. Cofiniti was thinly traded and the lack of liquidity for its stock was a serious detriment. A commitment to buy a significant portion of Rossette's post-Merger holdings at $5 per share, when, it seems, that a fair value at the time of the Merger was more along the lines of $1.86 per share or perhaps even less, can be seen as having value.FN66 As the Plaintiffs point out, no other stockholder was offered a comparable opportunity. Then again, no other stockholder had loaned the Company so much money, either.

FN65. The Put Option could be exercised at the earliest of one year, the exercise of an S & P option to acquire shares in Cofiniti, or a successful public offering.

FN66. As a result of the reverse stock split, *see supra* note 33, the 360,000 shares subject to the Put Option amounted to approximately 23% of the shares held by Rossette.

Assessing the fairness of the Put Option requires the Court to review it within the context of merger negotiations and final transactional terms. There would have been no challenge to the Merger if the term sheet had been implemented. The debt owed by the Company to Rossette was a demand liability; under the term sheet version, it would have remained a demand obligation subject to immediate collection upon the Merger. Rossette did not seek a revision of his right to insist upon immediate repayment. He acquiesced in the revision only when he understood that the Merger would fail without his further cooperation. The impetus for the adjustment came from Cofiniti's board. Although the right to sell Cofiniti back its stock for $5 per share in a year might seem like a sizeable benefit, it is clear that no one involved in the negotiations-on either side-believed that the Put Option had much, if any value. Indeed, it does not appear that anyone even attempted to put a value on the Put Option. Moreover, because it was proposed by and insisted upon by Cofiniti, one may readily assume that it made the Merger more advantageous to Cofiniti than it would have been under the term sheet arrangements; if so, since only Rossette's interests were affected, any benefit accruing to Cofiniti came at Rossette's expense.FN67

FN67. Indeed, Rossette regarded the Put Option as a "cram down," and was "livid" about its late inclusion; he informed Martin that "he felt deceived" and that Cofiniti "had duped him." JTX O (Martin Dep.) at 45, 52.

***14** In short, the Put Option was imposed by Cofiniti and caused a significant detriment to Rossette. Thus, the inclusion of the Put Option as an element of the Merger transaction was entirely fair to the Company's shareholders. Defendants are entitled to judgment in their favor on this claim. FN68

FN68. Cofiniti's management seemed to be of the view that Cofiniti would either go public or not be around when the year expired. JTX O

(Martin Dep.) at 48-52. One doubts that Rossette fully appreciated how fragile Cofiniti was.

C. *The Shifting of Attorneys' Fees*

The Plaintiffs seek an award of their attorneys' fees from Rossette because of what they characterize as his bad faith conduct in this litigation. Generally, of course, under the so-called American Rule, each party bears its own attorneys' fees. Those fees, however, may be shifted in the event that a party's bad faith conduct increased the costs of litigation.FN69

FN69. *See, e.g., Arbitrium (Cayman Islands) Handels AG v. Johnston,* 705 A.2d 225, 231 (Del. Ch.1997), *aff'd,* 720 A.2d 542 (Del.1998).

The Plaintiffs have observed that Rossette's self-serving version of the "facts" has been revised from time to time, suggesting a pattern of prevarication. Although Rossette's testimony at times was marked by a reluctance to be forthcoming and although he (or his counsel) was late in providing full disclosure of the breadth of the inaccuracies in the Company's financial records-especially in the months leading up to the Debt Conversion-both of which are troubling, they do not reach the level that would justify a reallocation of the burden of representation. Much of the inconsistency in Rossette's testimony can be traced to his after-the-fact full realization that the Company's prospects never amounted to much; at the critical times, he showed his then-more optimistic view of its affairs by continuing to prop it up with his personal funding. With the benefit of hindsight and the realization that he threw lots of good money down what may now be viewed from a historical perspective as a rat hole, a certain inconsistency seems inevitable.FN70

FN70. More to the point, the Court is satisfied that Rossette, although he did not always testify with total accuracy, did not intentionally tell untruths.

The Plaintiffs also assert that Rossette's pre-litigation conduct should support a finding that he acted in bad faith in defending this action, thus entitling them to a shifting of fees. Although the Court has found a breach of the duty of loyalty by Rossette, his behavior, before or during this litigation, likewise did not rise to the level of bad faith necessary to justify a shifting of attorneys' fees.

In short, the Plaintiffs have not provided an adequate basis for recovery of their attorneys' fees.

V. CONCLUSION

For the foregoing reasons, judgment will be entered in favor of Plaintiffs and against Rossette in the amount of $309,000, together with interest at the legal rate, compounded quarterly, and costs. Judgment will be entered in favor of Bachelor and against Plaintiffs on all claims against him. Plaintiffs' application for an award of attorneys' fees will be denied. Counsel are asked to confer and to submit an implementing form of order.

Del.Ch.,2010.
Gentile v. Rossette
Not Reported in A.2d, 2010 WL 2171613 (Del.Ch.)

END OF DOCUMENT

EXHIBIT 4

Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
Dhruv KHANNA, Patrick Sams, and Sybil Meisel, derivatively and on behalf of all those similarly situated, Plaintiffs,
v.
Charles MCMINN, Daniel Lynch, Frank Marshall, Richard Shapero, Robert Hawk, Robert E. Knowling, Jr., Debra Dunn, Hellene Runtagh, Larry Irving, Charles Hoffman, L. Dale Crandall, Richard A. Jalkut, and Crosspoint Venture Partners, L.P., Defendants,
and
COVAD COMMUNICATIONS GROUP, INC., a Delaware corporation, Nominal Defendant.

No. Civ.A. 20545-NC.
Submitted Nov. 7, 2005.
Decided May 9, 2006.

Stuart M. Grant, Jay W. Eisenhofer, Michael J. Barry, and Cynthia A. Calder, of Grant & Eisenhofer, P.A., Wilmington, Delaware; Mark C. Gardy, and Jill Abrams, of Abbey Gardy LLP, New York, New York; and Curtis V. Trinko, of The Law Office of Curtis V. Trinko, LLP, New York, New York, for Plaintiffs.

Alan J. Stone, Natalie J. Haskins, and Jason A. Cincilla, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; Douglas M. Schwab, Norman J. Blears, Robin E. Wechkin, and Kristi K. Hansen, of Heller Ehrman White & McAuliffe LLP, Menlo Park, California, for Defendants Charles McMinn, Daniel Lynch, Frank Marshall, Rich Shapero, Robert Hawk, Robert E. Knowling, Jr., Debra Dunn, Hellene Runtagh, Larry Irving, Charles Hoffman, L. Dale Crandall, and Richard A. Jalkut.

David C. McBride, Danielle Gibbs, and Adam W. Poff, of Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware; Steven M. Schatz, Terry T. Johnson, and Clayton Basser-Wall, of Wilson Sonsini Goodrich & Rosati, P.C., Palo Alto, California, for Defendant Crosspoint Venture Partners, L.P.

Jesse A. Finkelstein, Lisa Zwally Brown, and Candice Toll Aaron, of Richards, Layton & Finger, P.A., Wilmington, Delaware; Paul H. Dawes, Darius Ogloza, Jacqueline D. Molnar, and David M. Friedman, of Latham & Watkins LLP, Menlo Park, California, for Nominal Defendant Covad Communications Group, Inc.

MEMORANDUM OPINION AND ORDER

NOBLE, Vice Chancellor.

***1** Plaintiff Dhruv Khanna ("Khanna") is a cofounder and shareholder of Nominal Defendant Covad Communications Group, Inc. ("Covad") and served as its General Counsel and Executive Vice President from its formation in 1996 until June 2002 when he was removed from these positions amidst charges of sexual impropriety. On September 15, 2003, he brought this action, both derivatively and as a class action, to challenge acts and omissions of Covad's board while he was Covad's General Counsel and to contest certain omissions and misrepresentations which he alleges impaired the accuracy of Covad's proxy statements issued in advance of shareholders' meetings.[FN1] On August 3, 2004, Sybil Meisel and Patrick Sams, also Covad shareholders, joined him as representative plaintiffs with the filing of the Amended Derivative and Class Action Complaint (the "Amended Complaint").

FN1. Khanna, on August 11, 2003, also filed an action, under 8 *Del .C.* § 220, to compel Covad to grant him access to certain of its books and records. *See Khanna v. Covad Commc'n Group, Inc.,* 2004 WL

187274 (Del. Ch. Jan. 23, 2004). For convenience, exhibits produced at the § 220 trial are identified as "JTX", and the transcript of that trial is referred to as "Trial Tr."

The Individual Defendants are current and former directors of Covad. Also named as a defendant is Crosspoint Venture Partners, L.P. ("Crosspoint"), a venture capital firm closely connected to some of Covad's directors, a former investor in Covad, and the principal beneficiary of some of the actions which the Plaintiffs challenge. The Plaintiffs seek to impose liability on Crosspoint under principles of fiduciary duty for certain conduct when it was a large shareholder of Covad and under notions of aiding and abetting and *respondent superior.*

The Defendants, as one would expect, have moved to dismiss the Amended Complaint under Court of Chancery Rule 23.1 because pre-suit demand upon the board was not excused and under Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted. Not so typically, the Defendants have also moved to dismiss because, they contend, (1) Khanna did, in fact, make demand upon Covad's board through a letter transmitted shortly after he was terminated and (2) Khanna is not qualified to act as a representative plaintiff in this action because of his former role as General Counsel of Covad and because of the mixed motives prompting the filing of this action-not only as a shareholder, but as a disgruntled former employee. In addition, the Defendants seek dismissal of Meisel and Sams as representative plaintiffs because they are alleged to have been "tainted" by their association with Khanna. Finally, the parties quarrel over the confidential treatment to be given to certain of Khanna's allegations. This dispute requires resolution of opposing motions relating to maintaining the Amended Complaint under seal.

I. FACTS [FN2]

FN2. The "facts" are drawn primarily from the "well-pleaded" allegations of the Amended Complaint. Some "facts" are taken from documents (or portions thereof) incorporated into the Amended Complaint. Finally, for the debates over disqualification and confidential treatment of portions of the record, the Court looks to a broader range of sources.

Covad, a service provider of broadband internet and network access using digital subscriber line (DSL) technology, is a Delaware corporation headquartered in San Jose, California. It filed for bankruptcy in August 2001 and departed from that jurisdiction in December 2001.

A. *The Plaintiffs' Challenges-A Brief Overview*

In the Amended Complaint, the Plaintiffs seek redress for six matters (other than disclosure claims) allegedly resulting from breaches of fiduciary duties by various Covad Directors: (1) allowing the vesting of Defendant Charles McMinn's ("McMinn") founders' shares in Covad even though he had not satisfied the requirements for vesting; (2) permitting McMinn and Defendant Rich Shapero ("Shapero"), with Crosspoint, to develop Certive, Inc. ("Certive"), a competitor of Covad; (3) Covad's subsequent investment in Certive; (4) Covad's acquisition of BlueStar Communications Group, Inc. ("BlueStar"), an act that rescued a failing investment of Crosspoint and was the principal cause of Covad's entry into bankruptcy; (5) the BlueStar earn-out settlement; and (6) Covad's investment in DishnetDSL ("Dishnet"), an entity with which McMinn was involved, and the payments Covad made to end that relationship. Crosspoint is alleged to be liable for the adverse consequences of some of those fiduciary failures either directly, as a controlling shareholder, or as an aider and abettor and under the doctrine of *respondeat superior.*

***2** Additionally, Khanna, in correspondence with Covad's Board, shortly after his termination, made numerous allegations of wrongdoing against members of Covad's Board. The Plaintiffs contest the sufficiency of Covad's proxy statements in 2002, 2003, and 2004 principally because, it is alleged, the charges Khanna made against Covad's Board were not fully disclosed to the shareholders who could have used the information in determining how to vote for directors standing for reelection to the Board.

B. *Covad's Board of Directors*

When this action was filed, Covad's Board consisted of eight directors.

1. *Charles McMinn*

McMinn is a founder of Covad and Chairman of its Board of Directors. He has been on the Board-with the exception of an approximately one-year absence from November 1999 to late-October 2000-since October 1996. He was the company's Chief Executive Officer and President from October 1996 to July 1998.

McMinn is also a founder of Certive, which was incorporated in July 1999, and was Certive's Chief Executive Officer from November 1999 to October 2000. McMinn served as a director of BlueStar until Covad acquired it. He is also a member of Dishnet's board.

2. *Robert Hawk*

Hawk has been a member of Covad's Board since April 1998. Hawk is a "Special Limited Partner" of Crosspoint.[FN3] It is alleged that "through Crosspoint and directly, Hawk has owned a substantial equity interest in BlueStar." [FN4] Through Crosspoint, Hawk owned 12% of Diamond Lane (which paid $52 million to Covad for services rendered in 1998 and 1999) and a "significant" stake in Efficient Technologies, both of which are Covad vendors. Additionally, Hawk is alleged to have "joined the [Covad] board as a result of his friendship, connections and/or business affiliations with Defendants Shapero and/or McMinn." [FN5]

FN3. Amended Compl. at ¶ 12.

FN4. *Id.*

FN5. *Id.*

3. *Charles Hoffman*

Since June 2001, Hoffman has been a director, President, and Chief Executive Officer of Covad. It is alleged that he was recruited by McMinn and "immediately forged a close relationship with defendant McMinn," [FN6] whom he regards as his boss. Hoffman receives various benefits from Covad, including a $500,000 salary, a $375,000 annual bonus, a $100,000 signing bonus, term life insurance, and stock options.[FN7]

FN6. *Id.* at ¶ 17.

FN7. *Id.* at ¶ 138.

4. *Larry Irving*

Irving has served as a member of Covad's Board since April 2000. In the Amended Complaint, the Plaintiffs identify various instances in which Irving joined other Covad directors in making, what the Plaintiffs consider, egregious decisions.[FN8]

FN8. These decisions include allowing Shapero to sit on the boards of Covad competitors, allowing Hawk to maintain his investment in BlueStar, granting Hoffman an overly generous compensation package, allowing McMinn to serve on the Covad and Dishnet boards while the two companies were in litigation, and retaliating against Khanna when he objected to the Board's improper conduct. *Id.* at ¶ 139.

5. *Richard A. Jalkut*

Jalkut was appointed to the Covad Board on July 18, 2002. He is the President and Chief Executive Officer of TelePacific, Inc., a Covad reseller.

6. *Daniel Lynch*

Lynch has been a member of the Covad Board since April 1997. Lynch is a member of the Board of Advisors of Certive,[FN9] appointed soon after Covad's investment in Certive. He is also a long-time friend of McMinn. The two own homes in the same neighborhood and neighboring wineries in St. Helena, Napa. FN10

FN9. The Amended Complaint fails to develop sufficiently, for particularized pleading purposes, the nature of Certive's Board of Advisors. It may be that appointment to this position carried significant remunerative benefits, but the Plaintiffs' conclusory pleadings in this respect fail to set forth the detail necessary to satisfy Court of Chancery Rule 23.1.

FN10. Amended Compl. at ¶ 9.

7. *L. Dale Crandall*

***3** Crandall was appointed to the Covad Board on June 20, 2002. He also sits on the board of BEA Systems ("BEA"), a company that supplies Covad with software and related support. FN11 Covad paid in excess of $2.2 million to BEA in 2004.

FN11. Calder Decl., Ex. E, at 4. These facts are drawn from Covad's 2004 Proxy Statement. Although one may doubt whether this aspect of Covad's 2004 Proxy Statement was incorporated into the Amended Complaint, this information is not outcome-determinative.

8. *Hellene Runtagh*

Runtagh has been a member of the Covad Board of Directors since November 1999. "She became a director with the consent and approval of the McMinn-Shapero director appointees. Defendant Runtagh derived the benefits of being and remaining on the Board of Directors of, and receiving compensation from, Covad by supporting and favoring the self-dealing of other directors in the BlueStar and Dishnet Transactions." FN12

FN12. Amended Compl. at ¶ 15.

C. *Former Covad Board Members*

A brief review of the following former Covad directors is important to understanding, as the Plaintiffs tell the story, the "incestuous" nature of Covad's Board, as well as the transactions challenged by the Plaintiffs.

1. *Frank Marshall*

Marshall served on Covad's Board from October 1997 to December 2002 and was Covad's interim chief executive officer from November 2000 until June 2001. He also serves on Certive's Board of Advisors. He has been a partner in Sequoia Capital ("Sequoia"), a venture capital firm, which invested with Crosspoint. He is a director of NetScreen Technologies, a Covad vendor that received $33,000 from Covad in 2001. Defendant Marshall is alleged to be a longtime friend of McMinn.

2. *Rich Shapero*

Shapero served on the Covad Board-as Crosspoint's designee-from July 1997 to May 2002 and on the Covad compensation committee.

Shapero is the Managing Partner, as well as a General Partner, of Crosspoint. Crosspoint had stakes in various entities associated with Covad, such as Certive, BlueStar, Diamond Lane, and Efficient Technologies, another Covad vendor. Shapero was also a member of the boards of BlueStar and NewEdge Networks ("NewEdge").

3. *Robert E. Knowling, Jr.*

Knowling was Covad's Chief Executive Officer and a member of Covad's Board from July 1998 until November 1, 2000. He also served as Chairman of the Board from September 1999 until his departure from Covad in November 2000. Knowling is a former colleague of Hawk, with whom he worked at "US West Communications, Inc. and/or its affiliates." FN13 Covad's stock price began its "steep descent in the [s]pring of 2000" FN14 on Knowling's watch.

FN13. Amended Compl. at ¶ 13.

FN14. *Id.*

4. *Debra Dunn*

Dunn served on the Covad Board from April 2000 to October 2000. She is a senior executive at

Hewlett-Packard. Dunn was recruited to join the Covad Board through Knowling, who served on Hewlett-Packard's Board of Directors.

D. *Crosspoint and Other Relationships*

Crosspoint is a "venture capital firm that invests in early stage companies in two strategic areas: (a) Virtual Service Providers and E-Business Services; and (b) Broadband Infrastructure." FN15 Crosspoint had invested in Covad, Certive, BlueStar, and NewEdge and also "owned a significant stake in Diamond Lane and Efficient Technologies, both of which were Covad vendors." FN16 In addition, Crosspoint "co-invested in one or more companies alongside" Sequoia, with which Marshall is affiliated. FN17 As noted, Shapero serves as Crosspoint's General and Managing Partner, and Hawk is a Special Limited Partner. Crosspoint "cashed out" its investment in Covad in "1999-2000." FN18

FN15. *Id.* at ¶ 18.

FN16. *Id.* NewEdge is a "provider of dedicated internet access for businesses and communications carriers...." *Id.* at ¶ 11. Diamond Lane is "a Covad vendor who Covad paid $52 million for services rendered in 1998 and 1999." *Id.*

FN17. *Id.* at ¶ 18.

FN18. *Id.*

E. *The Plaintiffs' Challenges*

1. *The Certive Claims* FN19

FN19. Although referred to, for convenience, as the "Certive Claims," there are three separate aspects: (1) the vesting of McMinn's "founders' shares" (Count I); (2) the usurpation by McMinn of Covad's business opportunity with respect to the activities of Certive (Count II); and (3) the decision of Covad's Board to invest in Certive (Count III).

***4** The Plaintiffs allege that the events surrounding Covad's investment in Certive reflect a pattern of self-dealing by McMinn and Crosspoint and that various supine Covad directors were rewarded with lucrative positions in exchange for their support.

Covad went public in January 1999. McMinn was no longer chief executive officer, but needed to remain a full-time employee of Covad until November 2000 for his founders' shares to vest fully. While employed at Covad, McMinn began looking for other investment opportunities. He wrote to Knowling, then-chief executive officer of Covad: "The taking of board seats [with Crosspoint affiliates] and coming up with ideas that Crosspoint and I could invest in is what [C]rosspoint wanted me to do and what I thought we had agreed to with me helping them." FN20 He justified his involvement with other companies by contending that "these would be deals that Covad would benefit from [and] that Covad may or may not want to invest in/partner with." FN21 Knowling, although concerned about the example that McMinn's behavior would set for other Covad employees, eventually acquiesced: "You are the founder and exceptions can be made to make anything work." FN22 Thus, McMinn received his "founders' shares" despite the fact that he did not remain with Covad on a full-time basis until November 2000. This special treatment was not reported to Covad's shareholders.

FN20. *Id.* at ¶ 43.

FN21. *Id.* at ¶ 44.

FN22. *Id.* at ¶ 46.

One of the opportunities that McMinn was pursuing involved Certive, a privately-held provider of computerized data integration services. Certive's website, as of mid-2002, explained that Certive was "developing a full-service e-business network to provide live support and systems to entrepreneurs over a broadband connection...." FN23 McMinn was a founder of Certive, which was incorporated in July 1999 when McMinn was a full-time employee of Covad. Crosspoint and McMinn held substantial stakes in Certive. McMinn received 1,333,333 founders' shares of Certive and invested $1 million for an additional 666,667 Series A Preferred Shares. Crosspoint received 3 million Series A Preferred shares for an investment of $4.5 million.

FN23. *Id.* at ¶ 47.

Certive is alleged to have been in Covad's "line of business." FN24 Covad was not offered the opportunity to invest in Certive's Series A Preferred round of financing.

FN24. *Id.* at ¶ 153.

On September 22, 1999, the Covad Board blessed McMinn's involvement and investment in Certive *ex post.* This blessing came two months after McMinn had founded Certive and one month after McMinn and Crosspoint had invested in Certive's Series A Preferred shares. Covad's Board decided that "the company would not be interested in pursuing an investment in [Certive] on the terms and conditions offered to McMinn and Crosspoint." FN25 At this meeting, the Covad Board also adopted a "corporate opportunity policy" which forbade, without prior approval, a fiduciary of Covad to sit on the board of, or invest in, a company in competition with Covad.

FN25. *Id.* at ¶ 55.

***5** Nineteen days later, however, Covad invested in Certive's Series B-1 Preferred round of financing. Covad paid $5 million for 1,111,111 Series B-1 Preferred shares (approximately $4.50 per share). Additionally, Covad signed a Shareholders' Rights Agreement that bound Covad to vote its shares in favor of Crosspoint and McMinn's designees on the Certive Board. Hawk, Lynch, Marshall, and Knowling participated in the Covad Board's deliberations and vote.

After Covad's investment in Certive, Lynch and Marshall were invited to serve on Certive's Board of Advisers. "[Advisory board] positions are highly sought after and potentially lucrative as advisory board members in Silicon Valley companies are given stock options which during the 1990s became a source of great wealth for many people." FN26

FN26. *Id.* at ¶ 56.

2. *The BlueStar Transactions*

For convenience, Covad's involvement with BlueStar may be viewed as two separate, although closely related, transactions: (1) the BlueStar acquisition, and (2) the BlueStar earn-out settlement.

a. *BlueStar Acquisition*

On June 16, 2000, Covad announced that it had entered into a merger agreement with BlueStar. BlueStar sold DSL services directly to retail customers. From mid-1999 on, Crosspoint owned more than 40% of BlueStar's outstanding shares. McMinn and Hawk "owned a substantial number of preferred shares." FN27 Shapero and McMinn sat on the BlueStar board.

FN27. *Id.* at ¶ 58.

"By mid-2000, BlueStar had incurred significant debt and liabilities and was losing millions of dollars every month. Its efforts to raise money through an initial public offering of stock were unsuccessful and it (and its major investor, Crosspoint) needed a bail-out." FN28 Shapero lobbied Knowling for Covad to acquire BlueStar, and Covad eventually succumbed. A fairness opinion prepared by BlueStar's financial advisor for the transaction reported, "The management of [BlueStar] ... informed us that [BlueStar], as of June 14, 2000, expected to exhaust its liquidity in the near term and did not have a financing source for funding its anticipated operating and capital needs over the following 12 months ." FN29 In addition to BlueStar's fiscal problems, senior Covad management opposed the transaction: "BlueStar's entire business was built on a feet-on-the-street direct sales model already tried and rejected by Covad." FN30 The merger is alleged to have been "fraught with self-dealing because of the interlocking and conflicting relationships between the Covad and BlueStar boards." FN31

FN28. *Id.* at ¶ 61.

FN29. *Id.* at ¶ 63.

FN30. *Id.* at ¶ 69.

FN31. *Id.* at ¶ 71.

On September 22, 2000, Covad completed the BlueStar acquisition by issuing approximately 6.1 million shares of Covad common stock to BlueStar shareholders under an exchange ratio that enabled BlueStar preferred and common shareholders to receive an average price of $14 .23 per share of Bluestar. Additionally, BlueStar's stock options and warrants were converted into approximately 255,000 Covad shares at a fair value of $6.55 per share. The total consideration Covad paid was valued at, at least, $200 million. FN32 Knowling, Marshall, Lynch, Dunn, and Runtagh approved the BlueStar acquisition.

FN32. *Id.* at ¶ 73.

***6** The acquisition immediately appeared to be a failure as, the day after the merger was announced, Covad's shares dropped 27%. On June 25, 2001, within a year after the merger, Covad announced it was shutting down the BlueStar network and laying off more than 400 employees.

b. *BlueStar Earn-Out Settlement*

In addition to the consideration paid at the time of the merger, BlueStar shareholders were entitled to receive up to 5,000,000 additional Covad common shares at the end of 2001 if BlueStar achieved certain revenue and EBITDA goals. "Despite BlueStar's utterly dismal performance and failure to even approach, let alone reach, its EBITDA targets, in April 2001 Covad reached an agreement with BlueStar representatives, negotiated by Lynch, whereby BlueStar stockholders were given 3,250,000 of the 5,000,000 shares, in exchange for a release of all claims against [Covad]...." FN33 Lynch negotiated this settlement without final BlueStar accounting results and even though the former BlueStar shareholders were not entitled to any payments until the end of 2001. At the same time that Lynch's negotiations were taking place, Marshall "was sending emails to the Covad Board calling the BlueStar acquisition 'a very costly mistake, probably the worst mistake I have ever seen a company make.' ' FN34 No corporate record was kept of the negotiations. The BlueStar earn-out settlement cost Covad $100 million, to the substantial benefit of Crosspoint, Shapero, McMinn, and Hawk (who collectively received almost half of the 3,250,000 shares from the earn-out settlement). FN35 Covad reported that McMinn, Hawk, and Shapero did not participate in the meetings concerning the review and approval of the BlueStar earn-out settlement. FN36 Marshall, Lynch, Runtagh, and Irving participated in the BlueStar earn-out settlement deliberations and vote.

FN33. *Id.* at ¶ 74.

FN34. *Id.*

FN35. *Id.* at ¶ 78.

FN36. *See* Amended Compl. at ¶ 80 ("In fact, [Covad] has publicly stated that McMinn, Hawk and Shapero did not participate in the meetings concerning the 'review and approval' of the [BlueStar earn-out settlement]."); *see also* Stone Aff., Ex. E at 121 (Covad's 10-K for fiscal year ending December 2000).

3. *The Dishnet Transaction*

McMinn sat on the Board of Directors of Dishnet and held options to purchase shares of that company. Dishnet is a privately held telecommunications company that provides DSL and dial-up access in India.

On February 15, 2001, Covad-through a wholly owned subsidiary-purchased 2,000,000 shares of Dishnet for $22,980,000. In addition to the subscription agreement, Dishnet entered into an agreement with Covad to license Covad's proprietary operational support system for use in India. The business relationship soon deteriorated.

In October 2001, Dishnet filed a proof of claim in Bankruptcy Court against Covad asserting damages in excess of $24 million. Covad attempted to exercise its $23 million put option in Dishnet. As a result of these actions, McMinn was simultaneously sitting on the boards of two companies engaged in a substantial legal dispute.

Covad and Dishnet resolved their dispute. Among the terms of the settlement were (1) the sale of Covad's investment in Dishnet for $3 million, (2) resolution of Dishnet's claims against Covad, and (3) the relinquishment of Covad's put option in Dishnet.

F. *Proxy Disclosures and Khanna's Letter to Covad's Board*

***7** The Plaintiffs allege that Khanna protested against the transactions discussed above on the grounds that they were compromised by self-dealing and otherwise lacked substantive business purpose. Covad's Board then “vowed to remove Khanna so he would not be an obstacle to their self-dealing.” FN37 Khanna was accused of sexual harassment, removed as General Counsel, and placed on administrative leave in June 2002.

FN37. Amended Compl. at ¶ 110.

On June 10, 2002, Covad issued its 2002 Proxy Statement. The annual meeting of Covad shareholders was scheduled for July 25, 2002. On June 19, 2002, after he was relieved of his duties, Khanna (through his attorney) sent a letter to Covad's Board “outlining among other things, the breaches of fiduciary duty alleged against the Board in [the Amended Complaint], including the Board's conduct in the Certive, BlueStar, and Dishnet transactions.” FN38 Khanna contends that this was not a demand on the Board; “[r]ather, it was a last-ditch attempt on his part to get the slim minority of directors who did not have direct interests in these transactions to do something to seek a remedy for the corporation.” FN39

FN38. *Id.* at ¶ 122.

FN39. *Id.* at ¶ 123. The letter, which may be considered as incorporated into the Amended Complaint, was part of the record in the § 220 action as JTX 123. *See, e.g.*, Amended Compl. at ¶ 3.

Although Khanna's charges were broadly directed at alleged fiduciary breaches by the Covad Board-breaches which, if as alleged, would have affected all public shareholders adversely-the response sought by Khanna was unique to him and provided no direct benefit to the other shareholders. Khanna attempted to extract the following terms:

1. Mr. Khanna shall be allowed to join the Covad Board of Directors, as Vice Chairman, with a not less than 15-year contract, ... he shall be responsible for overall conflict of interest compliance.

2. Mr. Khanna shall be given a role as Executive Vice President for Corporate Strategy reporting directly to the CEO, which shall include the following areas: Public Advocacy Strategy, including legal and related PR strategy, press release review, and second (second to the CEO) public spokesperson (without any impairment to the CFO's role as head of Investor Relations); Legal Strategy, including Litigation Initiation and Settlement Strategy; New and Existing Product Implementation Strategy; ILEC Restructuring Strategy; and related strategies.

3. He will retain the responsibility of being Covad's chief representative at trade associations....

4. He will remain on all pre-existing e-mail mailing lists and will join any applicable new ones.

5. He will be compensated at all times not less

> than a comparable officer that serves as both an officer and as a director. He shall not be terminated or investigated for any reason other than fraud or illegal conduct during the 15-year period.
>
> 6. Covad will make a statement to the legal department, corporate officers and members of the Board clearing Mr. Khanna of any and all violations of law and stating that he has been subjected to two separate investigations and has been cleared of any ethical or integrity violations as well....
>
> ***8** 7. Mr. Khanna will have five individuals reporting to him on a solid line basis ..., and his administrative support person ..., plus a minimum of four individuals reporting to him on a dotted line basis....[FN40]

FN40. JTX 123.

On July 9, 2002, shortly after his letter to Covad's Board, Khanna sent a draft fiduciary duty complaint. His implicit threat: if the Board did not accede to his selfish wishes, a derivative and class action complaint would be brought, purportedly for the benefit of all shareholders.

Covad's Board formed a committee, consisting of directors Runtagh and Crandall, to investigate Khanna's allegations; the committee was not initially given any power to act independently of the Covad Board. Additionally, Crandall was given the authority to act alone on behalf of the committee if his opinion differed from that of Runtagh. Although Khanna was not aware of it, at some point Jalkut became a member of the committee. On September 20, 2002, the Board gave the committee authority to determine whether or not to bring a suit based on Khanna's allegations of wrongdoing.

In October 2002, the committee concluded that the company should not pursue litigation based on the Certive matters.[FN41] The Amended Complaint charges that only disclosures Covad's Board made of Khanna's allegations and the subsequent investigations into those allegations were in its March 2003 10-K, its May 2003 10-Q, and its 2004 Proxy Statement.[FN42] Both of Covad's 2003 disclosures were essentially the same; its March 2003 10-K recited:

FN41. *Id.* at ¶ 129. It is unclear from the Amended Complaint when the committee decided not to pursue claims based on the other transactions of which Khanna complained. It does allege that the committee "informed Khanna that [it] believed his allegations were without merit" on December 26, 2002. *Id.* at ¶ 133.

FN42. *Id.* at ¶¶ 204, 213. Paragraph 213 of the Amended Complaint contradicts Paragraph 204 by alleging that the disclosures were in the 2003 Proxy Statement. Additionally, Paragraph 133 of the Amended Complaint alleges that the "only public disclosure" of Khanna's allegations and the investigation occurred in Covad's March 2003 10-K; however, the Amended Complaint explains in other paragraphs that disclosures were made at least in the May 2003 10-Q and the 2004 Proxy Statement. *See id.* at ¶¶ 204, 213.

> In June 2002, Dhruv Khanna was relieved of his duties as our General Counsel and Secretary. Shortly thereafter, Mr. Khanna alleged that, over a period of years, certain current and former directors and officers had breached their fiduciary duties to the Company by engaging in or approving actions that constituted waste and self-dealing, that certain current and former directors and officers had provided false representations to our auditors and that he had been relieved of his duties in retaliation for his being a purported whistleblower and because of racial or national origin discrimination. He has threatened to file a shareholder derivative action against those current and former directors and officers, as well as a wrongful termination lawsuit. Mr. Khanna was

placed on paid leave while his allegations were being investigated.

Our Board of Directors appointed a special investigative committee, which initially consisted of Mr. Crandall and Ms. Runtagh, to investigate the allegations made by Mr. Khanna. Mr. Jalkut was appointed to this committee shortly after he joined our Board of Directors. This committee retained an independent law firm to assist in its investigation. Based on this investigation, the committee concluded that Mr. Khanna's allegations were without merit and that it would not be in the best interest of the Company to commence litigation based on these allegations. The committee considered, among other things, that many of Mr. Khanna's allegations were not accurate, that certain allegations challenged business decisions lawfully made by management or the Board, that the transactions challenged by Mr. Khanna in which any director had an interest were approved by a majority of disinterested directors in accordance with Delaware law, that the challenged director and officer representations to the auditors were true and accurate, and that Mr. Khanna was not relieved of his duties as a result of retaliation for alleged whistleblowing or racial or national origin discrimination. Mr. Khanna has disputed the committee's work and the outcome of the investigation.

***9** After the committee's findings had been presented and analyzed, the Company concluded in January 2003 that it would not be appropriate to continue Mr. Khanna on paid leave status, and determined that there was no suitable role for him at the Company. Accordingly, he was terminated as an employee of the Company. While the Company believes the contentions of Mr. Khanna referred to above are without merit, and will be vigorously defended if brought, it is unable to predict the outcome of any potential lawsuit. FN43

FN43. *Id.* at ¶ 133.

No other public disclosure was made of Khanna's termination and the charges he made in his letter to the Board.

II. CONTENTIONS

A. *Derivative Fiduciary Duty Claims*

Count I of the Amended Complaint alleges breaches of fiduciary duty against McMinn, Shapero, Marshall, Lynch, Hawk, and Knowling for allowing McMinn's founders' shares to vest. The Defendants respond that the Plaintiffs' claim is time-barred and that this decision is protected by the business judgment rule.

Count II of the Amended Complaint charges McMinn, Shapero, and Crosspoint with breaching their fiduciary duties by usurping a Covad corporate opportunity in founding, and investing in Series A Preferred shares of, Certive. The Defendants argue that this claim is time-barred, that it was properly rejected by a majority of disinterested and independent directors, and that the Plaintiffs have not properly alleged that pre-suit demand upon the Board would have been futile. Additionally, Crosspoint argues that this claim should be dismissed because the Plaintiffs do not sufficiently allege that Crosspoint owed fiduciary duties to Covad's shareholders.

Count III of the Amended Complaint alleges breaches of fiduciary duty by McMinn, Shapero, Hawk, Lynch, Marshall, and Knowling during Covad's acquisition of a substantial equity interest in Certive. The Plaintiffs assert that some of these directors were interested in the transaction and that the investment was detrimental to Covad's shareholders. The Plaintiffs contend that the investment constituted corporate waste. The Defendants respond that the Plaintiffs' claims surrounding the Certive investment are time-barred, that there was no breach of a duty of loyalty because the transaction was approved by a majority of disinterested and independent directors, that the Plaintiffs' claim for breach of fiduciary duty for failure to seek restitution for the Certive investment fails as a matter of law, and that pre-suit demand is not excused.

Count IV of the Amended Complaint asserts a claim against McMinn, Shapero, Hawk, Lynch, Marshall, Dunn, Knowling, Runtagh, and Irving for breaches of fiduciary duty with respect to the two BlueStar transactions (the acquisition and the earn-out settlement). The Defendants assert that this claim is time-barred and that the Plaintiffs have not shown that a majority of the directors who approved these transactions were interested or lacked independence.

Count V of the Amended Complaint alleges breaches of fiduciary duty by McMinn, Shapero, Hawk, Lynch, Marshall, Hoffman, Runtagh, and Irving for the Dishnet transaction. The Defendants contend that the Dishnet settlement was approved a majority of disinterested and independent directors.

***10** In addition, the Defendants assert that the Plaintiffs have failed to plead a proper claim for waste. Moreover, the Director Defendants have attempted to invoke the exculpatory provision adopted in Covad's Amended and Restated Certificate of Incorporation under 8 *Del.C.* § 102(b)(7), which would shield them from personal liability for money damages based on any breach of the duty of care.

Count VI of the Amended Complaint asserts a derivative claim against Crosspoint for aiding and abetting Covad's directors in breaching their fiduciary duties in the Certive and BlueStar transactions. Crosspoint argues that the Plaintiffs do not sufficiently plead an underlying breach of fiduciary duty (so there can be no secondary liability) and that the Plaintiffs failed to plead that Crosspoint knowingly participated in any breach of duty.

Count VII of the Amended Complaint seeks to set forth a claim against Crosspoint under the doctrine of *respondeat superior.* The Plaintiffs allege that Shapero and Hawk-acting as Crosspoint's agents-caused harm to Covad by orchestrating the Certive and BlueStar transactions. Crosspoint responds the Plaintiffs have failed to plead an underlying breach of fiduciary duty for the Certive and BlueStar transactions and that the Plaintiffs' *respondeat superior* claim fails as a matter of law.

B. *Demand on the Board and Demand Futility*

The Defendants also contend that Khanna's letter to the Board was a demand on Covad's Board and the Plaintiffs have not set forth facts that show that the demand was wrongfully rejected. Furthermore, the Defendants contend that, even if Khanna did not make a demand on Covad's Board, the Plaintiffs have not set forth facts demonstrating that demand would have been futile and, thus, all derivative claims must be dismissed. The Plaintiffs respond that Khanna's letter to the Board was not a demand and that they have indeed pleaded facts showing that demand on Covad's Board would have been futile and, therefore, that demand should be excused.

C. *Direct Claims for Breach of Fiduciary Duty with regard to Covad's 2002, 2003, and 2004 Proxy Statements* FN44

FN44. The Plaintiffs do not allege that the board elections were contested.

Count VIII of the Amended Complaint is a direct claim against McMinn, Shapero, Hawk, Lynch, Marshall, Irving, Hoffman, and Runtagh for breaches of fiduciary duty resulting from material omissions in Covad's 2002 Proxy Statement. In 2002, McMinn, Hawk, and Hoffman were reelected to the Covad Board. The Plaintiffs allege that 2002 Proxy Statement did not disclose certain information-*e.g.*, Khanna's June 19, 2002 letter to the Board, the Standstill Agreement,FN45 the real reasons for Khanna's termination, that the BlueStar earn-out criteria had not been met, and that McMinn was working for Certive in 1999-and that these omissions were material to shareholders. The Defendants argue that the Plaintiffs' claim is barred by laches and that Covad satisfied its disclosure obligations.

FN45. Covad and Khanna entered into the “Standstill Agreement” which allowed for "confidential settlement discussions" during the period of July 10, 2002 through July 23, 2002. *Id.* at ¶ 116. This period was subsequently extended through July 26, 2002. Under the Standstill Agreement, the parties agreed that "[d]uring the Negotiating Period, neither party shall take any actions to advance, or that will have the effect of advancing, its litigation position, and they shall diligently and vigorously focus their attention on resolving the disputes among them." *Id.*

Counts IX and X concern Covad's 2003 and 2004 Proxy Statements. In 2003, Lynch, Irving, and Jalkut were reelected to the Covad Board; and in 2004, Crandall and Runtagh were reelected. The Plaintiffs allege that certain information was either inadequately disclosed or entirely omitted-Khanna's June 19, 2002 letter, the real reasons for Khanna's termination from Covad, that the BlueStar earn-out criterion had not been met, and which transactions and directors Khanna was challenging-and that these omissions were material to shareholders. Again, the Defendants argue that the Plaintiffs' claims are barred by laches and that Covad satisfied its disclosure requirements.

D. *Motion to Disqualify Plaintiffs*

***11** Covad contends that Khanna must be disqualified as a representative plaintiff because (1) Khanna's ethical duties, as Covad's former General Counsel, prevent him from pursuing this litigation; (2) he is barred from pursuing litigation against his former client on matters with which he had a "substantial relationship"; (3) he participated, or at least acquiesced, in the challenged transactions; and (4) he has a personal agenda against the Defendants separate from Covad shareholders. Khanna denies all of these allegations. Additionally, Covad contends that Sams and Meisel must be disqualified because they have been "tainted" by exposure to Khanna's privileged information and because they are not the "driving force" behind this litigation.

E. *Motions to Strike Portions of the Amended Complaint-Motions to Seal/Unseal the Record*

Covad contends that Paragraphs 52, 54, 55, and 57 of the Amended Complaint should be stricken because they disclose privileged information in violation of Khanna's attorney-client duties. Khanna argues that these paragraphs should not be stricken because the information is public information gained from the § 220 proceeding and, with regard to paragraph 52, because Covad waived any privilege it may have had by introducing its facts as evidence at the § 220 trial.

Comparable arguments regarding privilege are made in the competing motions to seal and unseal the record.[FN46] In addition to the challenges presented above, Covad argues that Paragraphs 43, 44, and 74 of the Amended Complaint should remain sealed because they contain confidential and sensitive information.

FN46. Plaintiffs have moved to unseal the record, in addition to Covad's motion for continued sealing of portions of the record.

III. DEMAND FUTILITY

The Plaintiffs seek to assert multiple derivative claims on behalf of Covad. The Court must first inquire as to whether demand was made on Covad's Board. If it was not, the Court must then determine whether demand is excused.

A. *Legal Standard for Demand Futility*

"A shareholder's right to bring a derivative action does not arise until he has made a demand on the board of directors to institute such an action directly, such demand has been wrongfully refused, or until the shareholder has demonstrated, with particularity, the reasons why pre-suit demand would be futile."[FN47] This requirement, found in Court of Chancery Rule 23 .1,[FN48] arises from the fundamental principle that the board of directors manages the business and affairs of a corporation, including decisions of whether to bring suit on behalf of the corporation.[FN49] In order to bring a derivative claim, a plaintiff "must overcome the powerful presumptions of the business judgment rule...."[FN50]

Indeed, "[t]he key principle upon which this area of our jurisprudence is based is that the directors are entitled to a *presumption* that they were faithful to their fiduciary duties." FN51 "By its very nature the derivative suit impinges on the managerial freedom of directors." FN52 As a consequence, Court of Chancery Rule 23.1 imposes on a plaintiff a pleading burden that is "more onerous" than the burden a plaintiff must satisfy when confronted with a motion to dismiss under Court of Chancery Rule 12(b)(6).FN53

FN47. *Ash v. McCall,* 2000 WL 1370341, at *6 (Del. Ch. Sept. 15, 2000).

FN48. CT. CH. R. 23.1 ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

FN49. *See* 8 *Del.C.* § 141; *see also* *White v. Panic,* 793 A .2d 356, 363 (Del. Ch.2000), *aff'd,* 783 A.2d 543 (Del.2001).

FN50. *Rales v. Blasband,* 634 A.2d 927, 933 (Del.1993). This Court has previously explained that

> [t]he purpose for the demand requirement and concomitant heightened pleading standard is to "effectively distinguish between strike suits motivated by the hope of creating settlement leverage through the prospect of expensive and time-consuming litigation discovery and suits reflecting a reasonable apprehension of actionable director malfeasance that the sitting board cannot be expected to objectively pursue on the corporation's behalf."

White, 793 A.2d at 364 (quoting DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 9-2(b)(3)(i), at 554 (1998)); *see also* *Beam v. Stewart,* 845 A.2d 1040, 1050 (Del.2004).

FN51. *Beam,* 845 A.2d at 1050 (citing *Aronson v. Lewis,* 473 A .2d 805, 812 (Del.1984), *overruled on other grounds,* *Brehm v. Eisner,* 746 A.2d 244, 254 (Del.2000)).

FN52. *Aronson,* 473 A.2d at 811. "The hurdle of proving demand futility also serves an important policy function of promoting internal resolution, as opposed to litigation, of corporate disputes and grants the corporation a degree of control over any litigation brought for its benefit." *Rattner v. Bidzos,* 2003 WL 22284323, at *7 (Del. Ch. Sep. 30, 2003) (citations omitted).

FN53. *Levine v. Smith,* 591 A.2d 194, 207 (Del.1991), *overruled on other grounds,* *Brehm,* 746 A.2d at 254.

***12** As this Court has previously explained, depending on the circumstances, inquiry into whether demand is excused proceeds under either *Aronson v. Lewis* FN54 or *Rales v. Blasband.*FN55

FN54. 473 A.2d 805 (Del.1984).

FN55. 634 A.2d 927 (Del.1993).

> Under the two-pronged *Aronson* test, demand will be excused if the derivative complaint pleads particularized facts creating a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." As the Supreme Court stated in *Rales* ..., however, there are three circumstances in which the *Aronson* standard will not be applied: "(1) where a business decision was made

by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where ... the decision being challenged was made by the board of a different corporation." In those situations, demand is excused only where "particularized factual allegations ... 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." FN56

FN56. *In re Bally's Grand Deriv. Litig.,* 1997 WL 305803, at *3 (Del. Ch. June 4, 1997) (footnotes omitted). See also the Court's discussion at Part III(C)(2), *infra*, addressing analysis of "substantial threat[s] of personal liability" for directors applicable under *Rales* in certain circumstances.

In other words, if the pleadings present particularized "facts sufficient to create a reasonable doubt that ... a majority of the directors are disinterested and independent," FN57 then demand will be excused under either the test in *Rales* or the first prong of *Aronson.*

FN57. *White,* 793 A.2d at 364. The burden of demonstrating demand futility lies with the Plaintiffs. *See Aronson,* 473 A.2d at 812.

Disinterested "means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." "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." FN58

FN58. *In re J.P. Morgan Chase & Co.,* 2005 WL 1076069, at *8 (Del. Ch. Apr. 29, 2005) (quoting *Aronson,* 473 A.2d at 812, 816), *aff'd,* 2006 WL 585606 (Del. Mar. 8, 2006); *see also Beam,* 845 A.2d at 1049; *Rales,* 634 A.2d at 936.

If, however, the Court's "review of the complaint reveals that it does not allege with particularity facts from which the court could reasonably conclude" that at least half "of the directors in office when the complaint was filed were disabled from impartially considering a demand," then the plaintiff's derivative claim will be dismissed-unless the second prong of *Aronson* applies and is satisfied. FN59

FN59. *Highland Legacy Ltd. v. Singer,* 2006 WL 741939, at *1 (Del. Ch. Mar. 17, 2006); *see also Beneville v. York,* 769 A.2d 80, 86 (Del. Ch.2000) (describing analysis where half of board compromised).

"At the motion to dismiss stage of the litigation, '[p]laintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences.' " FN60 The Court "need not blindly accept as true all allegations, nor must [it] draw all inferences from them in plaintiffs' favor unless they are reasonable inferences." FN61 Pleading with particularity is essential for a plaintiff to satisfy the requirements of demand excusal. Indeed, such "pleadings must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings governed solely by Chancery Rule 8(a)." FN62 The Court must, however, "accept as true all well-pled allegations of fact in the complaint, and all reasonable inferences from non-conclusory allegations contained in the complaint must be drawn in favor of the plaintiff." FN63

FN60. *White v. Panic,* 783 A.2d 543, 549 (Del.2001) (citations omitted); *see also Kahn v. Roberts,* 1994 WL 70118, at *5

(Del. Ch. Feb. 28, 1994) ("Conclusory allegations of domination and control, without particularized facts showing that an individual person or entity interested in the transaction controlled the board's vote on the transaction, are insufficient to excuse pre-suit demand.").

FN61. *White,* 783 A.2d at 549 (citation omitted).

FN62. *Brehm,* 746 A.2d at 254 ("What the pleader must set forth are particularized factual statements that are essential to the claim. Such facts are sometimes referred to as 'ultimate facts,' 'principal facts' or 'elemental facts." ' (citations omitted)).

FN63. *Rattner,* 2003 WL 22284323, at *7 (citing *Grobow v. Perot,* 539 A.2d 180, 187 (Del.1988), *overruled on other grounds, Brehm,* 746 A.2d at 254).

B. *Khanna's Letter Was Not a Demand to Covad's Board*

***13** Before proceeding to demand futility analysis, the Court must first ascertain whether Khanna's letter of June 19, 2002, constituted a demand on the Covad Board. By making demand on a board of directors, a plaintiff concedes the disinterestedness and independence of that board.[FN64] It is then left to the board to determine whether to pursue litigation. A plaintiff's only recourse, in that circumstance, would be to demonstrate that demand was wrongfully rejected, but, as with any board decision, rejection of shareholder demand is afforded the presumptions of the business judgment rule.[FN65]

FN64. *See, e.g., Scattered Corp. v. Chicago Stock Exchange, Inc.,* 701 A.2d 70, 73 (Del.1997) (quoting *Levine,* 591 A.2d at 197-98).

FN65. *Id.*

In determining whether Khanna's June 19, 2002, letter to the Board was a demand, the Court cannot look for "magic words" establishing that a communication is a demand for purposes of Court of Chancery Rule 23.1.[FN66]

FN66. *See Yaw v. Talley,* 1994 WL 89019, at *7 (Del. Ch. Mar. 2 1994) ("There is no all-inclusive legal formula defining what types of communications will constitute a demand. That determination is essentially fact-driven.").

To constitute a demand, a communication must specifically state: (i) the identity of the alleged wrongdoers, (ii) the wrongdoing they allegedly perpetrated and the resultant injury to the corporation, and (iii) the legal action the shareholder wants the board to take on the corporation's behalf. Those elements are consistent with and derive from the policies underlying the demand requirement.[FN67]

FN67. *Id.*

The burden of demonstrating that a communication was a demand lies with the party alleging that the communication should be viewed as such.[FN68]

FN68. *See id.* ("Policy considerations require that the burden lie with the party asserting that a demand was made, and that ambiguous communications be construed against a finding of a demand.").

In this instance, the Defendants contend that the June 19, 2002, letter from Khanna's attorney [FN69] constituted a demand. The letter clearly meets the first two requirements of a demand: it identified the alleged wrongdoers and the harm they caused Covad. The issue, then, is whether the letter identified "the legal action the shareholder wants the board to take on the corporation's behalf." [FN70] Covad argues that the letter can be "fairly construed [to give] rise to the inference that Khanna was demanding the Board take legal action on the corporation's behalf" [FN71] and cites, in particular, to various requests (or, in the Defendants' view, demands) made by Khanna in the letter, such as his reinstatement as General Counsel and his appointment to Covad's Board.FN72

FN69. JTX 123.

FN70. *Yaw,* 1994 WL 89019, at *7 (emphasis added).

FN71. Reply Mem. in Supp. of Covad Commc'ns Group, Inc.'s Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Covad Reply Br. to Dismiss") at 3.

FN72. JTX 123, at 11-12.

Though it is not a question free from doubt, the Court rejects Defendants' argument for the following reasons. First, the Defendants bear the burden of establishing that demand was, in fact, made, and any ambiguity must be construed against a finding of demand. Second, the remedial actions sought by Khanna related to his removal as Covad's General Counsel and his future employment status at Covad. The relief would have been for his personal benefit; it would have accomplished little (or nothing) for the shareholders. The transactions challenged in this litigation are related, at most, tangentially to his termination dispute. In other words, the remedies Khanna sought in the letter addressed directly his claimed wrongful suspension and likely termination, and the letter cannot fairly be read as an attempt to seek a remedy for the challenged transactions for the good of Covad or its shareholders. FN73

FN73. This question is complicated by transmission of a draft complaint. *See* Amended Compl. at ¶ 123; JTX 124. Although the transmission of a draft complaint, along with other communications, has been previously held not to constitute demand, *see* *Yaw,* 1994 WL 89019, at *6-*8, the aggregate here draws near the threshold of demand status.

***14** Covad points out language in the letter-for example, the threat to "light a legal fuse" FN74-that could be read as an expansive threat to seek a remedy for every wrong alleged in the letter and that the remedies Khanna sought, while inadequate to "make whole" the shareholders at large, nonetheless were the remedies Khanna chose. A far more plausible reading of the letter, however, is that the remedies Khanna sought were, as the letter's opening sentence provides, "relat[ed] to his removal from the position of General Counsel of Covad." FN75 Ambiguity of this sort must be resolved in favor of Khanna (*i.e.*, the party not seeking to show that the letter was a demand). Therefore, the Court concludes that Khanna's June 19, 2002, letter did not constitute demand upon the Covad Board . FN76

FN74. JTX 123 at 12.

FN75. *Id.* at 1.

FN76. Covad also argues that the letter constituted demand because "[t]he Board did exactly what it was required to do upon receiving a pre-lawsuit demand" and notes that "Khanna was an active and willing participant in the investigation." Covad Reply Br. to Dismiss, at 4. Although this may be true, the Board's interpretation of what the letter represented does not control the Court's determination of whether it was a demand.

C. *Plaintiffs' Failure to Allege with Particularity that the Covad Board was Interested or Lacked Independence*

The Court now turns to the question of whether at least half of the Covad Board was either interested or lacked independence when this action was filed. FN77 The Court's demand-futility analysis here is somewhat complicated by the relatively long time-span during which the challenged transactions took place and by turnover in the membership of Covad's Board. A majority of Covad's Board changed after the events surrounding Counts II and III and, probably, Count I. Additionally, the

Plaintiffs bring Count I (the vesting of McMinn's founders' shares) on the theory that it was result of board inaction-*i.e.,* that no business decision was made. The parties agree, therefore, that demand-futility with respect to the Certive Claims must be analyzed under *Rales.* FN78 A majority of the Covad board has *not* changed, however, since the events surrounding Counts IV and V (*i.e.,* the "BlueStar Claims" and the "Dishnet Claims," respectively); therefore, the Court employs the two-prong standard of *Aronson* with respect to these claims.

FN77. *See, e.g., Brehm,* 746 A.2d at 257; *see also Highland Legacy Ltd.,* 2006 WL 741939, at *4; *In re Nat'l Auto Credit, Inc. S'holders Litig.,* 2003 WL 139768, at *8 (Del. Ch. Jan. 10, 2003); *Cal. Pub. Employees' Ret. Sys. v. Coulter,* 2002 WL 31888343, at *10 (Del. Ch. Dec. 18, 2002); *In re Bally's Grand,* 1997 WL 305803, at *3. *Cf.* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 9-2[b], at 9-75 to -76, 9-78 (2005), (considering which "Board"-at the time of suit or the time of the transaction-must be evaluated under *Aronson*).

FN78. *See Rales,* 634 A.2d at 934. With respect to Count I, the Amended Complaint fails to allege the date of the vesting of the disputed Covad shares: *Rales,* in one form or another, will control. *See, e.g.,* Pls.' Ans. Br. in Opp'n to Covad Commc'ns Group, Inc.'s Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Pls.' Ans. Br. to Covad's Mot. to Dismiss") at 30; Covad Reply Br. to Dismiss at 9; Pls.' Ans. Br. in Opp'n to Dir. Defs. Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Pls.' Ans. Br. to Dirs.' Mot. to Dismiss") at 31. *But cf. In re Bally's Grand,* 1997 WL 305803, at *3-*4 (declining to examine demand futility because complaint failed to identify directors on board at filing).

"Demand futility [will] be determined solely from the well-pled allegations of the Complaint." FN79 This analysis is fact-intensive and proceeds director-by-director and transaction-by-transaction. FN80 The Covad Board, at the time of filing of this action, consisted of eight directors: Irving, Jalkut, Lynch, Crandall, Runtagh, Hawk, Hoffman, and McMinn. FN81 If the Court concludes that the Plaintiffs failed in their efforts to allege that at least four of the directors were not disinterested and independent for demand purposes, then the Court's analysis with respect to *Rales* and the first-prong of *Aronson* is at an end.

FN79. *In re Cooper Co., Inc.,* 2000 WL 1664167, at *5 (Del. Ch. Oct. 31, 2000).

FN80. *See, e.g., Beam,* 845 A.2d at 1051 (explaining that review occurs on a "case-by-case basis").

FN81. As explained below, consideration of Jalkut does not prejudice the Plaintiffs. *See* Part III(C)(5), *infra.*

As a preliminary matter, the Court notes that the Amended Complaint repeatedly sets forth certain generalized, conclusory allegations. In the interest of efficiency, the Court examines these now. Demand-futility jurisprudence often recites that certain allegations cannot "without more," or "standing alone," satisfy the particularized pleading requirements of Court of Chancery Rule 23.1. These conclusory allegations add no, or only *de minimis,* substance to the Court's demand-futility inquiry; they are to be distinguished from substantive allegations that are, by themselves, insufficient but, when viewed *in toto,* may push the analysis over the threshold of "reasonable doubt" and thereby excuse demand.

***15** First, the Plaintiffs repeatedly allege that the Covad Board is McMinn (and/or Shapero) "dominated," or some variant thereof.FN82 Indeed, the Plaintiffs' theory as to why demand is excused appears, at times, to hinge largely on this characterization. The Plaintiffs have not, however, alleged that McMinn is a controlling shareholder, and, even if he were, "[t]here must be coupled with the allegation of control such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person." FN83 Whether McMinn (or any other director) "dominates" the Covad Board is a question that must be resolved director-by-director, based on particularized allegations of fact. "Independence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?" FN84 Conclusory, across-the-board allegations of a lack of independence will not prevail; allegations of this type are akin to the "shorthand shibboleth" which this Court has long-rejected. FN85

FN82. *See, e.g.,* Amended Compl. at ¶¶ 32, 40, 138.

FN83. *Aronson,* 473 A.2d at 815; *see also Beam,* 845 A.2d at 1050.

FN84. *Beam,* 845 A.2d at 1049-50; *see also Highland Legacy, Ltd .,* 2006 WL 741939, at *5 ("There must be some alleged nexus between the domination and the resulting personal benefit to the controlling party." (citing *Aronson,* 473 A.2d at 816)).

FN85. *See, e.g., Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *7; *see also* WOLFE & PITTENGER, *supra* note 77, § 9-2[b], at 9-57, 9-69 to -72.

Second, the Amended Complaint repeatedly alleges that McMinn (or another director) "recruited" certain individuals to be Covad directors, that those individuals took their seats at McMinn's (or others') "behest," and that those individuals became directors with the other directors' "consent and approval." FN86 Again, conclusory allegations of this nature do not advance the Court's inquiry; they will not "sterilize" a director's judgment with respect to demand.FN87 "The proper focus is the care, skill and diligence used by the directors in making the challenged decision rather than upon the way in which the directors obtained their seats in the boardroom." FN88 "Directors must be nominated and elected to the board in one fashion or another," FN89 and to hold otherwise would unnecessarily subject the independence of many corporate directors to doubt. Conclusory allegations of this type do not cast suspicion on the independence of directors without additional facts demonstrating reason to view the nomination process askance. As a consequence, such allegations, "without more," are of little assistance in view of the requirement for particularity- and the "piling-on" of more and similar conclusory allegations will not sum to a reasonable doubt.

FN86. *See, e.g.,* Amended Compl. at ¶¶ 15-17.

FN87. *See Aronson,* 473 A.2d at 816. *See also White,* 793 A.2d at 366; *Benerofe v. Cha,* 1996 WL 535405, at *7 (Del. Ch. Sept. 12, 1996); *cf. In re W. Nat'l Corp. S'holders Litig.,* 2000 WL 710192, at *15 (Del. Ch. May 22, 2000) (applying summary judgment standard).

FN88. *Emerald Partners v. Berlin,* 1993 WL 545409, at *4 (Del. Ch. Dec. 23, 1993) .

FN89. *In re W. Nat'l Corp.,* 2000 WL 710192, at *15.

Third, the Amended Complaint sets forth the repeated incantation that the directors' lack of independence is demonstrated by their "pattern" of votes and "acquiescence" in permitting McMinn and others to benefit from self-dealing transactions. FN90 The complaint fails either to explain, in most instances, how the directors' alleged acquiescence benefited them (other than possibly as addressed in the next paragraph) FN91 or to set forth particularized facts showing a pattern of votes (in addition to the few challenged transactions) from which the Court could draw a reasonable inference.FN92

FN90. *See* Amended Compl. at ¶¶ 14-16, 139.

FN91. *Cf. In re eBay, Inc. S'holders Litig.,* 2004 WL 253521, at *4-*5 (Del. Ch.2004).

FN92. *See, e.g., Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *7, *9; *Beam v. Stewart,* 833 A.2d 961, 981 (Del. Ch.2003), *aff'd,* 845 A.2d 1040 (Del.2004). *Cf. Brehm,* 746 A.2d at 257 n. 34.

> Although there may be instances in which a director's voting history would be sufficient to negate a director's presumed independence, routine consensus cannot suffice to demonstrate disloyalty on the part of a director. To conclude otherwise would simply encourage staged disagreements and nonunanimous decisions for the sake of nonunanimous decisions in the boardroom.

***16** Fourth, the Amended Complaint alleges, repeatedly, that the directors "derived the benefit of being and remaining on the Board of Directors of, and receiving compensation from, Covad...." FN93 The Plaintiffs then conclusorily allege that the price of these "benefits" was the directors' support for the "self-dealing" occurring at Covad.FN94 As with the allegations described above, the mere fact that a director receives compensation for her service as a board member adds little or nothing to demand-futility analysis, "without more" FN95 -*i.e.,* unless the pleadings demonstrate, for example, that the status or compensation was somehow "material" to the director or otherwise outside the norm.

FN93. *See* Amended Compl. at ¶¶ 14-17.

FN94. *See id.*

FN95. *See, e.g., Grobow,* 539 A.2d at 188; *cf. Highland Legacy Ltd.,* 2006 WL 741939, at *5; *White,* 793 A.2d at 366 (addressing allegations involving normal fees and compensation).

Finally, the Amended Complaint sets forth numerous allegations of various social and business ties among members of the Covad Board.FN96 With the exception of Lynch, however, as discussed in some detail below, the Plaintiffs' allegations amount to no more than the equivalent of a simple assertion that demand should be excused due to "structural bias." As explained in *Beam v. Stewart,* FN97 "to render a director unable to consider demand, a relationship must be of a bias-producing nature. Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence." FN98 The Court's analysis in *Beam* was primarily directed at social relationships, but it also may inform the evaluation of allegations of business relationships, as well: "Whether they arise before board membership or later as a result of collegial relationships among the board of directors, such affinities-standing alone-will not render pre-suit demand futile." FN99 Although not all allegations of past or present social or business relationships may be lumped in the category of allegations that provide no grist for the mill of demand-futility inquiry, the heightened strength of relationship required to find that a director's "discretion would be sterilized" renders allegations concerning most ordinary relationships of limited value, at most.FN100

FN96. *See* Amended Compl. at ¶¶ 13-14.

FN97. 845 A.2d 1040 (Del.2004).

FN98. *Id.* at 1051.

FN99. *Id.; see also Jacobs v. Yang,* 2004 WL 1728521, at *5-*6, *7 (Del. Ch. Aug. 2, 2004), *aff'd,* 867 A.2d 902 (Del.2005) (TABLE) (citing *Orman v. Cullman,* 794

A.2d 5, 27 n. 33 (Del. Ch.2002) ("The naked assertion of previous business relationships is not enough to overcome the presumption of a director's independence.")); *Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *9.

FN100. *See, e.g., Beam,* 845 A.2d at 1050-52; *see also* Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared,* 44 BUS. LAW. 503, 534-35 (1989).

Having examined the repeated, conclusory allegations that comprise too much of the Amended Complaint, the Court now begins a director-by-director (and, as necessary, transaction-by-transaction) inquiry into the specific, substantive allegations of the Amended Complaint relevant to demand excusal.[FN101]

FN101. It should be noted that, in several instances during the course of analysis, the Court identifies facts that the Plaintiffs did not plead in their attempt to obtain demand excusal. This is not intended to set forth a requirement that each of the absent facts be pleaded in order that demand be excused; on the contrary, the Court's intent is only to point out facts that, if alleged, could significantly increase the likelihood of a finding of interestedness or lack of independence.

1. *Crandall*

The Amended Complaint, on its face, fails to create a reasonable doubt as to the disinterestedness or independence of Crandall. Crandall was only appointed to the Covad Board on June 20, 2002, after the challenged transactions took place.[FN102] While this does not, alone, make demonstration of potential interest or lack of independence impossible, it does make the Plaintiffs' burden more difficult. Indeed, the Amended Complaint may be read to concede Crandall's disinterestedness and independence. The complaint does not list Crandall as among the seven members of the Covad Board who are alleged either to be interested or lack independence.[FN103]

FN102. Amended Compl. at ¶ 19. Nowhere in the Amended Complaint is Crandall alleged to have been interested in any of the transactions in question.

FN103. *See* Amended Compl. at ¶¶ 137, 140; *see also* CT. CH. R. 23.1 (requiring that complaint "allege with particularity ... the reasons ... for not making [demand]").

***17** The Plaintiffs, in their answering brief, however, assert for the first time that Crandall's independence is compromised by his ties to BEA Systems, a Covad vendor.[FN104] The Plaintiffs explain that Crandall is a member of the board of directors of BEA Systems, a supplier of software and related support that received in excess of $2.2 million in revenue from Covad in 2004. The Plaintiffs make no mention of BEA Systems in the Amended Complaint;[FN105] nevertheless, they now ask the Court to consider this information on the grounds that it is contained in Covad's 2004 Proxy, which is referenced in their brief with respect to the Plaintiffs' proxy disclosure claims.[FN106] Although the Court is skeptical that this constitutes a proper means of asserting by way of a *well-pleaded complaint* particularized facts within the meaning of Court of Chancery Rule 23.1,[FN107] the parties may refer to the substance of certain documents if those documents are "integral to plaintiffs' claims and incorporated in the complaint."[FN108] Here, the proxy statement was "integral" to the disclosure claims, not to assertions regarding Crandall's independence. To evaluate fully the Plaintiffs' claims, the Court will consider Crandall's ties to BEA Systems in analyzing his independence, as well.

FN104. Pls.' Ans. Br. to Covad's Mot. to Dismiss at 34.

FN105. *See* Amended Compl. at ¶ 19.

FN106. *See* Calder Decl., Ex. E (Covad's 2004 Proxy Statement).

FN107. A plaintiff for whom demand will be excused should be capable of demonstrating demand futility by recourse solely to the particularized facts alleged in the complaint. *Cf. Kaplan v. Peat, Marwick, Mitchell & Co.,* 540 A.2d 726, 727-28 (Del.1988) ("When deciding a motion to dismiss for failure to make a demand under Chancery Rule 23.1 the record before the court must be restricted to the allegations of the complaint.").

FN108. *Saito v. McCall,* 2004 WL 3029876, at *1 n. 9 (Del. Ch. Dec. 20, 2004). *Cf. In re Gen. Motors (Hughes) S'holder Litig.,* 2006 WL 722198, at *3 (Del. Mar. 20, 2006) (describing extent to which a court may consider matters outside complaint on motion to dismiss under Rule 12(b)(6)).

Ultimately, the inquiry into independence turns in this instance on whether Covad's business relationship with BEA Systems was material to BEA or to Crandall himself as a director of BEA.FN109 The 2004 Proxy merely reports that Crandall is a member of the BEA Systems board of directors and the amounts Covad paid for the firm's products and services. These facts, standing alone, are insufficient to cast reasonable doubt on Crandall's independence for demand purposes.FN110 The Court cannot discern whether the revenue from Covad is material to either BEA Systems or to Crandall because of his relationship with BEA Systems.FN111 Neither the terms of BEA Systems' relationship with Covad (*e.g.,* whether the companies have entered into a long-term contract), nor particularized facts supporting the Plaintiffs' conclusory statement in their brief that BEA Systems' business with Covad could be "taken away" FN112 by McMinn and others, are provided.FN113 Moreover, no allegation has been made that Crandall's responsibilities to BEA Systems include managing the firm's relationship with Covad; nor could the Court conclude that Crandall has a financial interest in BEA, other than possibly an unspecified director's salary, which might influence his decisions. FN114 Put simply, even considering Crandall's ties to BEA Systems, the Plaintiffs have not alleged particularized facts sufficient to demonstrate that Crandall independent discretion would be compromised.FN115

FN109. *See, e.g., Jacobs,* 2004 WL 1728521, at *6.

FN110. *See id; see also Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *9.

FN111. *See Jacobs,* 2004 WL 1728521, at *6.

FN112. Pls.' Ans. Br. to Covad's Mot. to Dismiss at 34.

FN113. These statements are too conclusory to demonstrate that particular interested Covad directors "have the authority or ability to cause [Covad] to terminate its relationships with the companies." *Jacobs,* 2004 WL 1728521, at *6.

FN114. *See id.*

FN115. *See id.* ("[T]he existence of contractual relationships with companies that directors are affiliated with potentially makes the board's decision more difficult, 'but it does not sterilize the board's ability to decide." ' (citation omitted)).

2. *Runtagh*

Similarly, the Plaintiffs fail to create a reasonable doubt as to Runtagh's disinterestedness and independence. The Plaintiffs' principal claim is that Runtagh lacks independence because "[s]he became a director with the consent and approval of the McMinn-Shapero director appointees" FN116 and "derived the benefits of being and remaining on the Board of Directors of, and receiving compensation from, Covad by supporting and favoring the self-dealing of other directors in the BlueStar and Dishnet transactions." FN117 As explained above, these bare allegations are insufficient to negate Runtagh's presumed independence.

FN116. Amended Compl. at ¶ 15.

FN117. *Id.* Similarly, the Court rejects the Plaintiffs' conclusory allegation that Runtagh "acquiesced knowingly in ... McMinn's breach of duty." *Id.* at ¶¶ 93, 139. *See Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *9 ("Our cases have determined that personal friendships, without more; outside business relationships, without more; *and approving of or acquiescing in the challenged transactions, without more,* are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment.") (emphasis added)).

***18** Interestingly, the Plaintiffs also allege that Runtagh has a "disabling interest" that was "acknowledged" by the Covad Board in its resolution creating the special committee to investigate the claims made by Khanna in his June 19, 2002 letter to the Covad Board . FN118 The Plaintiffs quote the resolution, which provides: "Mr. Crandall shall have the authority to act alone in the event that, in his sole judgment, an alleged material conflict of interest arises with respect to Ms. Runtagh." FN119 This short statement, however, cannot be construed as an admission by the Board, cannot satisfy demand-futility's pleading with particularity requirement, and does not permit a *reasonable* inference of interestedness or lack of independence. FN120

FN118. Amended Compl. at ¶¶ 125, 137. The Plaintiffs allege that "Defendant Runtagh ... has a disabling interest, which was acknowledged by defendants in their resolutions constituting the Committee." *Id.* at ¶ 137.

FN119. *Id.* at ¶ 125.

FN120. *See White,* 783 A.2d at 549 (The Court "need not blindly accept as true all allegations, nor must [it] draw all inferences from them in plaintiffs' favor unless they are reasonable inferences ." (citation omitted)).

Because Count I of the Amended Complaint (the vesting of McMinn's founders' shares) may be analyzed under *Rales* for having resulted from board inaction, one additional issue must be considered with respect to Runtagh's capacity to consider demand: whether she faces a "substantial likelihood" of personal liability resulting from the vesting of McMinn's shares. FN121 As the Court in *David B. Shaev Profit Sharing Account v. Armstrong,* FN122 explained: "Most notably in *In re Caremark Int'l Inc. Derivative Litigation,* and then in other cases ... this court has taken cognisance of allegations that the directors failed to act when they otherwise should have done so." FN123 When analyzing demand futility under *Rales* where no board action was taken, FN124 the Court looks not only to whether directors are disinterested and independent for demand purposes, but also to whether directors "face a substantial likelihood of personal liability, because doubt has been created as to whether their actions were products of a legitimate business judgment." FN125 A "mere threat of personal liability," however, is insufficient in this context. FN126

FN121. As discussed below, the Court considers whether a director considering demand faces a "substantial threat" of personal liability arising from the alleged wrongful acts-with a finding of a "substantial threat" resulting in reasonable doubt as to the capacity of that director to consider demand. *See, e.g., David B. Shaev Profit Sharing Account v. Armstrong,* 2006 WL 391931, at *4 (Del. Ch. Feb. 13, 2006) ; *Guttman,* 823 A.2d at 501. This analysis would perhaps apply equally, for example, in analyzing the disinterestedness of current directors who participated in the alleged wrongful conduct, *see Rales,* 634 A.2d at 936, even though a majority of board has "flipped." The confusion, here, lies in the fact that the Court cannot determine from the Amended Complaint whether Runtagh was a member of the Covad Board at the time the vesting challenged in Count I occurred-and, therefore, is unable to determine with confidence whether the *Rales* analysis proceeds under the first or second *Aronson* exception. *See Rales,* 634 A.2d at 934. As a consequence, the Court's analysis addresses both scenarios. The Court need not address these considerations for Board members other than Runtagh, however, because, with respect to Counts II and III, it is clear that a majority of the current Board members both did not participate in the underlying acts and have been determined otherwise to be disinterested and independent.

FN122. *Shaev,* 2006 WL 391931 (Del. Ch. Feb. 13, 2006).

FN123. *Id.* at *4 (citing *In re Caremark Int'l Inc. Deriv. Litig.,* 698 A.2d 959 (Del. Ch.1996)).

FN124. *Compare supra* note 121.

FN125. *Id.* (citing *Guttman,* 823 A.2d at 501).

FN126. *See Rales,* 634 A.2d at 936 ("[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors ....“ (quoting *Aronson,* 473 A .2d at 815)).

The Plaintiffs allege that a breach of duty occurred because, "under his Restricted Stock Purchase Agreement, McMinn needed to remain a full-time employee of Covad until November 2000 to fully vest in his founders' shares of [Covad]. If he did not maintain full-employment with the Company until all of his shares were vested, Covad had the right under the Restricted Stock Purchase Agreement to repurchase his unvested shares for mere pennies." FN127 McMinn, however, determined that he wished to pursue other opportunities (namely, the formation of Certive), and informed Knowling by email, on May 3, 1999, that he would be pursuing investment opportunities with Crosspoint. FN128 The Amended Complaint further provides that, although McMinn "offered to leave Covad's employ altogether, but only if he could 'accelerate the vesting of the remaining 31% of [his] unvested Covad stock," ' an "exception" was made for his benefit. FN129 "[U]nbeknownst to Covad's public shareholders, [McMinn] continued vesting his founders' shares, drew a full-time salary from Covad, and served as its Chairman of the Board...." FN130 The complaint additionally alleges that Shapero, as General and Managing Partner of Crosspoint, was aware of McMinn's activities, and that it was "highly likely" that Hawk, as a Special Limited Partner of Crosspoint, knew, as well . FN131 McMinn resigned as a Covad director on November 1, 1999, and did not rejoin the board until late October 2000.

FN127. Amended Compl. at ¶ 42.

FN128. *Id.* at ¶ 43.

FN129. *Id.* at ¶ 45.

FN130. *Id.*

FN131. *Id.* at ¶ 48.

***19** The Amended Complaint does not allege when McMinn's shares fully vested. It is this difficulty that potentially necessitates analysis of Runtagh's liability with respect to this claim. It perhaps can be said that two potential alternative conclusions may be reasonably inferred from the Plaintiffs' allegations: (1) that McMinn's shares were deemed vested when he resigned on November 1, 1999, or (2) that the exception for McMinn permitted his shares to vest fully as of November 2000. The Amended Complaint provides only that Runtagh joined the Covad board in "November 1999." FN132 If it is the former, then it is unreasonable to conclude that Runtagh faced a "substantial likelihood" of personal liability for a vesting of shares that occurred, at most, only on her first day as director. In the event it is the latter, however, it is theoretically possible that Runtagh could face personal liability for the vesting such that she would be unable to consider demand with respect to this claim. In that case, analysis of Runtagh's potential liability under *Caremark* would be necessary.

FN132. *Id.* at ¶ 15. A third inference that may be drawn is that the vesting ended with the meeting of the Covad board on September 22, 1999, at which the board "blessed" McMinn's founding of Certive, but also adopted a corporate opportunity policy "expressly requir[ing] the prior approval of the Board before a fiduciary of Covad could take a corporate opportunity for himself." *Id.* at ¶ 54.

Notwithstanding the above, the Court concludes that this potential aspect the Plaintiffs' vesting claim, however, is without merit for several reasons. The dilemma presented by the multiple alternative scenarios points to the foremost reason why the Court need not develop this analysis: the absence of alleged facts permitting the Court to determine whether vesting occurred throughout the relevant period fails to satisfy the particularity requirements of Court of Chancery Rule 23.1.FN133

FN133. Indeed, the imprecise allegation that Runtagh joined that Covad board in "November 1999" only compounds the Court's difficulties. Also, the question of whether the Plaintiffs' claims are time-barred has been vigorously debated; that defense would further diminish the prospect of liability for Runtagh (who also is not named by the Plaintiffs as a defendant liable with respect to Count I). *See Rales,* 634 A.2d at 936 (stating that a "mere threat of personal liability" is insufficient). Finally, the Plaintiffs have not argued that Runtagh is exposed to personal liability as the result of the vesting of McMinn's shares.

3. *Irving*

In setting forth their reasons for why Irving lacks independence, the Plaintiffs make conclusory allegations regarding Irving's voting history, that he became a director "with the consent and approval of the McMinn-Shapero nominees," and that he receives compensation as a Covad director.FN134 Again, bare allegations of this nature are insufficient, separately or cumulatively, to negate Irving's independence.

FN134. Amended Compl. at ¶¶ 16, 139.

First, the Plaintiffs allege that Irving "put[ ] the interests of the McMinn cronies ahead of Covad's...." This conclusory allegation, however, is essentially a repetition of the Plaintiffs' "acquiescence" arguments, which the Court has already rejected for being insufficient to assist in meeting the particularized pleading requirements. FN135 Second, the Plaintiffs' refrain that a particular director was appointed to the Covad Board "with the consent and approval of the McMinn-Shapero nominees" fails, without more. Finally, the Plaintiffs have failed to allege particularized facts demonstrating that the fees Irving receives as a director would somehow interfere with the exercise of his judgment; indeed, they have failed to enumerate even what these fees are. As a consequence, Irving's disinterestedness and independence are not subject to reasonable doubt on the basis of the facts plead.

FN135. *See also Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *9.

4. *Lynch*

The Plaintiffs have failed to satisfy their burden to present sufficient particularized facts to create a reasonable doubt as to the presumed disinterestedness and independence of Lynch. The Amended Complaint alleges that Lynch is a "long-time friend of McMinn." FN136 Indeed, the Plaintiffs' allegations provide that their friendship is "so close" that they own both homes in the same neighborhood and "neighboring wineries." Certainly, according to these allegations, Lynch and McMinn are not strangers-indeed, they maybe fairly close-but allegations of this nature do not allow a reasonable inference that the exercise of a director's discretion and judgment is impaired. As alluded to above, "to render a director unable to consider demand, a relationship must be of a bias-producing nature. Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence." FN137 This is true regardless of whether such ties arose as a consequence of the directors' board membership or whether they were pre-existing. FN138 "Mere allegations that [the directors in question] move in the same business and social circles, or a characterization that they are close friends, is not enough to negate independence for demand excusal purposes." FN139 In the context of pre-suit demand, "friendship must be accompanied by substantially more in the nature of *serious* allegations" supporting a reasonable doubt as to independence. FN140 In other words, considering "the risks that directors would take by protecting their social acquaintances in the face of allegations that those friends engaged in misconduct," FN141 the Plaintiffs have failed to create a reasonable doubt that Lynch "would be more willing to risk his ... reputation than risk the relationship with the interested director." FN142

FN136. Amended Compl. at ¶ 9.

FN137. *Beam,* 845 A.2d at 1051; *see also Odyssey Partners, L.P. v. Fleming Cos., Inc.,* 735 A.2d 386, 409 (Del. Ch.1999) ("That [directors] were neighbors or former neighbors is of no moment.").

FN138. *See Beam,* 845 A.2d at 1051.

FN139. *Id.* at 1051-52.

FN140. *Id.* at 1052 (emphasis added); *see also id.* at 1050-51 (describing other instances in which reasonable doubt might arise).

FN141. *Id.* at 1052.

FN142. *Id.*

***20** Similarly, "the naked assertion of a previous business relationship is not enough to overcome the presumption of a director's independence." FN143 In their Amended Complaint, the Plaintiffs again repeat their well-worn allegation that Lynch "derived the benefits of being and remaining on the Board ... of, and receiving compensation from, Covad ...;" FN144 the Court has already explained its reasons for giving little weight to such allegations. The Amended Complaint, however, also asserts in this instance that Lynch has "derived" these "benefits" as a consequence of certain unspecified "business dealings" with Covad directors. FN145 As discussed above, the sweeping absence of particularity, here, precludes a reasonable inference that Lynch's business dealings or relationships compromised his presumed independence.

FN143. *Orman,* 794 A.2d at 27; *see also Crescent/Mach I Partners, L.P. v. Turner,* 846 A.2d 963, 980-81 (Del. Ch.2000).

FN144. Amended Compl. at ¶ 9.

FN145. *Id.*

Finally, the Plaintiffs allege that Lynch was rewarded for his support with membership on Certive's "Advisory Board," FN146 and that fact demonstrates both his interestedness with respect to the Certive Claims, as well his lack of independence generally.FN147 Though the question may be close, the Plaintiffs' argument, however, ultimately fails for lack of support with sufficiently particularized allegations. The Amended Complaint does not inform the Court what membership on the Certive "Advisory Board" actually entails. Although the Court cannot conclude with certainty from the face of the pleadings, it does not appear to refer to Certive's board of directors. FN148 Moreover, although the Plaintiffs contend that the position is prestigious and lucrative,FN149 the only allegation offered to support this assertion is that Certive's website describes the Advisory Board by stating that "many companies use Advisory Boards as window dressing[,] Certive believes they should be much more...." FN150 Perhaps a certain level of prestige (at least from Certive's perspective) can be inferred from this statement, but that alone does not prove its materiality to Lynch.

FN146. *Id.* at ¶ 56.

FN147. *Id.* at ¶¶ 137, 138, 140.

FN148. *See id.* at ¶ 56. The Amended Complaint quotes the Certive website as explaining: "[The Certive Advisory] Board meets quarterly and *provides insight that we actively use to run the business.* [Advisory] Board meetings are lively and protracted-one and a half days. And, everyone attends." *Id.* (emphasis added). These allegations appear to refer to a group of experienced, outside advisors who generally advise those actually managing the company's affairs. This demonstrates the Court's difficulty (and the need for compliance with the requirement of particularized pleading): the Court can only hazard a guess, based on the allegations-and, therefore, no inference doubting Lynch's presumed independence and disinterestedness can flow from this allegation.

FN149. *Id.* ("These positions are highly sought after and potentially lucrative as advisory board members in Silicon Valley companies are given stock options which during the 1990s became a source of great wealth for many people.").

FN150. *Id.*

[I]n the absence of self-dealing, it is not enough to establish the interest of a director by alleging that he received *any* benefit not equally shared by the stockholders. Such benefit must be alleged to be *material* to that director. Materiality means that the alleged benefit was significant enough *"in the context of the director's economic circumstances*, as to have made it improbable that the director could perform her fiduciary duties to the ... shareholders without being influenced by her overriding personal interest." FN151

FN151. *Orman,* 794 A.2d at 23 (footnotes omitted) (emphasis in original).

The allegations provided by the Plaintiffs clearly fail to meet the above-articulated standard: they set forth no particularized allegations of compensation actually received by Lynch in return for his Advisory Board service or as to whether such compensation would be material to a director in Lynch's position. Indeed, the Plaintiffs allege only that Certive "grant[ed] stock interests in Certive *and/or* provide[d] *some form* of compensation" to Lynch for his service on the Advisory Board.FN152 These allegations fail to satisfy the materiality test described above, much less set forth particularized facts sufficient for the Court to conclude that Lynch was " 'beholden to [McMinn or Crosspoint] or so under their influence that [his] discretion would be sterilized." FN153

FN152. Amended Compl. at ¶ 56; *see also id.* at ¶¶ 137-38.

FN153. *Rales,* 634 A.2d at 936. Additionally, the Plaintiffs do not plead when Lynch received his appointment. The Plaintiffs offer no *particularized* facts demonstrating the necessary linkage between Lynch's appointment to the Certive Advisory Board and his relationship to McMinn. Perhaps the Court should infer this from the facts, but the Plaintiffs have also alleged that "Lynch is a private investor in a number of start-up companies in the Internet area." Amended Compl. at ¶ 33. Indeed, it is the relatively "incestuous" nature of Silicon Valley's business culture that appears to be at the heart of the Plaintiffs' suit; however, on the other hand, "cozy" business relationships of this nature are perhaps an almost inevitable by-product of a highly-sophisticated growth industry reliant almost entirely on innovation and a narrow field of experienced entrepreneurial talent.

5. *Jalkut*

***21** The Plaintiffs dispute inclusion of Jalkut in the Court's demand futility analysis because they allege that his appointment to the Covad Board occurred in violation of the Standstill Agreement between Covad and Khanna, FN154 which provided that the parties would "refrain from taking any action that could advance their respective positions." FN155 Essentially, the Plaintiffs argue that Covad advanced its position in litigation by appointing Jalkut because it gave "the McMinn-tainted Board one more vote in their camp." FN156 This argument begs the question, however, as the inquiry during demand futility analysis, in this context, is independence. Jalkut can only be viewed as a "vote in the McMinn camp" if he is not independent-and if he is not independent, then McMinn and his confederates gain no benefit from his presence. Thus, for demand futility purposes, it is appropriate to consider Jalkut because the inquiry into whether Covad advanced its litigation position by packing the Board (in violation of the Standstill Agreement) and inquiry into Jalkut's independence are substantially the same.

FN154. *See* Amended Compl. at ¶¶ 136, 138.

FN155. Pls.' Ans. Br. to Covad's Mot. to Dismiss at 33 n. 13.

FN156. *Id.*

Moreover, because the Court concludes that Jalkut is disinterested and independent, the Court's decision to include or to exclude Jalkut from its demand futility analysis results in no detriment to the Plaintiffs. Exclusion of Jalkut from the Board members considered lowers the total number of directors on the Board for demand futility purposes to seven-therefore, since the Court has already concluded that four are disinterested and independent, analysis under the first prong of *Aronson* is at an end. On the other hand, if Jalkut is included in the Court's analysis, then the total number of directors is raised to eight, with five disinterested and independent directors required to preclude demand excusal under *Aronson'* s first prong. Jalkut, then, is that fifth director.

Assuming that Jalkut is to be included, the Court turns to analysis of his disinterestedness and independence. The Plaintiffs allege that, in addition to his seat on the Covad Board, Jalkut serves as chief executive officer of TelePacific, a Covad reseller (*i.e.*, a Covad retailer). Specifically, the Plaintiffs allege that "[a]s the CEO of a customer of Covad, Jalkut lacks the independence to fairly and impartially judge the actions of his fellow Board members." FN157 As with Crandall, the Plaintiffs point to information available in the 2004 Proxy Statement (but not explicitly mentioned in the Amended Complaint) to support their claim. Indeed, the allegations in the Amended Complaint, standing alone, are exceedingly conclusory.

FN157. Amended Compl. at ¶¶ 20, 138 ("Jalkut lacks independence from the McMinn-dominated Board because he is the CEO and president of one of Covad's customers, TelePacific.").

Assuming that the 2004 Proxy Statement may be considered for these purposes, FN158 the Plaintiffs still fail to allege facts sufficient to create a reasonable doubt as to Jalkut's independence. Specifically, the Plaintiffs explain that Covad "recognized in excess of $1.3 million and $1.8 million in revenues from TelePacific [in 2002 and 2001], respectively." FN159 The Plaintiffs contend that this "obviously" resulted in "many millions more in revenue" for TelePacific, on the theory that services purchased from Covad by TelePacifc were then sold to TelePacific customers at a mark-up. FN160 Without particularized allegations of fact, however, there is nothing "obvious" about this argument. Without knowledge of the mark-up, one wonders if "many millions more" is even plausible. Moreover, although gross revenues are not unimportant, the critical information would be profits, something the Plaintiffs have not provided.

FN158. This may not be a good assumption. *Compare Hughes,* 2006 WL 722198, at *3 (holding that court may consider documents referred to in complaint "in some instances and for carefully limited purposes"). *See also supra* text accompanying note 108.

FN159. Pls.' Ans. Br. to Covad's Mot. to Dismiss at 33-34.

FN160. *Id.*

***22** Moreover, there are no particularized facts alleged adequately linking the business relationship between TelePacific and Covad with the claimed lack of independence of Jalkut. The Plaintiffs argue that TelePacific, as a customer of Covad, would not want to jeopardize the current pricing structure offered to TelePacific (as an increase in price has the potential to adversely affect TelePacific's profits). Arguments of this nature (*i.e.,* that a customer wants to avoid offending its supplier) must be considered with care. First, the Plaintiffs' contention assumes that the market for TelePacific's product is highly elastic and that, as a consequence, increases in cost will be absorbed by TelePacific, instead of passed on to the firm's customers. Although it may be reasonable to assume that some percentage of cost increases will be absorbed by a retailer, the amount (and therefore its materiality) may vary widely across firms and industries. The Plaintiffs argue that "Jalkut clearly does not want TelePacific to have to pay more for [Covad's] services," FN161 which, though certainly a reasonable observation, is insufficient to lead to the broader inference that Jalkut's judgment has been sterilized as to the best interests of Covad shareholders. FN162 Moreover, the Plaintiffs' allegations are insufficiently particularized to displace the notion that, in this context, if Covad unilaterally raised its prices relative to the market, TelePacific would purchase from another, lower-priced seller.

FN161. Pls.' Ans. Br. to Covad's Mot. to Dismiss at 33-34.

FN162. *Cf. Jacobs,* 2004 WL 1728521, at *5-*6.

Additionally, as with Crandall and BEA Systems, the Plaintiffs make no allegations as to the terms of TelePacific's business dealings with Covad; nor do the Plaintiffs allege facts permitting the Court to infer, in this context, that TelePacific's relationship with Covad is material. Although the Plaintiffs have asserted that Covad received certain revenue from TelePacific in 2001 and 2002, this tells the Court little about the materiality of this relationship to TelePacific. As a consequence, without more, the Plaintiffs have failed to create a reasonable doubt as to the presumed disinterestedness and independence of Jalkut.

In summary, the Court concludes that Khanna's June 19, 2002 letter to the Covad Board was not a demand letter, and, thus, there is no need to inquire into whether demand was wrongfully rejected. Additionally, although the Covad Board had "cozy" business and social relationships, the Plaintiffs have failed to plead particularized allegations that would cast a reasonable doubt on the disinterestedness and independence of at least half of the Covad Board. FN163 Consequently, the Plaintiffs have failed to show that demand was excused under the first prong of *Aronson* or under *Rales.* FN164

FN163. The Court notes that the factual paucity described above may have resulted from difficulties in accessing certain information. Indeed, even after using the "tools at hand" to develop particularized facts (*e.g.,* public filings and § 220), certain information may be restricted due to the fact that it is held by entities with no public disclosure obligations. Although the burdens presented by such obstacles have been recognized, *see Brehm,* 746 A.2d at 268 (Hartnett, J., concurring) ("Plaintiffs must not be held to a too-high standard of pleading because they face an almost impossible burden when they must plead facts with particularity and the facts are not public knowledge."), the pleading standard under which the Court examines allegations for requisite particularity remains unaltered, even for plaintiffs who employed the "tools at hand."

FN164. Accordingly, the Certive Claims (Counts I through III) must be dismissed.

IV. BUSINESS JUDGMENT

As discussed above, because the two prongs of the test for demand futility under *Aronson* "are disjunctive," the challenged transactions subject to analysis under *Aronson* must be examined under the test's second-prong, in addition to the first prong's "disinterestedness" and "independence" analysis. FN165 As a consequence, the BlueStar Transactions and the Dishnet Settlement each require inquiry into whether reasonable doubt is created that these challenged transactions were "otherwise the product of a valid exercise of business judgment." FN166

FN165. *See, e.g., In re J.P. Morgan & Co.,* 2005 WL 1076069, at *8.

FN166. *See Aronson,* 473 A.2d at 814. Analysis under the second prong of *Aronson* is not required for the Certive Claims, because a majority of the board has changed since the events giving rise to Counts II and III and because Count I does not challenge a business decision. *See Rales,* 634 A.2d at 934.

A. *Legal Standard*

***23** In order to satisfy the second prong of *Aronson,* the Plaintiffs must plead "particularized facts creating a reasonable doubt that the decisions of the [board] were protected by the business judgment rule." FN167 "[A]bsent particularized allegations to the contrary, the directors are presumed to have acted on an informed basis and in the honest belief that their decisions were in furtherance of the best interests of the corporation and its shareholders." FN168 It is not an easy task to allege that a decision falls outside the realm of the business judgment rule because "[t]his Court will not second-guess the judgment of a board of directors if it bases its decision on a rational business purpose." FN169 Thus, "[t]he burden is on the party challenging the decision to establish facts rebutting the presumption." FN170 In conducting its analysis, the Court must examine the "substantive nature of the challenged transactions and the board's approval thereof." FN171

FN167. *Brehm,* 746 A.2d at 258.

FN168. *Highland Legacy Ltd.,* 2006 WL 741939, at *7; *see also Levine,* 591 A.2d at 206 ("[P]laintiff ... must plead particularized facts creating a reasonable doubt as to the 'soundness' of the challenged transaction sufficient to rebut the presumption that the business judgment rule attaches to the transaction."); *Pogostin v. Rice,* 480 A.2d 619, 624 (Del.1984) ("A court does not assume that the transaction was a wrong to the corporation requiring corrective measures by the board."), *overruled on other grounds*, *Brehm,* 746 A.2d at 254.

FN169. *Kahn v. Roberts,* 1995 WL 745056, at *4 (Del. Ch. Dec. 6, 1995), *aff'd,* 679 A.2d 460 (Del.1996).

FN170. *Aronson,* 473 A.2d at 812.

FN171. *Id.* at 814.

A plaintiff seeking to demonstrate demand futility under the second prong of *Aronson* "must plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision." FN172 The Court's inquiry in this context is "predicated upon concepts of gross negligence." FN173 "The plaintiff faces a substantial burden, as the second prong of the *Aronson* test is 'directed to extreme cases in which despite the appearance of independence and disinterest a decision is so extreme or curious as to itself raise a legitimate ground to justify further inquiry and judicial review." ' FN174 Although the second prong of *Aronson* may potentially be satisfied by recourse to multiple theories, FN175 establishing that a board's decision falls outside the scope of the business judgment rule frequently requires a showing of facts tantamount to corporate waste. FN176 As a consequence, a plaintiff will bear a difficult, but not insurmountable, burden in pleading particularized facts demonstrating demand futility under this prong of *Aronson.* FN177

FN172. *In re Walt Disney Co. Deriv. Litig.,* 825 A.2d 275, 286 (Del. Ch.2003); *see also In re J.P. Morgan Chase & Co.,* 2005 WL 1076069, at *11. *Cf. Levine,* 591 A.2d at 206 (although addressing only whether directors were adequately informed, identifying self-interest, entrenchment, waste, and acting in such an uninformed manner as to constitute gross negligence as topics of analysis in this context).

FN173. *Aronson,* 473 A.2d at 812; *see also Brehm,* 746 A.2d at 259 ("Pre-suit demand will be excused in a derivative suit only if the Court ... conclude[s] that the particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process, *measured by concepts of gross negligence,* included consideration of all material information reasonably available." (emphasis in original)).

FN174. *Greenwald v. Batterson,* 1999 WL 596276, at *7 (Del. Ch. July 26, 1999) (quoting *Kahn v. Tremont Corp.,* 1994 WL 162613, at *6 (Del. Ch. Apr. 22, 1994)); *see also Highland Legacy Ltd.,* 2006 WL 741939, at *7.

FN175. *See, e.g., Levine,* 591 A.2d at 206; *see also* WOLFE & PITTENGER, *supra* note 77, § 9-2[b], at 9-76 n. 303 (describing analysis under second prong of *Aronson* generally as looking to substantive due care and to procedural due care).

FN176. *See Tremont Corp.,* 1994 WL 162613, at *6 ("The test for this second stage is thus necessarily high, similar to the legal test for waste.").

FN177. *See, e.g., Brehm,* 746 A.2d at 263 (describing waste as " 'an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration" ' (quoting *Glazer v. Zapata Corp.,* 658 A.2d 176, 183 (Del. Ch.1993)); *Grobow,* 539 A.2d at 189 (holding that waste depends on "whether 'what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid" ' (quoting *Saxe v. Brady,* 184 A.2d 602, 610 (Del. Ch.1962)); *see also Green v. Phil-*

lips, 1996 WL 342093 (Del. Ch. June 19, 1996) ("That extreme test is rarely satisfied, because if a reasonable person could conclude the board's action made business sense, the inquiry ends and the complaint will be dismissed.").

B. *The BlueStar Transactions*

The BlueStar acquisition was approved by the Covad Board on June 15, 2000, and announced on June 16, 2000. The Amended Complaint sets forth that, on September 22, 2000, the transaction was completed with Covad's issuance of approximately 6.1 million shares of Covad common stock to BlueStar stockholders "according to an exchange ratio by which BlueStar stockholders received an average market price of $14.23 in exchange for all outstanding preferred and common stock." FN178 The Amended Complaint explains that this resulted in a price to Covad of "at least $200 million" for BlueStar.FN179 The complaint further states that the day after the merger was announced, Covad's shares dropped 27%, constituting $1 billion of market value.FN180

FN178. Amended Compl. at ¶ 73. Outstanding BlueStar stock options and warrants were converted into options to purchase approximately 225,000 shares of Covad common stock at a "fair value" of $6.55 per share. *Id.*

FN179. *Id.*

FN180. *Id.* at ¶ 70. It is uncertain whether the drop in share price can be attributed solely to the BlueStar transaction, since the Amended Complaint ambiguously explains that, "at the same time [Covad] announced the merger," the company also announced that "it had reduced both the number of end-user lines it expected to be in service on June 30, 2000 and its 2000 line growth expectations primarily because of the channel conflict with BlueStar." *Id.*

***24** The Plaintiffs identify numerous grounds on which they contend that the BlueStar acquisition was not a valid exercise of the Covad Board's business judgment. They principally argue that the Board's approval process was procedurally deficient, that the Board failed to inform itself adequately and to act in good faith, and that the transaction constituted corporate waste.

The Amended Complaint alleges that no special committee of disinterested directors was formed to consider the transaction.FN181 The mere allegation of a failure to form a committee is insufficient, however, to satisfy *Aronson'* s second prong.FN182 This fact, however, is not without value, given the material interests in the transaction of at least one-quarter (*i.e* ., Shapero and Hawk) of the Covad Board.FN183 Moreover, the Plaintiffs allege that the acquisition was initiated by the repeated lobbying of Covad's then-chief executive officer and board member, Knowling. The Amended Complaint provides that "Shapero lobbied Knowling through lengthy emails on the weekend of May 20-21, 2000 to have Covad acquire BlueStar and NewEdge. After Shapero's full-court press, Knowling decided on May 21, 2000-without any due diligence-that Covad should acquire BlueStar." FN184 The Amended Complaint further alleges that the reason for the "hasty process" was that it "served BlueStar's interests (and, therefore, Shapero/ Crosspoint's interests) in that BlueStar was in a precarious financial condition and had it continued as a stand-alone company, it would have been unable to mask its serious problems any longer." FN185 Indeed, the Amended Complaint alleges that the fairness opinion rendered by Donaldson, Lufkin & Jenrette ("DLJ") to BlueStar with respect to the merger stated that DLJ had been informed by the "management of the Company" that "the Company, as of June 14, 2000, expected to exhaust its liquidity in the near term and did not have a financing source for funding its anticipated operating and capital needs over the following 12 months." FN186

FN181. *See* Amended Compl. at ¶ 65.

FN182. The parties' briefs contain significant debate over which directors participated in the review and approval of the challenged transactions and the effect of those directors' participation on the Court's analysis. The Covad Board at the time of the BlueStar acquisition was comprised of Dunn, Hawk, Irving, Knowling, Lynch, Marshall, Runtagh, and Shapero. The Amended Complaint, however, does not allege which directors participated in the review and approval of the BlueStar acquisition. Although Paragraph 80 of the complaint provides that, with respect to the BlueStar earn-out settlement, "under normal Covad practice, self-interested directors would have left any Board meeting when matters pertaining to their self-interest are discussed and voted upon," the Court is unable to draw any conclusions from this fact as to approval of the BlueStar acquisition under the standard governing motions to dismiss.

At the time of the BlueStar earn-out settlement, McMinn, Shapero, Hawk, Irving, Lynch, Marshall, and Runtagh were members of the Covad Board. Paragraph 80 does explicitly allege that McMinn, Hawk, and Shapero did not participate in board meetings for "review and approval" of the settlement.

FN183. The Amended Complaint provides that "at least as early as mid-1999, Shapero, through Crosspoint, owned approximately 46% of BlueStar's outstanding shares, and both McMinn and Hawk owned a substantial number of preferred shares." *Id.* at ¶ 59. Paragraph 72 of the Amended Complaint provides: "Each of Messrs. McMinn, Hawk and Shapero and/or Crosspoint were significant shareholders of BlueStar." Crosspoint, for which Shapero serves as General and Managing Partner, is alleged to have owned approximately 30 million shares, representing approximately 41.9% of all issued and outstanding BlueStar shares. *See id.* "Hawk, a Special Limited Partner of Crosspoint, was also a significant shareholder of BlueStar stock." *Id.* McMinn is alleged to have been the beneficial owner of approximately 656,942 shares of BlueStar common stock, *see id.;* however, it should be noted that McMinn had resigned from the Covad Board on November 1, 1999, prior to the BlueStar acquisition's approval. McMinn rejoined the Board in late October 2000, and was a member at the time of the BlueStar earn-out settlement.

FN184. Amended Compl. at ¶ 62. Shapero sat on the board of NewEdge Networks, a "provider of dedicated internet access for businesses and communications carriers." A reasonable doubt has also been shown as to Knowling's independence at the time of the acquisition. At that time, Knowling was Covad's chief executive officer, as well as a member of its Board, and "received a generous compensation package when hired": $1.5 million signing bonus, $400,000 salary, other bonuses, and stock options. *Id.* at ¶ 97. Additionally, Covad granted Knowling severance benefits "worth $1.5 million" and forgave a $500,000 loan to him when he resigned in November 2000 (months after the BlueStar acquisition). *Id.* Most significantly, Shapero served as a member of Covad's compensation committee at this time. *Id.* at ¶¶ 11, 72.

FN185. *Id.* at ¶ 62.

FN186. *Id.* at ¶ 63.

The Amended Complaint sets forth that "[a]lmost uniformly, Covad management objected to the transaction." FN187 Indeed, the Amended Complaint alleges that Knowling "was the sole Covad officer to support" the BlueStar acquisition. FN188 The complaint also describes a due diligence report prepared by Covad's engineering director, "which stated that the acquisition would be virtually useless because of the overlap in the companies' networks." FN189 The complaint alleges that the Board "ignored" management's due diligence findings, which were presented to the Board and which "expressed serious concern" that "Covad already had overlapping physical assets to provide DSL coverage in 70% of BlueStar service territory...." FN190 The Plaintiffs charge that the Covad directors did not "evaluate" the due diligence reports "prepared by ... [the director of engineering] and others that pointed out many of the key acute problems of BlueStar...." FN191

FN187. *Id.* at ¶ 64. The complaint particularly cites Khanna, Chuck Haas, Vice President and co-founder of Covad, and Ron Marquardt, Covad's engineering director, as having "expressed their objections to the deal."

FN188. *Id.* at ¶ 72.

FN189. *Id.* at ¶ 64. The Plaintiffs, in their answering brief, also charge, *inter alia*, that the directors approved the transaction after only a "35 minute telephone conversation" with five board members present. Pls.' Ans. Br. to Dirs.' Mot. to Dismiss at 40. This information, however, is not among the allegations of the Amended Complaint.

FN190. Amended Compl. at ¶ 68.

FN191. *Id.* at ¶ 65. The Plaintiffs' answering brief also provides that "no independent appraisal of BlueStar was sought much less obtained...." This allegation does not appear in the Amended Complaint. Pls.' Ans. Br. to Dirs.' Mot. to Dismiss at 40.

***25** Finally, the Plaintiffs argue that Covad's investment banker (Bear Stearns), which provided a fairness opinion for the transaction, "had a conflict of interest with respect to the merger, and the Board was aware of the conflict." FN192 The Amended Complaint recites that "Bear Stearns Corporate Lending, Inc ., an affiliate of Bear Stearns, provided BlueStar with a $40 million financing commitment to fund BlueStar's continuing operations until the effective date of the merger." FN193 The complaint states that, as a result of this bridge loan, it was in the interest of Bear Stearns "to render a favorable opinion ... and ensure the closing of the transaction," and that, "even though all the signs at the outset indicated that the transaction would spell financial disaster for Covad," Bear Stearns was conflicted from "urging (and therefore failed to urge) Covad to cancel the deal." FN194 As the Amended Complaint explains, "if Covad did not close the transaction, Bear Stearns would be left with the unpaid bridge loan...." FN195

FN192. Amended Compl. at ¶ 66. The Amended Complaint describes the fairness opinion as "perfunctory." *Id.* This perhaps adds context, but little substance, to the Court's inquiry. Moreover, the absence of an independent opinion on which the board relied would not, of itself, demonstrate gross negligence satisfying *Aronson'* s second prong. In this instance, however, the Amended Complaint alleges, for example, that Covad's management's opinion was "[a]lmost uniformly" hostile to the transaction.

FN193. *Id.* The Amended Complaint also provides that Bear Stearns was conflicted because it had an "ongoing interest in earning fees from this and other Covad transactions." *Id.* First, this is insufficiently particularized. Second, the mere fact that an investment bank will receive typical fees for its services does not render its advice conflicted.

FN194. *Id.*

FN195. *Id. Compare Crescent/Mach I Partners, L.P.,* 846 A.2d at 984-85.

The Court notes that the Amended Complaint does not specify when the bridge loan was extended to BlueStar. The chronology, however, may have substantial impact on the analysis. If the bridge loan was made prior to rendering the fairness opinion, then this fact certainly adds substance to the Court's "reasonable doubt" analysis. On the other band, if the loan was not negotiated or extended until *after* Bear Stearns rendered its fairness opinion (or until after the Covad Board's vote to approve), then the existence of the bridge loan would be substantially less significant to the Court's analysis. Issues of continuing reliance on Bear Stearns' advice might arise, but these would perhaps be distinct from reliance on the fairness opinion, itself.

The Court is commanded to make all reasonable inferences in favor of the Plaintiffs from particularized allegations. In this instance, the inference clearly intended by the Plaintiffs' from Paragraph 66 of the Amended Complaint is that loaned funds were at risk-not merely fees for making the loan-because the loan was extended before the opinion was delivered. Similarly, Paragraph 141 states that the Board obtained a "highly-conflicted Bear Sterns [sic] opinion in connection with the First BlueStar Transaction." The Plaintiffs' briefs support the Court's inference and make even more clear the light in which the Plaintiffs intended the allegations to be read. *See, e.g.,* Pls.' Ans. Br. to Covad's Mot. to Dismiss at 36-37 ("The Amended Complaint ... is replete with facts *known to the Board at the time it approved the transaction* which unequivocally show the gross negligence of Runtagh and Lynch.... The only financial opinion before the Board was that of Bear Stearns.... That opinion was hopelessly conflicted (and the Covad Board knew it) because a subsidiary of Bear Stearns had a $40 million bridge loan outstanding to BlueStar and would not see a dime of that money returned to it unless Covad acquired BlueStar."); *id.* at 12 ("[The Covad Board] accepted the fairness opinion of Covad's investment banker, Bear Stearns, despite the fact that Bear Stearns *had* a glaring conflict of interest with respect to the merger. Bear Stearns Corporate Lending, Inc .... *had given* BlueStar a $40 million financing commitment to fund BlueStar's continuing operations, and would have had no hope of recouping a dime of that money without the merger." (citing Amended Compl. at ¶ 66 (emphasis added))); Pls.' Ans. Br. to Dirs.' Mot. to Dismiss at 10 ("[The Covad board] accepted a favorable 'preliminary' opinion from an investment banker that the Covad Board *knew* had an enormous conflict that prevented it from evaluating the BlueStar acquisition in an objective manner." (citing Amended Compl. at ¶¶ 65, 66) (emphasis in original)). The Court recognizes that this is perhaps an example of particularly artful drafting, as well. Indeed, at the hearing on these motions, the Defendants pointed to documents produced in § 220 action that may resolve this issue; however, the Court may not consider them in the present analysis.

On a motion to dismiss, the Court is required to accept as true all well-pleaded allegations and to draw all reasonable inferences from such allegations in favor of the Plaintiffs. The Court acknowledges that the above facts, if true, create a reasonable doubt that the transaction was the product of a valid exercise of business judgment. The Plaintiffs have argued that, in acting to approve the merger, the directors committed violations of their duties of good faith and due care. Demand will be excused, for example, where the Court "conclude[s] that the particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process, *measured by concepts of gross negligence,* included consideration of all material information reasonably available." FN196 It is possible that demand may also be excused where the Court may reasonably doubt that directors have complied in good faith with the requirement they fulfill their fiduciary duties. FN197 This Court has previously addressed the possibility that

> FN196. *Brehm,* 746 A.2d at 259 (emphasis in original).

> FN197. *Cf. Guttman v. Huang,* 823 A.2d 492, 506 (Del. Ch.2003); *IHS,* 2004 WL 1949290, at *9 n. 36.

> disinterested, independent directors "knew that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss." If they did indeed act in such a way, they have acted in a manner that cannot be said to be the product of sound business judgment and so cannot be protected by the presumption of the business judgment rule. FN198

> FN198. *Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. ("IHS") v. Elkins,* 2004 WL 1949290, at *10 (Del. Ch. Aug. 24, 2004) (addressing motion to dismiss under Court of Chancery Rule 12(b)(6)) (quoting *In re Walt Disney Co.,* 825 A.2d at 289).

In other words, if they behaved in such a manner, then they " '*consciously and intentionally disregarded their responsibilities,*' and ... therefore, could be in violation of their fiduciary duties to the corporation." FN199

> FN199. *IHS,* 2004 WL 1949290, at *9 (quoting *In re Walt Disney Co.,* 825 A.2d at 289) (emphasis in original).

The Plaintiffs have pleaded particularized facts alleging, *inter alia,* that the Covad Board had members with significant, material interests in the transaction, ignored a management that objected to the acquisition "[a]lmost uniformly," failed to "evaluate" management due diligence findings that expressed "serious concerns" about the transaction, and knew of significant conflicts held by the investment banker rendering the fairness opinion on which the Board relied. FN200 As a consequence, the Court concludes that the allegations contained in the Amended Complaint create a reasonable doubt as to whether approval of the BlueStar transaction was the product of a valid exercise of business judgment by the Covad Board. FN201 Therefore, demand is excused as to the BlueStar acquisition of Count IV. FN202

> FN200. The Court acknowledges that, after an opportunity for discovery, it may become clear that the bridge loan was negotiated, and funded, only after Bear Stearns had rendered its opinion. *See, e.g., In re New Valley Corp.,* 2001 WL 50212, at *6 n. 17 (Del. Ch. Jan. 11, 2001) (remarking that affidavit might give reason to doubt allegations, but was nevertheless improper to consider on motion to dismiss); *Mizel v. Connelly,* 1999 WL 550369, at *5 n. 5 (Del. Ch. July 22, 1999) (same).

> FN201. The Director Defendants contend that their compliance with the "safe harbor" provisions of 8 *Del.C.* § 144(a) conclusively rebuts the Plaintiffs' contentions; however, compliance with § 144(a) does

not guarantee the benefit of the presumption of the business judgment rule that entire fairness review will not apply. *See, e.g., Benihana of Tokyo, Inc. v. Benihana, Inc.,* 891 A.2d 150, 185 (Del. Ch.2005); *In re Cox Commc'ns S'holders Litig.,* 879 A.2d 604, 614-15 (Del. Ch.2005); *Cal. Pub. Employees' Ret. Sys.,* 2002 WL 31888343, at *13. As the Court in *Benihana* explained:

> Satisfying the requirements of § 144 only means that the [challenged transaction] is not void or voidable *solely* because of the conflict of interest. ‘While non-compliance with §§ 144(a)(1), (2)'s disclosure requirement by definition triggers fairness review rather than business judgment rule review, the satisfaction of §§ 144(a)(1) or (a)(2) alone does not always have the opposite effect of invoking business judgment rule review.... Rather, satisfaction of §§ 144(a)(1) or (a)(2) simply protects against invalidation of the transaction ‘solely’ because it is an interested one. As such, § 144 is best seen as establishing a floor for board conduct but not a ceiling.” Thus, equitable common law rules requiring the application of the entire fairness standard on grounds other than a director's interest still apply.

891 A.2d at 185. Moreover, the Director Defendants' purported compliance may not be a matter amendable to resolution on the basis of the pleadings. *See supra* note 182.

The Director Defendants also argue that, since Covad's Amended and Restated Certificate of Incorporation exempts directors from liability for breaches of the duty of care pursuant to 8 *Del.C.* § 102(b)(7), all claims against the Director Defendants involving duty of cares must be dismissed. However, “when a duty of care breach is not the *exclusive* claim, a court may not dismiss based upon an exculpatory provision.” *Alidina v. Internet.com Corp.,* 2002 WL 31584292, at *8 (Del. Ch. Nov. 6, 2002) (citing *Emerald Partners v. Berlin,* 787 A.2d 85, 91 (Del.2001); *see also Malpiede v. Townson,* 780 A.2d 1075 (Del.2001).

Additionally, charter provisions adopted under § 102(b)(7) merely work to exculpate liability, but do not erase the underlying breach of fiduciary duty. As a consequence, a tension potentially exists between the effect of § 102(b)(7) provisions on analysis under *Rales* and under the second-prong of *Aronson.* For instance, the pertinent question under *Rales,* in this context, is whether a director faces a “substantial likelihood” of personal liability, which, if it exists, would then be deemed as compromising the director's capacity to consider demand. *See, e.g., Guttman,* 823 A.2d at 501. If a mere breach of a duty of care is the exclusive well-pleaded claim, however, then, in the presence of a § 102(b)(7) provision, the question posed by *Rales,* above, will likely be answered in the negative. *See id.* With respect to analysis under *Aronson'* s second prong, however, courts are instructed to ask whether the “challenged transaction was otherwise the product of a valid exercise of business judgment”-*i.e.,* the pertinent question, in this context, is whether an underlying breach has occurred and not whether a substantial threat of liability exists, regardless of breach. The crucial factor, however, would seem to be questions of the potential for personal liability which affect capacity to consider demand. *See id.* (“When ... there are allegations that a majority of the board that must consider a demand acted wrongfully, the *Rales* test sensibly addresses concerns similar to the second prong of *Aronson.* To wit, if the directors face a 'substantial likelihood' of personal liability, their ability to consider a demand impartially is compromised under *Rales*, excusing demand."); *see also Aronson,* 473 A.2d at 815 ("[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors, although in rare cases a transaction may be so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists.").

FN202. With respect to the Defendants' motion under Court of Chancery Rule 12(b)(6), the Court's conclusion here that demand is excused under the more demanding standard of *Aronson'* s second-prong necessarily moots analysis under Rule 12(b)(6).

The Defendants contend that the challenge to the BlueStar acquisition is barred by laches (or the "borrowed" three-year statute of limitations) because the Original Complaint was filed more than three years after the Covad Board's approval of the transaction. *See* Mem. in Supp. of Dirs.' Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Dirs.' Op. Br. to Dismiss") at 26-27 (citing *Kahn v. Seaboard Corp.,* 625 A.2d 269, 271 (Del. Ch.1993); *In re Marvel Entm't Group, Inc.,* 273 B.R. 58, 73-74 (D.Del.2002)). *But see* Pls.' Ans. Br. to Dirs.' Mot. to Dismiss, at 21 (citing *Kaufman v. Albin,* 447 A.2d 761 (Del. Ch.1982); *Dofflemyer v. W.F. Hall Printing Co.,* 558 F.Supp. 372 (D.Del.1983)). The motion to dismiss, with respect to the Defendants' affirmative defense of laches, is reviewed under Court of Chancery Rule 12(b)(6). Because the Court is unable to discern with reasonable certainty from the complaint that laches applies, the Court cannot grant the Defendants' motion on this ground at this time. *See, e.g.,* Amended Compl. at ¶ 144; Reply in Supp. of Dirs.' Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Dirs.' Reply Br. to Dismiss") at 9 (alluding to "requirement" that BlueStar shareholders "approve the transaction by tendering their shares on September 22, 2000").

***26** The Court, furthermore, will not conduct business judgment analysis examining the BlueStar earn-out settlement separately. The two aspects of the BlueStar investment, proximate in time, as well as presenting issues of fact and law not easily bifurcated, are best tackled by treating them as one for demand excusal purposes. Thus, demand is also excused with respect to claims the Plaintiffs asserted in Count IV involving the BlueStar earn-out settlement. FN203

FN203. Although the acquisition appears disastrous with the benefit of hindsight, the Court cannot permit the *ex post* results of a decision to cloud analysis of a board's *ex ante* judgment. *See, e.g., White,* 783 A.2d at 554; *Ash,* 2000 WL 1370341, at *8; *Greenwald,* 1999 WL 596276, at *7 (citing *In re Walt Disney Co. Deriv. Litig.,* 731 A.2d 342, 361-62 (Del. Ch.1998), *aff'd in part and rev'd in part, sub nom. Brehm,* 746 A.2d 244; *Litt v. Wycoff,* 2003 WL 1794724, at *10 (Del. Ch. Mar. 28, 2003); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom* *and its Progeny as a Standard of Review Problem,* 96 NW. U.L.REV. 449, 454-55 (2002).

> BlueStar's performance has been characterized as "dismal," but the Court notes the possibility that the ultimate failure of the deal may have had much to do with exogenous market forces affecting all of the telecommunications industry during this time. The failure to anticipate and avoid these reversals of fortune may perhaps not have been the result of, for example, bad faith, but rather aggressive and overly-optimistic business strategies that, in times of better economic fortune, are lauded as demonstrative off entrepreneurial skill and wisdom.

C. *The Dishnet Settlement* [FN204]

FN204. Although the Plaintiffs cast aspersions on Covad's decision to invest in Dishnet, they have not pursued any attack with particularized allegations.

Again, the Plaintiffs challenge the Covad Board's alleged failure to employ certain procedural devices (*e.g.*, a special committee) in approving the Dishnet Settlement.[FN205] As above, such allegations do not establish a *per se* rebuttal of the business judgment rule, as the Plaintiffs suggest. The Plaintiffs make only a conclusory allegation that the agreement was entered into "without the benefit of the necessary financial and legal analysis...." [FN206] This clearly fails to meet the requirement that the Plaintiffs plead particularized facts. Although the Plaintiffs' briefs rely heavily, and expand, upon this "fact," the Court must look to the Amended Complaint to determine whether the Plaintiffs have satisfied their pleading burden-and they have not.[FN207]

FN205. Amended Compl. at ¶ 141. At the time of the Dishnet settlement, McMinn, Shapero, Lynch, Marshall, Hawk, Hoffman, Irving, and Runtagh comprised the Covad Board. The Amended Complaint does not allege which directors participated in review and approval of the settlement. Although Paragraph 93 of the complaint addresses McMinn's "course and conduct in connection with the failed Dishnet investment" and provides that "the other Covad directors at the time-including Shapero, Lynch, Marshall, Hawk, Hoffman, Irving and Runtagh-acquiesced knowingly in, and as a group supported," McMinn's conduct, the Court cannot draw any conclusions with regard to director participation on the basis of the pleadings under the standard governing motions to dismiss.

FN206. *Id.* at ¶ 92. The Plaintiffs also make the highly conclusory allegation that, with respect to Dishnet, "the other Covad directors at the time," excluding McMinn, "acquiesced knowingly in, and as a group supported, McMinn's breach of duty. *Id.* at ¶ 93.

FN207. Although the Plaintiffs point out that McMinn was director of both Dishnet and Covad at this time, the Plaintiffs do not allege that McMinn participated in the meeting or voted to approve the settlement. The Amended Complaint essentially sets forth only the terms of the settlement. *See, e.g., id.* at ¶¶ 89, 92. This is significant in light of Paragraph 80 of the Amended Complaint, which, in addressing the Board's consideration of the BlueStar earn-out settlement, provides that "under normal Covad practice, self-interested directors would have left any Board meeting when matters pertaining to their self-interest are discussed and voted upon...."

The Plaintiffs' allegations regarding the Dishnet settlement appear principally, if not exclusively, directed toward corporate waste. The allegations of the Amended Complaint do not amount to waste because it cannot be said that the benefits received by Covad from the settlement are "so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid." FN208 It is not, however, outside the realm of business reasonableness to conclude that Covad was better off settling with Dishnet and putting the Dishnet ordeal behind it than to engage in a drawn-out battle with the risk of losing. FN209 There are certainly instances in which settling claims-even though of questionable merit-is the prudent course of conduct. Based on the facts alleged, the Plaintiffs have failed to plead that the Covad Board's decision to enter into the Dishnet settlement was beyond the business judgment rule. FN210

FN208. *See* note 177, *supra.*

FN209. If, as the Plaintiffs allege, the key principal of Dishnet "had a highly mixed reputation in Asia," *id.* at ¶ 88, it may not have been outside the realm of business judgment to determine that an immediate disentanglement from Dishnet was worth the cost.

FN210. The Director Defendants' opening brief contends that this action should be dismissed on the grounds that the Plaintiffs have failed to state a claim under Court of Chancery Rule 12(b)(6). *See* Dirs.' Op. Br. to Dismiss at 1, 3. In support of their argument, the Director Defendants contend that their approvals of the transactions are protected under the business judgment rule. *See* Dirs.' Op. Br. to Dismiss at 34-35. In their answering brief to the Director Defendants, the Plaintiffs raised certain arguments questioning applicability of the protections of the business judgment rule. *See* Pls.' Ans. Br. Dirs.' Mot. to Dismiss at 30, 43-46. As the Plaintiffs chose only to address these arguments to the Director Defendants' briefing with respect to Rule 12(b)(6), in this context, the Court neither addresses them with respect to demand excusal nor expresses a view as to their potential applicability in light of dismissal of the various claims under Rule 23.1. *Compare* Pls.' Ans. Br. to Covad's Mot. to Dismiss 40-43.

V. AIDING AND ABETTING CLAIMS

The Plaintiffs assert claims in Count VI of the Amended Complaint against Crosspoint for aiding and abetting poorly behaving fiduciaries with respect to the Certive and BlueStar transactions. The Court has already determined that the Plaintiffs' claims regarding Certive must be dismissed for failure to make demand upon the Board. The Court now addresses the Plaintiffs' aiding and abetting claim with respect to the BlueStar transactions.

A third party may be liable for aiding and abetting a breach of a corporate fiduciary's duty to the stockholders if the third party "knowingly participates" in the breach. To survive a motion to dismiss, the complaint must allege facts that satisfy the four elements of an aiding and abetting claim: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, ... (3) knowing participation in that breach by the defendants," and (4) damages proximately caused by the breach. FN211

FN211. *Malpiede,* 780 A.2d at 1096 (quoting *Gilbert v. El Paso Co.,* 490 A.2d 1050, 1057 (Del. Ch.1984) ("It is well settled that a third party who knowingly participates in the breach of a fiduciary's duty becomes liable to the beneficiaries of the trust relationship."), *aff'd,* 575 A.2d 1131 (Del.1990)); *Penn Mart Realty Co. v. Becker,* 298 A.2d 349, 351 (Del. Ch.1972)); *see also Laventhol, Krekstein, Horwath and Horwath v. Tuckman,* 372 A.2d 168, 170-71 (Del.1976) ("[P]ersons who knowingly join a fiduciary in an enterprise which constitutes a breach of his fiduciary duty of trust are jointly and severally liable for any injury which results.”).

***27** The Court notes first the distinction between the party who stands in a fiduciary relationship (described by the first and second elements of the test) and the non-fiduciary defendant (described by the test's third element) against whom the aiding and abetting claim is brought.FN212 Of course, the Covad Board at the time of the BlueStar acquisition owed fiduciary duties to Covad and its shareholders, thereby satisfying the first element of an aiding and abetting claim. Moreover, the Court has already determined that the Plaintiffs' claims with respect to the BlueStar transactions survive the motion to dismiss; thus, the second element of the test is satisfied here, as well. Similarly, the Amended Complaint sufficiently alleges that, in the event a breach of fiduciary duty is proved, damages were proximately caused.FN213 As to the requirement that there be “knowing participation” in the breach by the non-fiduciary defendant (*i.e.*, Crosspoint), “[a] claim of knowing participation need not be pled with particularity. However, there must be factual allegations in the complaint from which knowing participation can be reasonably inferred.” FN214 Shapero's status as a Covad director and General and Managing Partner of Crosspoint is sufficient to impute knowledge of Shapero's conduct with respect to the BlueStar acquisition to Crosspoint, for purposes of this motion to dismiss.FN215 The allegations of the Amended Complaint support the reasonable inference that Shapero, and therefore Crosspoint, knew of BlueStar's gloomy business prospects at the same time he was touting the potential acquisition.FN216 Moreover, the allegations permit the reasonable inference that Shapero-by his statements and influence over, at least, Knowling-initiated, induced, and contributed to the underlying breach of Covad's Board.FN217 The Amended Complaint sets forth that “Shapero lobbied Knowling through lengthy emails on the weekend of May 20-21, 2000, to have Covad acquire BlueStar and NewEdge.” FN218 Additionally, the Complaint alleges:

FN212. *See, e.g., In re Gen. Motors (Hughes) S'holder Litig.,* 2005 WL 1089021, at *24 (Del. Ch. May 4, 2005), *aff'd,* 2006 WL 722198 (Del. Mar. 20, 2006).

FN213. *See also Hughes,* 2005 WL 1089021, at *23 (requiring that “damages to the plaintiff resulted from the concerted action of the fiduciary and the non-fiduciary” (quoting *Jackson Nat'l Life Ins. Co. v. Kennedy,* 741 A.2d 377, 386 (Del. Ch.1999)).

FN214. *Hughes,* 2005 WL 1089021, at *24 (quoting *In re Shoe-Town, Inc. S'holders Litig.,* 1990 WL 13475, at *8 (Del. Ch. Feb. 12, 1990)). Crosspoint's motion to dismiss the Plaintiffs' aiding and abetting claim is reviewed under Court of Chancery Rule 12(b)(6).

FN215. *See, e.g., Carlson v. Hallinan,* 2006 WL 771722, at *20-*21 (Del. Ch. Mar. 21, 2006) (imputing majority shareholder's knowledge to nonfiduciary defendant-entities for which shareholder serves as director and officer) (citing *In re HealthSouth Corp. S'holders Litig.,* 845 A.2d 1096, 1108 n. 22 (Del. Ch.2003), *aff'd,* 847 A.2d 1121 (Del.2004) (TABLE)).

FN216. *See* Amended Compl. at ¶¶ 58, 59, 62, 63.

FN217. Because Shapero serves as General and Managing Partner of Crosspoint, his acts permit the Plaintiffs to charge Crosspoint with “participation” in the context of the third element of the aiding and abetting claim. Indeed, the emails sent by Shapero to Knowling were from Shapero's Crosspoint email account and are signed “Rich Shapero, Managing Partner, Crosspoint Venture Partners.” Calder Decl., Ex. Q.

FN218. Amended Compl. at ¶ 62.

According to Covad's amended Form S-4/A, filed with the Securities and Exchange Commission on August 30, 2000, BlueStar's directors, which included defendants McMinn and Shapero, suggested that the CEOs of BlueStar and Covad meet initially to discuss a possible business combination. In fact, the documents produced in the § 220 action clearly show that Shapero, a member of Covad's compensation committee, repeatedly and directly lobbied (and ultimately persuaded) Knowling, the CEO whose compensation was determined by Shapero and his other committee members, that Covad should acquire BlueStar. FN219

FN219. *Id.* at ¶ 72. The Amended Complaint additionally provides:

> Each of Messrs, McMinn, Hawk and Shapero and/or Crosspoint were significant stockholder of BlueStar. Specifically, McMinn was the beneficial owner of approximately 656,942 shares of BlueStar common stock. Shapero's venture capital firm, Crosspoint, owned approximately 30 million shares of BlueStar stock, which represented approximately 41.9% of all of BlueStar's issued and outstanding common stock. Hawk, a Special Limited Partner of Crosspoint, was also a significant shareholder of BlueStar stock. BlueStar's CEO, Robert Dupuis, had previously worked for Crosspoint and thus had ties to Shapero and Hawk.

> *Id.* It should be noted that McMinn was not a member of Covad's Board at the time of the acquisition, having resigned on November 1, 1999, and rejoining only in "late October 2000." *Id.* at ¶ 8.

Crosspoint contends that documents produced as a consequence of the § 220 action, and on which the Plaintiffs in part rely,FN220 fail to demonstrate that Shapero acted improperly.FN221 Specifically, Crosspoint argues that document LWDK 0002013 shows that Shapero's statements were not improper, but merely constituted permitted "expression" of Shapero's views. FN222 The Court need not resolve the question of the characterization of the disputed emails, however, since a reasonable inference to draw from the allegations in the Amended Complaint is that Shapero's power to infect the decisions of Knowling and the Board, and the process by which this was accomplished, were premised not solely on his salesmanship (as reflected in this limited email chain), but, *inter alia*, on his power over Knowling's compensation as a member of Covad's compensation committee. Thus, the Court concludes that, based on the allegations before it, the Plaintiffs' claim against Crosspoint for aiding and abetting, with respect to the BlueStar transactions, cannot be dismissed.FN223

FN220. *See* Pls.' Ans. Br. in Opp'n to Def. Crosspoint Venture Partners, L.P.'s Mot. to Dismiss Am. Deriv. & Class Action Compl. ("Pls.' Ans. Br. to Crosspoint's Mot. to Dismiss") at 33 (citing Calder Decl., Exs. Q (LWDK0002013-2015), R (LDWK0002987-2988); *see also* Amended Compl. at ¶ 72 (stating that "the documents produced in the § 220 action clearly show" Shapero's involvement).

FN221. Reply Br. in Further Supp. of Def. Crosspoint Venture Partners, L.P.'s Mot. to Dismiss Pls.' Am. Deriv. & Class Action Compl. ("Crosspoint's Reply Br. to Dismiss") at 26.

FN222. *See id.* at 25-26. Crosspoint states that "[a]n interested director's expression of his views does not taint the decision of the disinterested directors." *Id.* (citing *In re Ply Gem Indus. Inc. S'holders Litig.*, 2001 WL 755133 (Del. Ch. June 26, 2001); *Lewis v. Leaseway Transp. Corp.*, 1990 WL 67383 (Del. Ch. May 16, 1990)). Shapero, however, is alleged to have moved well beyond merely "expressing his views." Moreover, the inference can be drawn that he was well aware of BlueStar's dismal circumstances and prospects.

FN223. The Plaintiffs asserted fiduciary duty claims against Crosspoint arising out of the Certive matters because, at that time, Crosspoint controlled a significant, even if less than half, portion of Covad's outstanding stock. Those claims were dismissed for failure to make demand on the Board. By the time of the BlueStar Transaction, Crosspoint had eliminated (or substantially reduced) its holdings in Covad and, thus, no longer owed (if it ever did) fiduciary duties to Covad.

Additionally, in the context of the motion to dismiss, the Court cannot conclude that, *inter alia*, that the transaction was the product of arms-length negotiations sufficient to preclude aiding and abetting liability. *Compare* *Hughes*, 2005 WL 1089021, at *26-*28.

VI. *RESPONDEAT SUPERIOR* CLAIM

***28** In Count VII of the Amended Complaint, the Plaintiffs also assert claims against Crosspoint under the doctrine of *respondeat superior*. The Court concludes that these claims must be dismissed in their entirety. The Plaintiffs have not cited any authority demonstrating that such claims are permissible, in this context. "*Respondeat superior* imposes liability upon a principal for the torts of his agent committed within the scope of their agency relationship." FN224 As has already been described above, Crosspoint stands as a *non-fiduciary* defendant in this litigation vis-à-vis Covad and its shareholders with respect to the BlueStar matters. FN225 Indeed, this is a critical element of the Plaintiffs' aiding and abetting claim against Crosspoint. To permit recovery, in this circumstance, under the common law tort law doctrine of *respondeat superior* "would work an unprecedented, revolutionary change in our law, and would give investors in a corporation reason for second thoughts about seeking representation on the corporation's board of directors." FN226 As a consequence, the Court determines that the Plaintiffs' claim for *respondeat superior* is insufficient as a matter of law, under these circumstances, and, therefore, must be dismissed.

FN224. *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 1995 WL 376919, at *8 (Del. Ch. June 15, 1995) (citing *Fields v. Synthetic Ropes, Inc.*, 215 A.2d 427, 432 (Del.1965)). Count VI also briefly mentions the "Certive Transaction." *See* Amended Compl. at ¶ 181.

To the extent that the Plaintiffs may seek to plead an aiding and abetting claim against Crosspoint for matters arising out of events described by Counts I through III-which have been dismissed for failure to make demand on the Board, as described above-the Plaintiffs may not assert a claim for aiding and abetting, since the underlying claims may not be pursued.

FN225. *Cf. Emerson Radio Corp. v. Int'l Jensen Inc.*, 1996 WL 483086, at *20 (Del. Ch. Aug. 20, 1996) ("As a stockholder, [defendant third-party entity] could attain fiduciary status only if it were a majority shareholder or it actually controlled the affairs of [defendant corporation].").

FN226. *Emerson Radio Corp.*, 1996 WL 483086, at *20 n. 18 (analogizing plaintiffs' claims in that case to claims brought under theory employed by the Plaintiffs in this litigation). *Cf.* *USAirways Group, Inc. v. British Airways PLC*, 989 F.Supp. 482, 494 (S.D.N.Y.1997) (denying recovery under this theory of tort law since it would "undermine" and "circumvent[ ] clear limitations imposed by Delaware corporate law").

VII. PROXY STATEMENT DISCLOSURES

The Plaintiffs also assert direct claims against McMinn, Shapero, Hawk, Lynch, Marshall, Irving, Hoffman, Runtagh, Crandall, and Jalkut for material omissions from Covad's Proxy Statements from 2002, 2003, and 2004. The Plaintiffs allege that Covad shareholders might not have elected the directors who were up for election during those years had the omitted information been disclosed. Specifically, the Plaintiffs allege that the following material information should have been disclosed:

1. Khanna's June 19, 2002 letter to the Covad Board. (2002, 2003, & 2004)

2. The Standstill Agreement with Khanna. (2002)

3. "The real reasons for and circumstances relating to the removal of Khanna as General Counsel and his intention, expressed to them, of taking legal action, if necessary, to seek redress for the harm defendants had caused Covad." (2002, 2003, and 2004)

4. The earn-out criterion for the BlueStar transaction had not been met, and Shapero, McMinn, and Hawk derived a great benefit from the settlement. (2002, 2003, and 2004)

5. "[D]efendant McMinn, during the time period of February to November 1999 when he purported to be working for Covad full-time, was actually working for himself and Crosspoint to find new investment vehicles." (2002)

6. Generalized information with respect to Khanna's allegations-specifically, which transactions and which directors challenged. (2003 & 2004)

In 2002, McMinn, Hawk, and Hoffman were slated for election and were re-elected. In 2003, Jalkut, Irving, and Lynch were slated for election and were re-elected. In 2004, Crandall and Runtagh were slated for election and were re-elected. Each of these elections was apparently uncontested.

A. *Legal Standards*

1. *Motion to Dismiss*

***29** The standards governing this Court's analysis of motions to dismiss under Rule 12(b)(6) have recently been reiterated:

> (i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are "well-pleaded" if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the "plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof." FN227

FN227. *Hughes,* 2006 WL 722198, at *3 (quoting *Savor, Inc. v. FMR Corp.,* 812 A.2d 894, 896-7 (Del.2002)).

Although the Court must "accept as true all of the well-pleaded allegations of fact and draw reasonable inferences in the plaintiff's favor," FN228 it is "not ... required to accept as true conclusory allegations 'without specific supporting factual allegations.' " FN229 Instead, the Court must "accept only those 'reasonable inferences that logically flow from the face of the complaint' and 'is not required to accept every strained interpretation of the allegations proposed by the plaintiff.' " FN230 It should also be noted that the standard governing motions under Court of Chancery Rule 12(b)(6) is "less stringent" than the standard employed in demand futility analysis under Court of Chancery Rule 23.1.FN231

FN228. *Id.* (citing *Malpiede,* 780 A.2d at 1082).

FN229. *Id.* (citing *In re Santa Fe Pac. Corp. S'holder Litig.,* 669 A.2d 59, 65-66 (Del.1995)); *see also Solomon v. Pathe Commc'ns Corp.,* 672 A.2d 35, 38 (Del.1996).

FN230. *Hughes,* 2006 WL 722198, at *3 (quoting *Malpeide,* 780 A.2d at 1082).

FN231. *Malpiede,* 780 A.2d at 1082-83 (citations omitted); *see also Rabkin v. Philip A. Hunt Chem. Corp.,* 498 A.2d 1099, 1104 (Del.1985).

2. *Fiduciary Duty with Respect to Disclosure*

Delaware common law of fiduciary duty requires that directors disclose fully and with complete candor all material facts in soliciting proxies from shareholders.FN232 Although it has been held that this duty is "best discharged through a broad rather than a restrictive approach to disclosure," FN233 only material facts must be disclosed. "An omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote." FN234

FN232. *Arnold v. Soc'y for Sav. Bancorp, Inc.,* 650 A.2d 1270, 1277 (Del.1994); *see also Malpiede,* 780 A.2d at 1086 (explaining that "duty of disclosure" does not exist as an independent fiduciary duty).

FN233. *Zirn v. VLI Corp.,* 621 A.2d 773, 779 (Del.1993); *see also Loudon v. Archer-Daniels-Midland Co.,* 700 A.2d 135, 144 (Del.1997) (declining to adopt "bright line" test for disclosure violations, even though it might be "better practice" for directors "to be more candid and forthcoming in their communications to stockholders when presenting a slate for election to the board").

FN234. *Rosenblatt v. Getty Oil Co.,* 493 A.2d 929, 944 (Del.1985) (quoting *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449 (1976)) ("Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."). In order to be material, however, it need not be demonstrated that disclosure of a fact would have changed the shareholder's vote.

In order to allege adequately a violation of disclosure requirements, a plaintiff must plead "some basis for a court to infer that the alleged violations were material. For example, a pleader must allege that facts are missing from the proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury." FN235 The test for whether an omitted fact is material is context-specific, and, therefore, determinations of materiality will not frequently be appropriate on a motion to dismiss.FN236 Nevertheless, this Court may resolve such questions at the motion to dismiss stage if it is satisfied with reasonable certainty that no set of facts could be proved that would permit the plaintiffs to obtain relief under the allegations made.FN237 Even though the Court's analysis in this context is not overly stringent, "it is inherent in disclosure cases that the misstated or omitted facts be identified and that the pleading not be merely conclusory." FN238

FN235. *Loudon,* 700 A.2d at 141; *see also M & B Weiss Family Ltd. P'ship of 1996 v. Davie,* C.A. No. 20303, slip op. at 5, Chandler, Ch. (Bench Ruling Del. Ch. Apr. 12, 2005). *Cf. Orman,* 794 A.2d at 31 ("In order for a plaintiff to state properly a claim for breach of a disclosure duty by omission, he must 'plead facts identifying (1) material, (2) reasonably available, (3) information that (4) was omitted from the proxy materials." ' (quoting *O'Reilly v. Transworld Healthcare, Inc.,* 745 A.2d 902, 926 (Del. Ch.1999)); *accord Wolf v. Assaf,* 1998 WL 326662, at *1 (Del. Ch. June 16, 1998).

FN236. *See, e.g., Alessi v. Beracha,* 849 A.2d 939, 949 n. 68 (Del. Ch.2004).

FN237. *Seagraves v. Urstadt Property Co., Inc.,* 1989 WL 137918, at *5 (Del. Ch.

Nov. 13, 1989); *see also In re Encore Computer Corp. S'holders Litig.,* 2000 WL 823373, at *8-*9 (Del. Ch. June 16, 2000); *In re JCC Holding Co., Inc.,* 843 A.2d 713, 720 (Del. Ch.2003); *Orman,* 794 A.2d at 32.

FN238. *Loudon,* 700 A.2d at 140.

3. *Self-flagellation*

A long-standing principle of disclosure jurisprudence provides that a board need not engage in "self-flagellation." FN239 Notwithstanding the requirement that directors disclose fully all material facts in the solicitation of proxies from shareholders, a board of directors is not required to "confess to wrongdoing prior to any adjudication of guilt," FN240 nor must it "draw legal conclusions implicating itself in a breach of fiduciary duty from surrounding facts and circumstances prior to a formal adjudication of the matter." FN241

FN239. *See, e.g., Stroud v. Grace,* 606 A.2d 75, 84 n. 1 (Del.1992).

FN240. *Loudon,* 700 A.2d at 145.

FN241. *Stroud,* 606 A.2d at 84 n. 1. *Compare Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC,* 2006 WL 846121, at *10 (Del. Ch. Mar. 28, 2006).

4. *Laches*

***30** "The essential elements of laches are: (1) the plaintiff must have knowledge of the claim and (2) there must be prejudice to the defendant arising from an unreasonable delay by the plaintiff in bringing the claim." FN242 Essentially,

FN242. *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C.,* 864 A.2d 930, 951 (Del Ch.2004), *vacated on other grounds,* 875 A.2d 632 (Del.2005) (TABLE).

> [l]aches is defined as an unreasonable delay by a party, without any specific reference to duration, in the enforcement of a right. An unreasonable delay can range from as long as several years to as little as one month. The temporal aspect of the delay is less critical than the reasons for it, because in some circumstances even a long delay might be excused. FN243

FN243. *Steele v. Ratledge,* 2002 WL 31260990, at *3 (Del. Ch. Sept. 20, 2002) (footnotes omitted).

Determination of what constitutes "unreasonable delay" is most often necessarily a factual and context-specific inquiry and, therefore, not generally appropriate for resolution on a motion to dismiss. If, however, the pleadings make reasonably certain that laches is applicable and there can be no facts reasonably supporting a contrary inference, then no insurmountable procedural hurdle exists to prevent the Court from resolving the issue on a motion to dismiss claim. FN244

FN244. *See Bay NewFoundland Co., LTD. v. Wilson & Co., Inc.,* 28 A.2d 157 (Del. Ch.1942), *aff'd,* 37 A.2d 59 (Del.1944); *cf. Steele,* 2002 WL 31260990, at *3 (applying doctrine of laches on summary judgment when "undisputed material facts" established applicability). Although this Court is frequently reluctant to apply laches on a motion to dismiss, *see, e.g., Goldman v. Pogo.com, Inc .,* 2002 WL 1358760, at *2 n. 16 (Del. Ch. June 14, 2002), there is no *per se* bar to its application when it is clearly appropriate.

5. *Incorporation and Consideration of Matters Outside the Complaint*

"The complaint generally defines the universe of facts that the [Court] may consider in ruling on a ... motion to dismiss. When the [Court] considers matters outside of the complaint, a motion to dismiss is usually converted into a motion for summary judgment and the parties are permitted to expand the record." FN245 The Court may, however, "in some instances and for carefully limited purposes," consider documents referred to in the complaint in order to rule on a motion to dismiss. FN246 Additionally, the Court may take judicial notice "of matters that are not subject to reasonable dispute." FN247 As a consequence, the Court will consider the challenged Covad proxy statements, as well as other documents incorporated into the Amended Complaint, in its analysis of the motion to dismiss.

FN245. *Hughes,* 2006 WL 722198, at *3 (citations omitted); *see also* CT. CH. R. 12(b).

FN246. *See Hughes,* 2006 WL 722198, at *3 (citing *In re Santa Fe Pac. Corp.,* 669 A.2d at 69).

FN247. *See id.* (citing DEL. R. EVID. 201(b)).

B. *Analysis*

The Plaintiffs have identified information they allege was omitted from Covad Proxy Statements and have explained it was material because its omission permitted the re-election of particular directors who would perhaps not have been re-elected otherwise. The Plaintiffs ask the Court to grant equitable relief by overturning the 2002, 2003, and 2004 elections. "The courts of this state 'have long held that inequitable conduct by directors that interferes with a fair voting process may be set aside in equity." ' FN248 Therefore, "voiding results of directorial elections and ordering a new election is an appropriate remedy when an election occurs using materially false and misleading proxy materials." FN249

FN248. *Millenco L.P. v. meVC Draper Fisher Jurvetson Fund I, Inc.,* 824 A.2d 11, 15 (Del. Ch.2002) (quoting *Linton v. Everett,* 1997 WL 441189, at *9 (Del. Ch. July 31, 1997)).

FN249. *Shamrock Holdings of Cal., Inc. v. Iger,* 2005 WL 1377490, at *5 n. 37 (Del. Ch. June 6, 2005). The Court notes that the Amended Complaint does not specifically request that the Court order a new election.

Below, the Court addresses first the application of laches to the Plaintiffs' 2002 Proxy disclosure claims. The Court then turns to each of the Plaintiffs' remaining 2003 and 2004 Proxy disclosure claims and addresses them *seriatim.*

1. *Analysis of Plaintiffs' 2002 Proxy Claims Under Laches Doctrine* FN250

FN250. This action was filed on September 15, 2003, well before Covad's issuance of the 2004 Proxy Statement on April 30, 2004, and the 2004 Covad Board meeting on June 10, 2004.

It should also be noted that the Plaintiffs did not file their Amended Complaint asserting claims for omissions in the 2004 Proxy until August 3, 2004. Whether the Plaintiffs' 2004 Proxy claims should be dismissed because they were not sooner filed is a question the Court need not decide here, given its analysis below.

The 2002 Proxy Statement is JTX 16; the 2003 Proxy Statement is JTX 24; and the 2004 Proxy Statement appears at Calder Decl., Ex. E.

***31** As stated above, laches does not, in the mill run of cases, present a proper basis on which the Court may dismiss a plaintiff's claims, since determination of what constitutes "unreasonable delay" is frequently a factual and context-specific inquiry. Notwithstanding the Court's general reluctance to employ laches at the motion to dismiss stage, the Court will, however, dismiss claims when "unreasonable delay" may be found from the face of the pleadings and it is reasonably certain that no set of facts can be proved which would otherwise preclude such a finding.

In the present litigation, the chronology relevant to laches analysis is undisputed. The Plaintiffs seek now to overturn the 2002 election for directors. The directors elected in 2002 have since completed their three-year terms of office. This fact alone makes equitable relief with respect to the 2002 Proxy claim impossible.

Moreover, the Court is troubled by Khanna's delay of more than a year after the 2002 board elections in filing his Original Complaint challenging the adequacy of 2002 Proxy Statement. The Draft Complaint presented to the Covad board by Khanna on July 9, 2002 (as well as his letter to the board of June 19, 2002) demonstrates that he was aware of the facts underlying his disclosure claims before the 2002 board meeting, at the latest (and probably much earlier). Indeed, Khanna served as General Counsel of Covad when the transactions he now challenges (and which underlie the bulk of his disclosure claims) took place. Very few shareholders would stand in a better position to know the relevant facts than a corporation's General Counsel. FN251

FN251. The Plaintiffs also argue that an issue of fact as to Khanna's delay in filing this action is created by a letter from Covad's outside counsel to Khanna's counsel, dated February 13, 2003, Pls.' Ans. Br. to Covad's Mot. to Dismiss at 46-47. JTX 62. The Court notes, first, that the February 13, 2003 letter was actually in response to a letter from Khanna's counsel sent two days earlier, on February 11, *see* JTX 63, and not an email from Khanna, dated November 13, 2002, *see* JTX 33. Moreover, although the February 13 letter does provide that Khanna's disclosure objections would be "refer[ed] ... to the Company, which is being advised by separate counsel on its disclosure obligations," the Court does not view this as potentially mitigating Khanna's already by then extensive delay in seeking the wide-ranging equitable relief he now requests.

Although this Court may overturn a board election, a plaintiff seeking such relief must present her claims with reasonable alacrity if useful equitable relief is to be granted.FN252 Moreover, finality and predictability with respect to a corporation's governing structure clearly are not of insignificant benefit to the corporate enterprise.FN253 Khanna, with his knowledge of the facts he now asserts were improperly omitted, could have acted at the time of the 2002 election. Similarly, he could have filed an action for equitable relief promptly following the 2002 election. The Plaintiffs have offered the Court no persuasive explanation for his delay of more than one year.

FN252. The policy considerations animating this view in the context of challenges to board elections also apply in the context of challenges to mergers, although perhaps with more severe consequences for the dilatory plaintiff. *Cf. In re J.P. Morgan Chase & Co.,* 2005 WL 1076069, at *12 (holding that failure to file TRO in merger context resulted in "equitable [being] relief is no longer practicable," since the " 'eggs' ha[d] been irretrievably 'scrambled' and there [was] no possibility of effective equitable relief"); *see also Arnold,* 678 A.2d at 537. *But see Loudon,* 700 A.2d at 138 (in context of board election, stating that "[a] timely complaint, properly pleaded and supported by proof sufficient to invoke preliminary equitable relief, could result in an *early* injunction or the imposition of corrective disclosures *before* the complained-of corporate activity had been consummated" (emphasis added)).

FN253. *Compare Bay Newfoundland Co. v. Wilson & Co.,* 37 A.2d 59, 62 (Del.1944) (addressing certainty interests in the distinct, but analogous context of corporate act approval).

The Court concludes that, in light of equitable principles guiding the exercise of its jurisdiction, it would be inequitable to award the Plaintiffs the relief they seek with respect to their 2002 Proxy disclosure claims. Khanna served as Covad's General Counsel during the period the challenged transactions were approved; however, Khanna filed suit only after his termination, thus generating concern that his actions were motivated by his employment dispute. FN254 Khanna's role at Covad provided him with knowledge and a platform from which the problems could have been addressed. Khanna now seeks to employ that knowledge against the corporation, and its directors, well after the fact. FN255 Moreover, the addition of Sams and Meisel, as plaintiffs, fails to ameliorate the Court's concerns. FN256 The Court cannot permit the Plaintiffs in this instance to have stood effectively idle until more than a year after the 2002 annual meeting to bring their challenge before this Court. Fundamentally, this is not an instance in which the grant of equitable relief would comport with its general notions of equity, and, as a consequence, the Plaintiffs' claims with respect to the 2002 Proxy Statement must be dismissed under the doctrine of laches.FN257

FN254. The Court acknowledges the Plaintiffs' allegations that Khanna objected to the transactions and that he was investigated internally for sexual harassment as a result of his objections, *but see* Pls.' Ans. Br. to Covad's Mot. to Dismiss at 42 n. 14 (explaining that Khanna's objections with respect to Dishnet-and presumably the other transactions, as well-were business advice only, and not legal advice); however, the Court does not view Khanna's termination as isolated from Khanna's filing litigation against the defendants soon thereafter-*i.e.,* the timing of events is not mere coincidence. Indeed, given the Court's treatment of Khanna's June 19 letter to the Covad Board as made in the employment context (which is a treatment that the Plaintiffs necessarily desire), the Court will not now view the present litigation as unrelated (*i.e.,* not to gain advantage in what may perhaps be viewed as a substitute for convoluted employment litigation).

FN255. This does not diminish, however, the Court's ruling, below, that certain information is not subject to attorney-client privilege.

FN256. The Court holds Sams and Meisel, as co-plaintiffs with Khanna, charged with the behavior of Khanna that took place prior to their appearance in this action.

FN257. The Court also notes that prior decisions have held claims for equitable relief moot when the challenged directors' terms have expired. *See* *Loudon,* 700 A.2d at 138; *see also M & B Weiss Family Ltd. P'ship of 1996,* C.A. No. 20303, slip op. at 5. This applies to Hawk, and it also likely applies to the claims against McMinn and Hoffman. Because McMinn and Hoffman were re-elected on expiration of their terms in 2005, however, the Court declines to rely on this principle.

2. *Analysis of Plaintiffs' Individual Proxy Disclosure Claims*

a. *Disclosure Claim # 1: Khanna's June 19, 2002 Letter to the Covad Board (2002, 2003, and 2004 Proxy Statements)*

***32** The Plaintiffs first claim that the failure to disclose Khanna's June 19, 2002 letter to the Covad Board constituted a material omission from Covad's 2002 Proxy Statement.FN258 Based on the foregoing analysis, this claim must be dismissed.

FN258. Amended Compl. at ¶ 194.

The claims presented in the Amended Complaint with respect to the 2003 and 2004 Proxy Statements do not specifically identify the letter as a material omission.FN259 Nevertheless, assuming *arguendo* that the Amended Complaint does set forth such claims, they would be dismissed as well.

FN259. *Compare id.* at ¶ 194, *with* ¶¶ 204, 213. Indeed, as explained above, failure to identify the omitted facts which form the basis of a plaintiff's claim is, in itself, cause to dismiss. *See Loudon,* 700 A.2d at 140.

First, any such claims involving the 2003 and 2004 Proxy Statements fail principally because, as explained above, Khanna's June 19, 2002 letter must be viewed primarily as part of an on-going employment dispute between Covad and Khanna. Therefore, the letter is a document that the Company is not required to disclose, standing alone. This Court has already ruled in the Plaintiffs' favor on this issue, deeming the letter not to have been a demand on the Covad Board, but the Plaintiffs must endure the consequences along with the benefits of this conclusion. Moreover, the Plaintiffs' claims with respect to the letter fail because disclosing the letter (and its characterization of the challenged transactions) would amount to a requirement that the Covad Board disclose and adopt Khanna's pejorative characterization of the challenged conduct. This would amount to “self-flagellation.”

b. *Disclosure Claim # 2: Standstill Agreement (2002 Proxy Statement)*

As explained above, this claim must be dismissed because it is a challenge to the 2002 Proxy Statement. The Court also briefly notes, however, that the Plaintiffs have failed to satisfy the materiality standard necessary to survive the motion to dismiss this claim, as well. On June 10, 2002, the Proxy Statement was issued. On June 19, 2002, Khanna sent the Covad Board his letter. The directors were elected on July 25, 2002. Thus, with regard to the 2002 disclosure of the Standstill Agreement, the question becomes whether this was material before July 25, 2002. The Court concludes that it was not. Since the Standstill Agreement related solely to Khanna's employment claims, it was not relevant to shareholders, at least in the way that the Amended Complaint alleges.FN260

FN260. As discussed above, Khanna's June 19, 2002 letter-read it in the light most favorable to the Plaintiffs-relates to Khanna's employment dispute. The corporate governance allegations are subordinate to the employment demands. Similarly, the Standstill Agreement relates to Khanna's employment claims. The Amended Complaint does not allege that this understanding changed while the Standstill Agreement was in effect between July 10, 2002 and July 26, 2002. Obviously, at some point the posture of Khanna's claims against Covad purportedly changed from being centered on his termination to seeking redress for shareholders in general. When the nature of these claims changed is unclear from the Amended Complaint. However, it is clear that it was after July 25, 2002.

Moreover, the Amended Complaint alleges that the omissions from Covad's 2002 Proxy Statement led to the election of McMinn, Hawk, and Hoffman and that the omitted facts would have been material to this decision. It is not at all clear how disclosure of the Standstill Agreement would have been material to the decision of whether to reelect these directors.

c. *Disclosure Claim # 3: “Real Reasons” for Khanna's Termination as General Counsel of Covad (2002, 2003, & 2004 Proxy Statements)*

As with the above discussion of the June 19, 2002 letter, the Plaintiffs' third disclosure claim (that the “real reasons” behind Khanna's termination should have been disclosed) would constitute admissions of wrongdoing, which the Defendants contest, before a final adjudication on the merits. This constitutes a request that the Board engage in classic “self-flagellation,” and, therefore, this claim is dismissed as well.FN261 Moreover, the Plaintiffs' challenges to the 2002 Proxy must also be dismissed with respect to this claim for the reasons stated above.FN262

FN261. The Court also views the additional disclosures the Plaintiffs seek here to be not material to shareholders' decisions of whether to elect particular directors, especially since they relate to an employment dispute. Moreover, the only directors whom the Plaintiffs allege tried to "intimidate" Khanna (McMinn and Hoffman) were re-elected in 2002.

FN262. With respect to their 2002 Proxy claim, the Plaintiffs additionally assert that the Defendants failed to "disclose ... [Khanna's] intention, expressed to them, of taking legal action, if necessary, to seek redress for the harm defendants had caused Covad." Amended Compl. at ¶ 196. This claim is set forth in the same paragraph as the alleged omission of the "real reasons" for Khanna's termination. Khanna's purported "intentions," as a shareholder or even as a former General Counsel, cannot be said to be a material fact that a board must disclose in its proxy statement in this context.

d. *Disclosure Claim # 4: Failure to Satisfy the BlueStar Earn-Out Criteria (2002, 2003, & 2004 Proxy Statements)*

***33** The Plaintiffs also allege that the failure of BlueStar to meet the earn-out criteria set forth in the BlueStar Acquisition constituted a material omission from all three challenged Covad Proxy Statements. Specifically, the Plaintiffs allege: "Defendants also did not disclose that the earn-out criteria for the BlueStar transaction had not been met, but that they decided to pay out the 3,250,000 shares. Defendants Crosspoint, Shapero, McMinn, and Hawk derived great benefit by, between them, receiving almost 50% of the 3,250,000 shares issued by Covad in this transaction."FN263

FN263. *Id.* at ¶¶ 197, 206, 215.

At the outset, the Court notes that the 2002 Proxy disclosure claims must be dismissed for the reasons set forth above. The Court, therefore, addresses only the Plaintiffs' claims with respect to the 2003 and 2004 Proxies. With respect to these two proxy statements, the Amended Complaint fails to set forth allegations sufficient to survive the Defendants' motion to dismiss. The materiality of any disclosure must be analyzed within the scope of the pleadings. Thus, the fact that BlueStar failed to meet its earning targets must be considered in light of its materiality to shareholders' decision to elect particular directors (*i.e.*, in the context in which the Plaintiffs bring their disclosure claims). Viewed in this light, BlueStar's earning disclosure cannot be viewed as material.FN264

FN264. The BlueStar acquisition and earn-out settlement had occurred more than two years before the 2003 proxies were solicited. Shareholder approval was not required for the BlueStar earn-out settlement. If approval had been required, then disclosure of this information would likely have been material to that decision.

The only potential argument as to why disclosure would be material to shareholders, in the context of the board elections, is that the directors' approval of the earn-out payment may have been relevant in deciding whether or not to elect a particular director. This rationale alone, however, is not sufficient to mandate disclosure. A large quantity of information may exist regarding any director that *could* be useful to shareholders in making a decision whether or not to elect a particular director. Yet, the question is not merely whether a disclosure might be helpful in deciding to elect a director, but, instead, whether the information reaches the necessary threshold of materiality.FN265 The business decision of a board to settle certain disputed claims is not, standing alone, within the class of information that is the proper subject of disclosure when shareholder action is not requested with respect to that action but, instead, in the context of a director election. FN266 Because the BlueStar earn-out settlement was just one of many decisions that Covad's directors made, and given the passage of time following the earn-out settlement, the Court concludes that disclosure of BlueStar's financial data measured against Covad's earn-out obligations to former BlueStar shareholders in the 2003 and 2004 Proxy Statements was not material to the Covad shareholders in this context. Disclosure would not have significantly altered the total mix of information available to shareholders in deciding how to cast their votes in the 2003 and 2004 elections for disinterested directors. FN267

FN265. A proxy statement need not disclose the details of all transactions in which uninterested directors slated for re-election participated. Certainly, broad disclosure is preferred, *see, e.g., Zirn,* 621 A.2d at 779, but the Plaintiffs' expectations are too expansive in this context.

The Amended Complaint does not identify the lack of detail about Lynch's role in negotiating the BlueStar transaction as an improper omission from the 2003 Proxy Statement. *See* Amended Compl. at ¶¶ 197, 206, 215.

FN266. *Cf. Loudon,* 700 A.2d at 145. ("The details of a corporation's inner workings and its day-to-day functioning are not the proper subject of disclosure.").

FN267. The Court takes a dim view of the 2002 Proxy Statement's vague (if at all extant) references to the interests of McMinn and Hawk in the BlueStar earn-out settlement. Had the Plaintiffs' 2002 Proxy claims not been dismissed in their entirety, the Court may have found the disclosure shortcomings in this context material for purposes of the motion to dismiss.

***34** Moreover, Covad had already disclosed facts relevant to the BlueStar acquisition and settlement in its 2002 Proxy Statement, and Covad's 2003 10-K describes BlueStar's subsequent liquidation. Indeed, the disclosures of the 2002 Proxy approach, if not fulfill, disclosure of the information the Plaintiffs contend was improperly omitted. Although the Proxy Statement does not explicitly set forth that the criteria were not met, it does make clear that (1) the full amount BlueStar stockholders were originally to receive under the earn-out provisions was not paid, (2) settlement occurred before the full earn-out period had passed, and (3) the settlement was agreed-to "in exchange for a release of all claims against [Covad]." FN268

FN268. According to the 2002 Proxy Statement:

In connection with our acquisition of BlueStar, we agreed to place approximately 800,000 shares of our common stock in a third-party escrow account. Up to 5,000,000 additional common shares of our common stock were to be issued if BlueStar achieved certain specified levels of revenues and earnings before interest, taxes, depreciation and amortization in 2001. However, in April 2001, we reached an agreement with the BlueStar stockholders' representative to resolve this matter, as well as the matters that caused 800,000 of the Company's common shares to be held in escrow as of December 31, 2000, by providing the BlueStar stockholders with 3,250,000 of the 5,000,000 shares, in exchange for a release of all claims against the Company. BlueStar's former stockholders received the additional shares of the Company's common stock during 2001. The 800,000 common shares held in escrow were ultimately returned to the Company under this agreement.

Were the Court to conclude that the failure to meet the earn-out criteria was material to the shareholders' decision and did not constitute self-flagellation-*e.g.,* if the proxy had been sent to solicit shareholder approval of the settlement-then the prior disclosures of material information would be insufficient to grant a motion to dismiss.[FN269] The Plaintiffs' claim presents a distinct set of issues, however. In the context of a director election, the Court, in this instance, must ask questions similar to those considered in both *Loudon v. Archer-Daniels-Midland Co.*[FN270] and *Wolf v. Assaf:*[FN271] Where can it be said that a bright-line rule should apply requiring disclosure of mere facts concerning a past action of the board that would otherwise appear to have bearing on a director's election no greater (unless the conclusion is made that the conduct was "wrongful") than any other facts regarding the numerous business decisions with which the director has been involved? Such a rule would seem to invite overwhelming disclosure of a broad range of information in the context of director elections (*e.g.,* information surrounding *all* transactions which the director has voted to approve) in order to avoid potential future litigation. Although broad disclosure is encouraged, it is also possible for such disclosure to become so extreme as to render proxies confusing and not particularly useful to shareholders in casting an informed vote.[FN272]

FN269. *Compare Wolf,* 1998 WL 326662, at *3 ("Including the description of the federal class action in the 10-K and attaching it to the proxy statement creates a substantial likelihood that the reasonable shareholder would have been on notice to review and would have been likely to review its contents."), *with ODS Techs., L.P. v. Marshall,* 832 A.2d 1254, 1261-62 (Del. Ch.2003) (granting preliminary injunction since omissions of purpose and effect underlying proposed amendments "cross the line" to become "affirmatively misleading," and rejecting argument that reference by 10-K mailed with proxy to attachment sent to shareholders in unrelated distribution years earlier was sufficient as it would create "a 'super' shareholder standard and create almost limitless opportunities for deception of the 'reasonable' shareholder"). *Cf. Bren v. Capital Realty Group Senior Housing, Inc.,* 2004 WL 370214, at *9 (Del. Ch. Feb. 27, 2004) (although denying summary judgment and motion to dismiss, stating: "All material facts to the action must be disclosed. This does not require, however, that all material information that was previously disclosed be disclosed again with the specific correspondence requesting action." (citations omitted)).

FN270. 700 A.2d 135 (Del.1997).

FN271. 1998 WL 326662 (Del. Ch. June 16, 1998).

FN272. *Cf. Brown v. Perrette,* 1999 WL 342340, at *8 (Del. Ch. May 14, 1999) (noting that "disclosure of a single unadorned fact can quickly snowball into wide-ranging disclosure of facts and opinions that otherwise would never come before the shareholders" (citing *Wolf,* 1998 WL 326662, at *4)).

The Plaintiffs might respond that BlueStar's shareholders were so undeserving of the earn-out payment, and Covad's decision to make any earn-out payment were so egregious, that disclosure of BlueStar's earnings would have been material to Covad shareholders, because it would have alerted them that Covad's directors were not pursuing Covad's best interest. This argument, however, accepts Khanna's pejorative description of the BlueStar earn-out settlement, which the Covad Board was not required to disclose because it would constitute the legal characterization of facts (and not a statement of facts). Disclosure of the failure of BlueStar to meet the earn-out criteria would be material to shareholders in this context only if approval of the settlement by the directors up for re-election had been wrongful.[FN273] Thus, the Plaintiffs seek a disclosure "which by inference would convey" a breach of fiduciary duty. FN274 Disclosure of the single, unadorned fact of the failure to meet the earn-out criteria, standing alone in the proxy to elect directors-especially in 2003 and 2004, two and three years after the settlement-would likely invite, if not require, the Board to explain its reasons why the settlement was warranted. The Court, then, views this as sufficiently analogous to other plaintiffs' prior "attempt[s] to 'skirt' the 'self-flagellation' rule," which would ultimately place the Court on a "well greased slippery slope" and on which the Court declines to tread.FN275

FN273. *Cf. Loudon,* 700 A.2d at 145.

FN274. *See Wolf,* 1998 WL 326662, at *4.

FN275. *Id.; accord Loudon,* 700 A.2d at 145. *But cf. Brown,* 1999 WL 342340, at *7 (discussing, in context of Court's analysis of disclosures with respect to a transaction approval, potential drawbacks of application of self-flagellation rule).

> Finally, the Court views as pertinent to the Court's discussion in *Wolf* of the plaintiff's arguments that the omission in that action was "material to [the director's] character, competence, or fitness for office" is instructive:

> Delaware law does not, however, require a proxy statement to impugn a director's character or draw negative inferences from his past business practices. It only requires a summary of his credentials and his qualifications to serve on the board as well as a description of any conflicts of interest. Nothing in our law requires a masochistic litany of management minutiae. If we required companies to include a detailed, subjective assessment of a director's character and past performance in proxy statements before an election, I do not see how this Court could avoid a flood of second-guessing, hindsighted shareholders seeking to contest admittedly subjective conclusions. This form of subjective titillation has never been required as spice for the "total mix."

> 1998 WL 326662, at *5. The Plaintiffs' claims with respect to the 2002 Proxy Statement have been dismissed for the reasons described above. Moreover, the Plaintiffs do not challenge the summary of credentials and qualifications or of any conflicts of interest with respect to the 2003 or 2004 Proxies.

e. *Disclosure Claim # 5: McMinn's Status at Covad While Creating Certive (2002 Proxy Statement)*

***35** The Plaintiffs' fifth disclosure claim alleges that the 2002 Proxy "did not disclose that defendant McMinn, during the time period of February to November 1999 when he purported to be working for Covad full-time, was actually working for himself and Crosspoint to find new investment vehicles." FN276 A requirement that the board make this type of disclosure would implicate considerations similar to those discussed, above, with respect to the Plaintiffs' fourth disclosure claim. Moreover, it would require that Covad adopt Khanna's interpretation of McMinn's employment status, as well as his conformity or non-conformity with the conditions on his compensation. As such, the claim must be dismissed. Additionally, this claim constitutes a challenge to the 2002 Proxy Statement, and therefore must be dismissed for the reasons set forth above.

FN276. Amended Compl. at ¶ 198.

f. *Disclosure Claim # 6: Disclosure of Challenged Directors, Officers, and Transactions (2003 & 2004 Proxy Statements)*

The Plaintiffs also make generalized claims with respect to the 2003 and 2004 Proxy Statements.FN277 They variously allege that the directors failed to disclose "anything about Khanna's allegations regarding the Certive, Bluestar or Dishnet transactions;" "[t]he substance of Khanna's allegations;" or "the information showing the pattern and practice of self-dealing and other malfeasance by the directors...." FN278 The only omissions they point to with any reasonable specificity is that "Defendants did not identify which directors and officers or which transactions were the subject of Khanna's allegations." FN279

FN277. *Id.* at ¶¶ 204, 213.

FN278. *Id.* at ¶¶ 204, 205, 213, 214.

FN279. *Id.* at ¶¶ 204, 213.

As explained above, "it is inherent in disclosure cases that the misstated or omitted facts be identified and that the pleading not be merely conclusory." FN280 Certainly, the threshold is relatively low in order for a claim to be considered well-pleaded on a motion to dismiss under Court of Chancery Rule 12(b)(6). Nevertheless, in order to state a claim for material omission from a proxy statement, a plaintiff must, *inter alia,* identify the facts that were improperly omitted.FN281 The Plaintiffs claim here could be fairly read to challenge non-disclosure of all facts asserted in the Plaintiffs' Amended Complaint (or Khanna's June 19, 2002 letter to the Covad board or his July 9, 2002 Draft Complaint). The Court will not attempt, however, to parse a broadly generalized claim for non-disclosure for the benefit of the Plaintiffs-it is their responsibility to identify in a reasonable manner the facts which they allege were improperly omitted.

FN280. *Loudon,* 700 A.2d at 140.

FN281. *See id.* at 141; *id.* at 144 (upholding trial court's ruling that complaint "failed to 'identify any specific fact that should have been disclosed.' "); *see also M & B Weiss Family Ltd. P'ship of 1996,* C.A. No. 20303, slip op. at 5.

As a consequence, the Court understands the Plaintiffs to be asserting a claim for failure to identify the directors, officers, and transactions that were the subject of Khanna's allegations.FN282 At the outset, the Court notes that, once Khanna had filed his Original Complaint on September 15, 2003, after the 2003 election, the subsequent 2004 Proxy discloses both the initiation of the lawsuit and lists the former and current directors named as defendants. FN283 Though the 2004 Proxy Statement does not specifically identify the Certive, Bluestar, and Dishnet transactions as being the subject of his suit, it does describe in sufficient detail the history of Covad's dealings with Khanna, the steps it took in investigating his claims, the result of that investigation, and the general claims he now asserts.FN284 Indeed, a requirement that the proxy statement disclose details (and conclusions that could be drawn from those details) to the degree the Plaintiffs apparently wish would most likely cross into self-flagellation. Therefore, the Court concludes that the Plaintiffs have failed to state a claim with respect to the 2004 Proxy Statement.

FN282. Although the Amended Complaint is not clear, it does provide in the first sentence of the relevant paragraphs that "defendants did not disclose anything about Khanna's allegations regarding the Certive, BlueStar or Dishnet transactions." *See* Amended Compl. at ¶¶ 204, 213. The Court, therefore, understands the Plaintiffs to be claiming that these listed transactions should have been disclosed as having been the "subject of Khanna's allegations." *See id.*

FN283. *See* 2004 Proxy Statement at 6-7.

FN284. Neither Crandall nor Runtagh, the directors slated for re-election in 2004, was interested in any of the challenged transactions, and the Court does not view disclosure of these particular transactions as being the "subject of Khanna's allegations" as material to these directors' re-election. Covad's disclosure puts any shareholder who is concerned by Khanna's allegations on notice that the Covad Board is "too cozy" and that the shareholder should either vote no as to Covad's slate of directors or seek the nomination of fresh candidates.

***36** With respect to the 2003 Proxy Statement, no lawsuit had been filed during most important period (*i.e.*, before the 2003 election).FN285 Although the Plaintiffs seek to characterize this information (*i.e.*, the directors, officers, and transaction that were the subject of Khanna's allegations) as "facts," information of this sort is not normally the subject of proper disclosure claims. The Court, instead, views the Plaintiffs' claim in this context as analogous to prior instances in which this Court has held that proxy statements need not set forth the "opinions of stockholders" who have merely voiced opposition to a transaction, even if they are "large holders of ... stock." FN286

FN285. Though Khanna had filed his § 220 demand on Covad on June 10, 2003 (and a related § 220 action in this Court on August 11, 2003, *see Khanna,* 2004 WL 187274), the date relevant to the present analysis is that on which he filed the present litigation.

FN286. *In re Triton Group Ltd. S'holders Litig.,* 1991 WL 36471, at *9 (Del. Ch. Feb. 22, 1991), *aff'd sub nom. Glinert v. Lord,* 604 A.2d 417 (Del.1991) (TABLE); *see also Seibert v. Harper & Row, Publishers, Inc.*, 1984 WL 21874, at *6 (Del. Ch. Dec. 5, 1984). Khanna is the largest, or one of the largest, individual shareholders of Covad.

The Plaintiffs' contention that Khanna's opinions, as a former General Counsel of Covad, carry more weight and therefore merit different treatment is unpersuasive.FN287 That Khanna's allegations came forth only contemporaneously with a contentious employment dispute, after Khanna had failed to take affirmative action when the transactions occurred, makes the Court less willing to draw a distinction for these Plaintiffs.

FN287. *See* Pls.' Ans. Br. to Dirs.' Mot. to Dismiss at 27.

Moreover, in response to Khanna's letter, Covad appointed a special committee to investigate whether there was any substance to his claims. An independent law firm was then retained by the committee to aid its investigation.FN288 The committee, comprised of Crandall, Runtagh, and Jalkut, FN289 directors whom the Court has already determined are disinterested and independent, informed Khanna of its conclusion that the allegations had no merit on December 26, 2002.FN290 Khanna's allegations, the investigation, and the investigation's conclusions were disclosed in Covad's March 2003 10-K.FN291 In view of Covad's actions, then, to require more would constitute self-flagellation. Because the Court finds that the Plaintiffs' 2003 Proxy disclosure claim does not, in this instance, properly state a claim for omitted material facts, it must also be dismissed.

FN288. Amended Compl. at ¶ 133 (quoting Covad's March 2003 10-K).

FN289. The Amended Complaint provides that the Covad Board determined, on July 18, 2002, that Crandall and Runtagh "had the authority to add" Jalkut to the investigation committee. *Id.* at ¶ 126. It also alleges that Jalkut's appointment "most likely" occurred "after Khanna's September 2002 meetings with counsel for the Committee," but before February 19, 2003, when Khanna was informed of Jalkut's appointment. *Id.* at ¶ 130.

FN290. Amended Compl. at ¶ 133.

FN291. *Id.* at ¶¶ 133. The Amended Complaint also provides that similar disclosures were made in Covad's May 2003 10-Q. *Id.* at ¶ 204.

VIII. MOTIONS TO CONTINUE TO SEAL/

UNSEAL THE RECORD AND TO STRIKE PORTIONS OF THE AMENDED COMPLAINT

The Court now turns to motions addressing whether certain allegations should be given confidential treatment.

A. *Motion to Strike Portions of the Amended Complaint*

1. *Whether the Amended Complaint Contains Privileged Information*

Covad maintains that Paragraphs 52, 54, 55, and 57 of the Amended Complaint contain privileged information. Rule 502 of the Delaware's Rules of Evidence defines the attorney-client privilege:

> A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client ... between the client or the client's representative and the client's lawyer or the lawyer's representative....[FN292]

FN292. DEL. R. EVID. 502(b)(1). Although Khanna's professional obligations may be defined by California, the parties have pointed to no material difference between the lawyer conduct rules of California and Delaware.

In order for the communication to be confidential, the communication must not have been "intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication ." [FN293] Although the identity of one's attorney is usually not privileged,[FN294] the subject matter of the communications is privileged.

FN293. DEL. R. EVID. 502(a)(2).

FN294. *See, e.g., Gotham Partners v. Hallwood Realty,* 1999 WL 252377, at *1 (Del. Ch. Mar. 31, 1999) ("Neither the status nor identity of an attorney whose communications are privileged are privileged facts.").

***37** In the case at hand, the Amended Complaint, at times, reveals the subject matter of communications between Covad and Wilson Sonsini Goodrich & Rosati, P.C. ("Wilson Sonsini"), the law firm representing it-namely that the Certive transaction was a possible corporate opportunity for Covad. It is fair to read Paragraphs 52 [FN295] and 54 [FN296] as revealing confidential information-specifically, the general subject matter of Covad's communications with its inside- and outside-counsel.

FN295. Amended Compl. at ¶ 52 ("Khanna voiced his opposition to the [Certive] deal, and raised with defendant Knowling and [Wilson Sonsini] the issue of Certive being a possible corporate opportunity for Covad."). This paragraph discusses both the opinions of Khanna, Covad's inside-counsel, of the Certive transaction and the subject matter of Covad's conversations with Wilson Sonsini, its outside-counsel.

FN296. *Id.* at ¶ 54 ("[T]he Board adopted (with the counsel of the conflicted Wilson Sonsini firm) a corporate opportunity policy which expressly required the prior approval of the Board before a fiduciary of Covad could take a corporate opportunity for himself...."). This reveals that Wilson Sonsini worked with Covad on its corporate opportunity policy, which, of course, reveals the subject matter of Wilson Sonsini's representation of Covad. Furthermore, if the information alleged in the Amended Complaint was gained from Khanna's attendance at the board meeting as General Counsel, then the information may be privileged for this reason as well.

Although paragraphs 52 and 54 reveal the subject matter of Wilson Sonsini's representation of Covad, it is less clear why paragraphs 55 and 57 are privileged. Paragraph 55 states that "[the Board] even disregarded the very obvious conflict of counsel to Covad, Wilson Sonsini, serving as counsel for Certive during the period when McMinn was founding Certive while on Covad's payroll as a full-time employee and representing Certive in the very transaction by which Covad acquired its Certive shares." FN297 Paragraph 55 then goes on the describe Wilson Sonsini's interest in Certive. FN298 Neither of these statements is privileged. Moreover, the fact of Wilson Sonsini's representation of Covad during the Certive transaction is not privileged because the identity of one's attorney does not constitute privileged information. FN299

FN297. *Id.* at ¶ 55.

FN298. The Court notes that Wilson Sonsini's interest in Certive is not privileged because it does not reveal any confidential information that Covad provided to (or advice received from) Wilson Sonsini. Instead, Paragraph 55 merely discusses Wilson Sonsini's independent ownership interest in Certive. Covad holds no privilege with regard to this information.

FN299. *See supra* note 294 and accompanying text.

Paragraph 57 states that "while at Covad and on Covad's time, and using Covad's outside counsel, Wilson Sonsini, [McMinn] developed and pursued the Certive business opportunity...." FN300 As with Paragraph 55, Paragraph 57 only reveals the identity of Covad's outside counsel and, therefore, is not privileged.

FN300. Amended Compl. at ¶ 57.

2. *Whether the Privilege was Waived with Regard to the Information in the Amended Complaint*

Because the Court has determined that Paragraphs 52 and 54 contain privileged information, it must now consider whether the attorney-client privilege, with respect these Paragraphs, has been waived by Covad.

> The doctrine of waiver is expressly codified by Rule 510 of the Delaware Uniform Rules of Evidence which provides that "[a] person upon whom these rules confer a privilege against disclosure waives the privilege if he or his predecessor while holder of the privilege voluntarily discloses or consents to disclosure of any significant part of the privileged matter." FN301

FN301. *The Cove on Herring Creek Homeowners' Ass'n, Inc. v. Riggs,* 2001 WL 1720194, at *2 (Del. Ch. Dec. 28, 2001).

The Court first considers Khanna's argument that Covad waived its privilege by disclosing information to him when he was wearing his "Vice President hat," as opposed to his "General Counsel hat." Khanna cites authority, including *United States v. Vehicular Parking, Ltd.,* FN302 for the proposition that "legal advice that is merely incidental to business advice may not be protected." FN303 In *Vehicular Parking,* the court, ruling on the defendants' claims of privilege, held that "the communications in question indicate [that the defendants' attorney] was advising on matters of business. Privilege is not accorded to such communications." FN304 Privilege as to the communications at issue in that case, however, was not a close call. The court had no difficultly separating the roles of attorney and businessman. As the court explained, "[The set of communications in question] is more than attorney-talk. It is big-as well as basic-business diction." FN305

FN302. 52 F.Supp. 751 (D.Del.1943).

FN303. Pls.' Ans. Br. in Opp'n to Covad Commc'ns Group, Inc.'s Mot. to Disqualify Pls. & Mot. to Strike Portions of Am. Deriv. & Class Action Compl. ("Pls.' Ans. Br. to Mot. to Disqualify") at 22.

FN304. 52 F.Supp. at 753.

FN305. *Id.; see also* DEL. R. EVID. 502(a)(2) (describing "confidential information" as "disclosure made in the furtherance of the rendition of professional *legal* services" (emphasis added)).

***38** It is significantly more difficult, however, to relate the understanding that "business diction" occurring between an attorney and her client is not privileged to the case at hand. Khanna provides no specific evidence-other that stating that he was a Vice President at Covad-to buttress his assertion that the information Covad deems privileged was obtained outside his legal capacity. Instead, the Plaintiffs cite authority that would place the burden on Covad to demonstrate that the information it wishes to protect was given in Khanna's legal capacity.[FN306] The Court of Appeals in *In re Sealed Case,*[FN307] ruling on a corporation's claim that certain communications were privileged and could not be testified to by its former general counsel, explained that it was "mindful ... that [the general counsel] was a Company vice president, and had certain responsibilities outside the lawyer's sphere. The Company can shelter [the General Counsel's] advice only upon a clear showing that [the General Counsel] gave it in a professional legal capacity."[FN308] The Court of Appeals also explained, however, that "advice does not spring from lawyers' heads as Athena did from the brow of Zeus,"[FN309] and, since some nonlegal background is necessary for lawyers to give legal advice, the mere mention of nonlegal information does not negate the attorney-client privilege.[FN310]

FN306. *See, e.g., In re Sealed Case,* 737 F.2d 94, 99 (D.C.Cir.1984) ("The Company can shelter [in-house counsel's] advice only upon a clear showing that [in-house counsel] gave it in a professional legal capacity.").

FN307. 737 F.2d 94 (D.C.Cir.1984).

FN308. *Id.* at 99; *see also id.* ("It remains the claimant's burden, however, to present to the court sufficient facts to establish the privilege; the claimant must demonstrate with reasonable certainty that the lawyer's communication rested in significant and inseparable part on the client's confidential disclosure." (citations omitted)).

FN309. *Id.*

FN310. *Id.*

In re Sealed Case was written in the context of the attorney and client, on the same side of litigation, trying to protect privilege. It was *not* written in the context of the attorney trying to break the attorney-client privilege. In other words, *In re Sealed Case* deals with an attorney and client attempting to deploy the attorney-client privilege as a shield, not an attorney trying to break the privilege and use the information as a sword. Given the importance this Court places on the attorney-client privilege and an attorney's ethical duties to his former client,[FN311] in the situation where an attorney is seeking to use potentially privileged information as a sword against a former client, the inquiry has been framed as:

FN311. *See, e.g., Continental Ins. Co. v. Rutledge & Co., Inc.,* 1999 WL 66528, at *1 (Del. Ch. Jan. 26, 1999) ("The importance of the attorney-client privilege is central to the American model of adversarial litigation.").

> whether it can reasonably be said that in the course of the former representation the attorney might have acquired information related to the subject of this subsequent representation. [The Court] will not inquire into their nature and extent. Only in this manner can the lawyer's duty of absolute fidelity be enforced and the spirit of the rule relating to privileged communications be

maintained.[FN312]

FN312. *T.C. Theatre Corp. v. Warner Bros. Pictures, Inc.,* 113 F.Supp. 265, 268-69 (S.D.N.Y.1953). This Court has previously followed portions of *T.C. Theatre Corp.*-namely its “substantial relationship” test. *See Ercklentz v. Inverness Mgmt. Corp.,* 1984 WL 8251 (Del. Ch. Oct. 18, 1984).

In the present litigation, because Khanna served as General Counsel of Covad, it can reasonably be inferred that Khanna received information regarding the Certive transaction in his legal capacity. Furthermore, Khanna's response on learning information regarding the transaction was of a legal nature, [FN313] which leads one to infer that the information was provided to him in the context of seeking legal advice. Finally, the fact that, as Khanna claims, he was “told to leave the meeting when the Board was ready to *discuss* and vote on the Board's ratification of the McMinn and Crosspoint investments in Certive” [FN314] leads one to believe that his *business* opinion was not valued (even for discussion purposes) and, thus, it is unlikely that he would have originally been given the information to provide a business opinion. For these reasons, the Court finds Khanna's argument, that the information in Paragraphs 52 and 54 of the Amended Complaint is not privileged because he was wearing his “Vice President hat” when he learned the information, to be unpersuasive.

FN313. *See* Amended Compl. at ¶ 52 (noting that Khanna voiced his opposition to the deal as a possible corporate opportunity and objected to Shapero sitting on the board of a competitor).

FN314. *Id.* at ¶ 53 (emphasis added).

***39** The only issue remaining, with regard to whether Paragraphs 52 and 54 are privileged, is whether Covad waived its privilege through disclosure during the § 220 trial.[FN315] The Court addresses Paragraph 52, first.

FN315. *See supra* note 301, and accompanying text.

This Court has previously held that the attorney-client privilege does not apply “when the party holding the privilege waives the privilege in one of two basic ways: (1) the party injects the communications into the litigation, or (2) the party injects an issue into the litigation, the truthful resolution of which requires an examination of the confidential communications.” [FN316] Additionally, the “attorney-client privilege may be waived by the public disclosure of information that was formerly confidential.” [FN317] A fair reading of Joint Exhibit 119 from the § 220 trial, which is a letter from Khanna's counsel to an attorney for a subcommittee of Covad's Board, demonstrates that Covad waived privilege with respect to Paragraph 52. Covad used Joint Exhibit 119 at the § 220 trial. Perhaps Covad's intent was to introduce only letter itself and not the subsequent chronology (authored by Khanna) attached to the letter. Permitting Covad to introduce the document as evidence at the § 220 hearing, and then allowing Covad to shield an integral and incorporated attachment to that document (and clearly referenced in the document itself),[FN318] would defeat the purpose of the “inject into litigation” exception to attorney-client privilege.[FN319] Joint Exhibit 119 clearly references, on multiple occasions, the attachment; and the letter can be viewed as a summary of that attachment. Since the attachment was so integral to the letter, the introduction, by Covad, of part of Joint Exhibit 119 into litigation waives the attorney-client privilege as to the entire document. Thus, the Court concludes that Paragraph 52 does not contain any currently privileged information because privilege was waived.

FN316. *Baxter Int'l, Inc. v. Rhone-Poulenc Rorer, Inc.,* 2004 WL 2158051, at *3 (Sept. 17, 2004).

FN317. *Texaco, Inc. v. Phoenix Steel Corp.,* 264 A.2d 523, 525 (Del. Ch.1970).

FN318. JTX 119 (Letter from Grellas to Poss, at 1 (9/10/2002) ("We have attached a detailed chronology prepared by Mr. Khanna....")).

FN319. According to *Baxter Int'l:* "The [inject into litigation] exception is based on the principles of waiver and of fairness, so that the party holding the privilege cannot use it as both a sword and a shield." 2004 WL 2158051, at *3.

Waiver issues with regard to Paragraph 54 are relatively easy to resolve. The information alleged to be privileged (*i.e.,* Wilson Sonsini's involvement in shaping Covad's Corporate Opportunity Policy) can be inferred from documents produced by Covad in the § 220 production. Specifically, document LWDK 0003485 contains the policy, and document LWDK 0003473 lists the attendees at the board meeting at which the policy was adopted. This list includes a Wilson Sonsini attorney, acting as secretary. These two facts, made available through the § 220 production, lead to the inference that the Covad Board adopted its Corporate Opportunity Policy with the advice of a Wilson Sonsini attorney, who was present at the meeting.

In conclusion, the information in Paragraphs 55 and 57 of the Amended Complaint is not protected by the attorney-client privilege. Covad placed the information contained in Paragraph 52 into litigation and, thus, waived attorney-client privilege with regard to the pertinent documents. Finally, the information contained in Paragraph 54 can be deciphered from the documents produced in the § 220 production. For these reasons, the Court denies Covad's motion to strike Paragraphs 52, 54, 55, and 57 from the Amended Complaint.

B. *Motions to Seal/Unseal the Amended Complaint*

***40** Much of the briefing with regard to sealing and unsealing overlaps the Court's analysis, above, concerning the motion to strike portions of the Amended Complaint. Specifically, Covad argues that the Amended Complaint should remain sealed because Paragraphs 52, 54, 55, and 57 contain privileged information and Paragraphs 43, 44, and 74 contain trade secrets and unnecessarily embarrass Covad executives and board members.

The sealing of Court records is addressed in Court of Chancery Rule 5(g), which states:

> (1) Except as otherwise provided in this Rule ... all pleadings and other papers ... filed with the Register in Chancery shall become a part of the public record of the proceedings before this Court.
>
> (2) Documents shall not be filed under seal unless and except to the extent that the person seeking such filing under seal shall have first obtained, for good cause shown, an order of this Court specifying those documents ... which should be filed under seal; provided, however, the Court ... may determine whether good cause exists for the filing of such documents under seal. FN320

FN320. CT. CH. R. 5(g)(1)-(2); *see also Romero v. Dowdell,* C .A. No. 1398-N, slip op. (Del. Ch. Apr. 28, 2006).

For the reasons discussed above, the challenged portions of the Amended Complaint do not contain currently privileged information. It necessarily follows that the record should not be sealed on this basis. Additionally, this Court is unable to determine what are the "trade secrets" revealed by Paragraphs 43, 44, and 74. Although these Paragraphs perhaps reveal some internal matters at Covad, they are relevant to the Plaintiffs' case and simply are not sufficiently sensitive to counteract the strong policy reasons as to why the record is presumed to be public unless good cause is shown as to why it should be otherwise. Additionally, although perhaps Marshall's admission of a mistake is embarrassing, this information, disclosed in Paragraph 74, is relevant to the Plaintiffs' claim in that a member of Covad's board thought the BlueStar transaction was a disaster and yet Covad, as alleged, unnecessarily made a performance-based earn-out payment to BlueStar's former shareholders. While perhaps embarrassing, it is nonetheless relevant. An unfortunate consequence of litigation is that information sometimes surfaces that parties would prefer to keep in the dark.[FN321] Sealing any complaint that contains mildly embarrassing information would defeat the presumption, set forth in Rule 5(g), that a record is public unless good cause is shown as to why it should be sealed.

FN321. *See Romero,* C.A. No. 1398-N, slip op. at 5-7.

Therefore, the Court denies Covad's Motion for the Continued Sealing and Resealing of Documents and grants the Plaintiffs' Cross-Motion to Unseal the Record.

IX. DISQUALIFICATION OF THE PLAINTIFFS

The remaining issue for the Court to address is Covad's motion to disqualify Khanna, Sams, and Meisel as derivate and class plaintiffs in this action. This motion presents two questions: first, whether Khanna may continue as a representative plaintiff in the litigation; and second, if the Court finds Khanna not a proper representative plaintiff, whether Sams and Meisel may nevertheless continue as plaintiffs. The Court addresses these issues in turn, below.[FN322]

FN322. The Court, in considering whether each of the Plaintiffs may bring this case, is not restricted solely to the face of the Amended Complaint and documents incorporated into it. When necessary, the Court may, in this context, look to affidavits submitted by the parties, as well as documents and testimony submitted as part of the related, earlier § 220 action. *But cf. Canadian Commercial Workers Indus. Pension Plan v. Alden,* 2006 WL 456786, at *8-*9 (Del. Ch. Feb. 22, 2006) (applying summary judgment standard in that instance).

***41** Khanna served as Covad's General Counsel for approximately six years, until mid-2002 when he was relieved of his duties. The parties adopted an overtly hostile posture soon thereafter.[FN323] During his time at Covad, Khanna served as a senior executive with supervisory responsibilities over Covad's legal department, in addition to the matters on which he worked directly. Khanna was Covad's General Counsel during the relevant periods for all of the challenged transactions.[FN324]

FN323. *See, e.g.,* JTX 123 (June 19, 2002 letter to Covad Board from Khanna's counsel).

FN324. The Dishnet Subscription Agreement was dated February 15, 2001, and the Dishnet Settlement was entered into by Covad in February 2002. *See* Amended Compl. at ¶¶ 86, 92. Khanna was told of the charges of sexual impropriety against him on May 9, 2002, *see* JTX 106; JTX 123 at 8, and suspended from his position the following month.

Plaintiffs seeking to maintain derivative claims must satisfy the adequacy requirements implicit in Court of Chancery Rule 23.1.[FN325] "[A] derivative plaintiff serves in a fiduciary capacity as representative of persons whose interests are in plaintiff's hands and the redress of whose injuries is dependent upon her diligence, wisdom and integrity."[FN326] In a challenge to a particular plaintiff's adequacy, however, the burden rests with the defendant.[FN327] "The defendant must show a substantial likelihood that the derivative action is not being maintained for the benefit of the shareholders."[FN328]

FN325. *See, e.g., Youngman v. Tahmoush,* 457 A.2d 376, 379 (Del. Ch.1983). The analysis of the Plaintiffs' capacity to serve as derivative plaintiffs will, in this instance, be the same as the analysis of the propriety of their service as class representatives. *See, e.g., In re Fuqua Indus.*

S'holder Litig., 752 A.2d 126, 129 n. 2 (Del. Ch.1999) ("[A]nalysis of adequacy requirements is generally the same under Rules 23 and 23.1 as cases decided under Rule 23(a)(4), *i.e.*, the adequacy requirement of Rule 23, may be used in analyzing the adequacy requirements of Rule 23.1." (citations omitted)).

FN326. *In re Fuqua Indus.*, 752 A.2d at 129 (citing *Katz v. Plant Indus., Inc.*, 1981 WL 15148, at *1 (Del. Ch. Oct. 27, 1981)).

FN327. *See Emerald Partners v. Berlin*, 564 A.2d 670, 674 (Del. Ch.1989).

FN328. *Id.; see also Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *8.

A number of factors may be considered in determining whether a plaintiff is deemed "adequate" for these purposes:

(1) economic antagonisms between the representative and the class;

(2) the remedy sought by plaintiff in the derivative litigation;

(3) indications that the named plaintiff was not the driving force behind the litigation;

(4) plaintiff's unfamiliarity with the litigation;

(5) other litigation pending between plaintiff and defendants;

(6) the relative magnitude of plaintiff's personal interests as compared to her interest in the derivative action itself;

(7) plaintiff's vindictiveness toward defendants; and

(8) the degree of support plaintiff was receiving from the shareholders she purported to represent. FN329

FN329. *In re Fuqua Indus.*, 752 A.2d at 130.

This list, however, is not exhaustive.FN330 "Typically, the elements are intertwined or interrelated, and it is frequently a combination of factors which leads a court to conclude that the plaintiff does not fulfill the requirements of 23.1...." FN331 It is possible that the inadequacy of a plaintiff may be concluded from a "strong showing of only one factor [; however,] that factor must involve some conflict of interest between the derivative plaintiff and the class." FN332

FN330. *See Katz*, 1981 WL 15148, at *2 (explaining that the factors are "[a]mong the elements which the courts have evaluated").

FN331. *Id.*, at *2 (quoting *Davis v. Comed, Inc.*, 619 F.2d 588, 593-94 (6th Cir.1980); *see also In re Fuqua Indus.*, 752 A.2d at 130 n. 5.

FN332. *In re Fuqua Indus.*, 752 A.2d at 130; *see also Canadian Commercial Workers Indus. Pension Plan*, 2006 WL 456786, at *8 (explaining that "economic" conflicts are often the primary consideration); *Youngman*, 457 A.2d at 379 (noting exception that "fact that the plaintiff may have interests which go beyond the interests of the class, but are at least co-extensives with the class interest, will not defeat his serving as a representative of the class"). The Court in *Youngman* also explained that "purely hypothetical, potential or remote conflicts of interests never disable the individual plaintiff." *Id.* (citation omitted).

The Court finds Khanna an inadequate representative plaintiff, one who must therefore be disqualified, for two principal reasons.FN333 First, *Ercklentz v. Inverness Management Corp.*FN334 effectively controls disposition of this issue. In *Ercklentz*, the Court granted the defendants' motions to disqualify the plaintiff's law firm, which had formerly represented the defendant corporation, and the plaintiff, who had formerly served as general counsel (and director) of the defendant corporation. In granting the motion to disqualify the plaintiff, the Court ruled that "the ethical considerations which bar an attorney from acting as counsel against his former client also preclude him from acting as a class or derivative plaintiff against his former client." FN335 The Court determined that, because the general counsel's former representation of his corporate employer involved issues that were "substantially related" to the claims he sought to assert derivatively, the plaintiff would be disqualified.FN336 The parties agree that this is the standard to be applied.FN337

FN333. The Court's analysis addresses only the issue of whether Khanna may serve a representative plaintiff, which implicates considerations distinct from affording an attorney the opportunity to vindicate rights *personal to him. See, e.g., Doe v. A Corp.,* 709 F.2d 1043 (5th Cir.1983) (disqualifying former in-house attorney as representative plaintiff in suit against former corporate employer, but permitting him to continue suit asserting personal cause of action).

FN334. 1984 WL 8251 (Del. Ch. Oct. 18, 1984).

FN335. *Id.* at *4 (citing *Richardson v. Hamilton Int'l Corp.,* 469 F.2d 1382 (3d Cir.1972); *Doe,* 709 F.2d 1043).

FN336. *See Ercklentz,* 1984 WL 8251, at *4-*5; *see also* DELAWARE LAWYERS' RULES OF PROFESSIONAL CONDUCT ("D.L.R.P.C.") 1.6, 1.9. *Cf. Richardson,* 469 F.2d 1382; *Doe v. A Corp.,* 330 F.Supp. 1352 (S.D.N.Y.1971), *aff'd sub nom., Hall v. A Corp.,* 453 F.2d 1375 (2d Cir1972).

FN337. *See* Pls.' Ans. Br. to Mot. to Disqualify at 15; Mem. in Supp. of Covad Commc'ns Group, Inc.'s Mot. to Disqualify Pls. ("Covad's Op. Br. to Disqualify") at 8.

***42** To determine whether matters are "substantially related" for purposes of a conflict of interest with a former client the Court must evaluate: the nature and scope of the prior representation at issue; the nature and scope of the present lawsuit against the former client; and whether during the course of the previous representation the client may have disclosed confidential information that could be used against the former client in the current lawsuit. Matters may be substantially related if they involve the same transaction or legal dispute or there is substantial risk that confidential information obtained in the former representation could materially advance the client's position in the current matter. The former client is not required to reveal specific details of the information shared with the attorney, rather the Court may determine whether information regularly shared in that type of representation creates an unavoidable conflict with the current case. FN338

FN338. *Hendry v. Hendry,* 2005 WL 3359078, at *4 (Del. Ch. Dec. 1, 2005) (citing *Sanchez-Caza v. Estate of Whetstone,* 2004 WL 2087922, at *3 (Del.Super.Sept. 16, 2004))); D.L.R.P.C. 1.9 cmt. 3.

In the parties' briefs, much is made of the effect of language from *T.C. Theatre Corp.,* which is quoted by the Court in *Ercklentz:* "In cases of this sort the Court must ask whether it can reasonably be said that in the course of the former representation the attorney *might* have acquired information related to the subject of his subsequent representation." *Ercklentz,* 1984 WL 8251, at *2 (quoting *T.C. Theatre Corp.,* 113 F.Supp. at 269 (emphasis added)). In *Er-*

cklentz, the Court noted that this test set forth a strict standard that, although followed by the Third Circuit, *see Richardson,* 469 F.2d at 1385, had been modified by the Second Circuit, which instead required that the "issues involved in the two representations have been 'identical' or 'essentially the same" ' in order to find that a substantial relationship existed. *Ercklentz,* 1984 WL 8251, at *2. Ultimately, the Court concluded that it need not decide which standard to apply, since the defendants had met the higher burden of demonstrating that the two representations were essentially the same. *See id.* at *4; *see also* ABA Formal Op. 99-415 (Sept. 8, 1999) ("Representation Adverse to Organization by Former In-House Lawyer") (describing, in Part A(2), tests for "same or substantially related matters," and indicating approval of Second Circuit formulation).

The standard articulated in Comment 3 of D.L.R.P.C. 1.9, adopted in response to revisions of the ABA's Model Rules of Professional Conduct following the report of the ABA's Ethics 2000 Commission, appears to craft a middle approach between the two previously competing tests described above. *See also* E. Norman Veasey, *Ethics 2000: Thoughts and Comments on Key Issues of Professional Responsibility in the Twenty-First Century,* 5 DEL. L.REV. 1, 13 (2002).

Specifically, Comment 3 to D.L.R.P.C. 1.9 provides that "[a] conclusion about the possession of such information may be based on the nature of the services the lawyer provided the former client and information that would in ordinary practice be learned by a lawyer providing such services." Additionally, "[i]n the case of an organizational client, general knowledge of the client's policies and practices ordinarily will not preclude a subsequent representation; on the other hand, knowledge of specific facts gained in a prior representation that are relevant to the matter in question ordinarily will preclude such a representation." FN339 These principles govern the Court's analysis of whether Khanna's prior representation of Covad as its General Counsel is substantially related to the matters at issue in the present litigation.

FN339. D.L.R.P.C. 1.9 cmt. 3.

The Plaintiffs' principal argument as to why Khanna should not be disqualified is that the information he received regarding the challenged transactions was in his capacity as an officer and shareholder of Covad, and not as Covad's General Counsel. FN340 The Plaintiffs contend that Khanna's duties as General Counsel were primarily related to telecommunications regulatory work and that Covad's board members actively sought to "keep Khanna 'out of the loop" ' with respect to the challenged transactions. FN341 The Plaintiffs add that Khanna "was wholly preoccupied with hotly contested telecommunications regulatory matters and related litigation" and that, even if the board had not kept him " 'out of the loop,' the reality is that he likely still would not have even had time to participate in the transactions as counsel." FN342

FN340. *See* Pls.' Ans Br at 16 (citing Amended Compl. at ¶¶ 108-11).

FN341. Pls.' Ans. Br. to Mot. to Disqualify at 16, 22.

FN342. *Id.* at 16 n. 3.

These arguments are not persuasive, however, in light of Khanna's status as Covad's senior in-house counsel. In his testimony at the § 220 trial, Khanna claimed that he "owned" corporate governance issues for Covad and that he would have had a "role to play" in such areas. FN343 Indeed, Khanna's Original Complaint sets forth that, as General Counsel, he was "charged with the role of reviewing all conflict of interest matters for Covad. FN344 Khanna's June 19, 2002 letter to the Covad Board states that, with respect to the BlueStar acquisition: "Mr. Khanna had seriously objected, both on pure legal grounds (concerning the Clayton Act violations) and on legal/business grounds (waste and self-dealing)." FN345

FN343. Trial Tr. 121, 136-37.

FN344. *See* Original Compl. at ¶ 40.

FN345. JTX 123.

***43** Khanna's contention that board members did not solicit his advice does not dampen the Court's concerns as to the source of his information and the circumstances under which he obtained it. The Court finds that a "substantial risk" exists that an attorney in Khanna's position would, in the ordinary course, have learned confidential information relating to the challenged transactions. This concern is supported by the fact that Khanna, acting as board secretary, signed the minutes of the June 15, 2000 Covad board meeting at which the BlueStar acquisition was approved. FN346 The Plaintiffs argue that Khanna was ordinarily excluded from board meetings when transactions of this nature were approved; however, the Plaintiffs cite only to board minutes regarding the Certive transaction. FN347 Although it is the Defendants' burden to demonstrate that disqualification should occur, the Court concludes that this burden has been satisfied with respect to demonstrating a "substantial risk" that Khanna learned confidential information relating to the present litigation. FN348 Moreover, document LDWK 0002012, an email from Knowling to several Covad employees, including Khanna, dated May 21, 2000, more than two weeks before the Board's vote, states, "Here is the game plan. I've asked Bear Stearns to move forward with BlueStar ASAP with an objective to come to terms on a deal this week. Tim, *Drhuv*, Davenport and Lach *are the handlers on this transaction.*" FN349 It is unreasonable for Khanna now to argue that he was not involved with the BlueStar acquisition (claiming to have been fully engaged in regulatory matters or otherwise kept in the dark by the Covad Board about what was a major transaction, even though he served as Covad's General Counsel).

FN346. *See* JTX 117.

FN347. Moreover, even assuming, *arguendo*, that Khanna was excluded during the portions of the meeting discussing the BlueStar transaction, this would not diminish the substantial risk (indeed, likelihood) that Khanna learned confidential information either before his temporary absence or after rejoining the Board's meeting.

FN348. The Plaintiffs also argue that, unlike in *Ercllentz,* Khanna was not a member of the board and did not approve of the challenged transactions. That, however, is not a requirement for disqualification.

FN349. Calder Decl., Ex. R. (emphasis added).

In this instance, the issue of adequacy as a representative plaintiff, however, is not confined exclusively to Khanna's ethical responsibilities as Covad's former General Counsel. Indeed, the Court need not embrace here a *per se* rule of disqualification applicable to former in-house lawyers as representative plaintiffs. FN350 Additional factors support, under these circumstances, the Court's decision that, with respect to Khanna, a substantial likelihood exists that the representative action is "not being maintained for the benefit of the shareholders." Specifically, Khanna's employment dispute with Covad has impaired Khanna's capacity to vindicate shareholders' best interests. The June 19, 2002 letter to the Covad Board, demonstrates a self-interested motivation that is not consistent with the continued pursuit of a derivative and class action by this plaintiff-a plaintiff on whom the Covad shareholders would be relying. The June 19, 2002 letter makes clear that Khanna's initial motive in threatening to bring the action was to provide leverage in his attempt to regain (and enhance) his position at Covad after his suspension as General Counsel. The letter lays out numerous requirements to be imposed on the Covad Board, including that Khanna be appointed to the Covad Board "with a not less than 15-year contract[, subject only to a vote of the general shareholders based on the classified Board seat]," "be given a role as Executive Vice President for Corporate Strategy," "be compensated at all times not less than a comparable officer that serves as both an officer and as a director," and be permitted to name five individuals who would report directly to him. None of these requirements inures directly to the benefit of the shareholders, if at all-instead, the benefit is directed almost exclusively, if not solely, to Khanna. The letter continues on to threaten that

FN350. The Court recognizes that, in a derivative suit, relief is not sought from the company; this distinction was afforded no substance in *Ercklentz. See* 1984 WL 8251, at *4-*5.

***44** Mr. Khanna is more than prepared to act to defend himself, and his reputation for tenacity in this regard well precedes him. But he does not desire to light a legal fuse unless his is given no choice. The choice, then, belongs to the company and its Board. We can only hope that it is wisely made.

The Court acknowledges that mere selfish motives FN351 and past bad behavior FN352 do not necessarily disqualify an individual from serving as a derivative plaintiff. The posture of these parties, however, demonstrates ample history of bad will creating a substantial likelihood that Khanna will not maintain and prosecute the action according to the best interests of the shareholders.FN353

FN351. *See Youngman,* 457 A.2d at 382. ("Though the plaintiff may well have in part a selfish motive in bringing this action, which is not unusual, he will be permitted to continue to act on behalf of [the class].")

FN352. *See Emerald Partners,* 564 A.2d at 674-75. The Court notes that, in support of Khanna's argument that his actions during the initial stages of this dispute should be overlooked by the Court, Khanna has purported to waive any employment claims he may have had against Covad. Trial Tr. at 47. Khanna refers the Court to *Emerald Partners,* where this Court permitted a plaintiff who had engaged in "greenmail" in the past to continue as a derivative plaintiff because "Emerald further asserts that it no longer seeks to 'make a quick buck' from the situation. In support of this contention, Emerald has presented evidence that it rejected offers of 'greenmail' payments.... I am not persuaded, therefore that Emerald is maintaining this suit solely in its own interest, or that it will be unable to fairly and adequately represent the interests of ... other shareholders." 564 A.2d at 674-75. However, concerns about "greenmail" are far different from the concerns surrounding Khanna. The concern with a derivative plaintiff engaging in greenmail is that the plaintiff will sell out too quickly, will not pursue corporate governance reform involving the nominal defendant, or will seek personal financial reward at the expense of the corporate enterprise to the detriment of shareholders in general. These concerns are not unfounded. However, in the greenmail situation, the prospective plaintiff's goal is economic in nature and, once a greenmail offer has been rejected, the concerns discussed *supra* are not applicable. In the case at hand, Khanna's objectives are more qualitative in nature. One can reasonably infer that many of Khanna's issues with Covad's Board are personal in nature and, therefore, the fact that Khanna has offered to forego these claims carries less weight than in a less personal situation, such as one involving greenmail.

FN353. The Plaintiffs also point to the Court's ruling in the § 220 action that Khanna's § 220 demand was brought under a "proper purpose." The Court's ruling in that context, however, involved different standards and policies than those considered in the Court's analysis of Khanna's adequacy as a representative plaintiff.

In concluding that Khanna must be disqualified as a representative plaintiff, the Court relies primarily on Khanna's position as Covad's former General Counsel and the ethical quagmire that follows. This result is significantly supported, however, by the cloud hanging over the litigation created by the tangential and acrimonious employment dispute between Khanna and his former employer. Although the existence of a substantial relationship between Khanna's prior representation of Covad and the matters presently at issue is likely sufficient grounds to deem Khanna inadequate as a representative plaintiff under *Ercklentz,*[FN354] the Court ultimately concludes that, as a consequence of these two "intertwined and interrelated" considerations described above, Khanna must be disqualified as a representative plaintiff in this action.[FN355]

FN354. This conclusion may be viewed as equivalent to the "strong showing" of one factor, demonstrating a conflict of interest, necessary to disqualify a plaintiff as an adequate representative. *See In re Fuqua Indus.,* 752 A.2d at 130.

FN355. The Defendants have asked that the Court enter an injunction preventing Khanna from further participating in this litigation and from aiding any other persons in bringing their claims, in this context. No evidence has yet been presented to the Court requiring entry of injunctive relief-indeed, the Court's disqualification of Khanna relies in substantial part on the presumption that a danger exists that confidences will be revealed where a "substantial relationship" has been found. The Court presumes that Khanna will conform his behavior with his ethical obligations as a member of the bar; however, the Court may revisit this issue, if necessary.

Covad asserts two grounds for the disqualification of Sams and Meisel, in addition to Khanna: (1) that they are not the "driving force" behind the litigation and (2) that they have been improperly tainted by Khanna. Covad, as movant, must satisfy its burden of demonstrating inadequacy with respect to Sams and Meisel, in addition to Khanna. The evidence before the Court does not, as yet, constitute a sufficient showing of conflict to conclude in this context either that the remaining Plaintiffs are not the "driving force" behind the litigation,[FN356] or that the same potential taint surrounding Khanna extends to Sams and Meisel.[FN357] Moreover, the Court is not satisfied that the evidence before it merits the disqualification of Sams and Meisel when these factors are viewed together. Counsel for the Plaintiffs have represented to the Court that "there has been no disclosure of privileged information by Khanna to the other plaintiffs or to any of plaintiffs' counsel."[FN358] It is within the Court's discretion, then, to rely on their representations as officers of the Court.[FN359] The Court may, however, reconsider disqualification of Sams and Meisel at a later date, should it become necessary.[FN360]

FN356. Although whether a plaintiff is the "driving force" behind litigation is among the factors to be considered in determining adequacy for purposes of Court of Chancery Rule 23.1, *see, e.g., Youngman,* 457 A.2d at 379-80, Covad has yet to present persuasive evidence pointing to more than the potential that Sams and Meisel may not be sufficiently interested and involved to continue with this action. *See, e.g.,* Trial Tr. 54. This potential is insufficient. *Com-*

pare Nolen v. Shaw-Walker Co., 449 F.2d 506, 508-10 (6th Cir.1971) (finding strong showing of evidence that plaintiff was a front for person in actual control of litigation, who also had ties to corporations with which court concluded that litigation was intended to force nominal defendant to merge), *with In re Fuqua Indus.,* 752 A.2d at 130-36 (denying motion to disqualify, and, although addressing motion to disqualify focusing on one factor and thereby necessitating “strong showing,” suggesting that “driving force” factor, in order to impact analysis, requires satisfaction of a fairly demanding burden by defendants).

> Covad's “driving force” arguments would have significant impact were the Court to conclude that Sams and Meisel's ability to maintain this action relied solely or in large part on information received from Khanna that was privileged or confidential-this, of course, would implicate considerations addressed with respect to Covad's second basis for arguing that Sams and Meisel should be disqualified, as well. Indeed, Covad contends that Sams and Meisel are not among the contemplated parties having proper access to documents produced as a consequence of the earlier § 220 trial under the Confidentiality Agreement resulting from that action. Covad states that “the Confidentiality Agreement provides that the Discovery Material produced in that action may be made available to ... parties *to that litigation,* i.e., the Section 220 Action.... It provides that additional parties that are joined *in that litigation* may sign the Confidentiality Agreement and thereby receive access to the Discovery Material.... However, plaintiffs Sams and Meisel *were not parties to the Section 220 Action,* and therefore they were *not* eligible to receive the Discovery Material produced in that action.” Covad Commc'ns Group, Inc.'s Reply to Pls.' Ans. Br. to Covad Commc'ns Group, Inc.'s Mot. to Disqualify Pls. (“Covad's Reply Br. to Disqualify”) at 25-26 (emphasis in original). The Court, however, rejects this argument. The present litigation was initially filed during the pendency of the prior § 220 action, and the Court does not view this as a fair reading of the parties' intent. Given that the Amended Complaint contains no improperly divulged privileged or confidential information and that Sams and Meisel have access to the § 220 action documents, the Court finds Covad's “driving force” arguments unpersuasive on the record before it.

FN357. The Court recognizes the potential for abuse in this context. Khanna's disqualification ultimately results from the Court's consideration of more than one factor. The Court is not, however, persuaded that the case law cited by Covad creates a *presumption* that Khanna's presence has improperly tainted Sams and Meisel, in this context. Meisel has separate counsel. The record is unclear whether Sams is similarly represented by separate counsel. Moreover, much of Covad's argument is premised on its contention that the Amended Complaint contained, and therefore evidenced the improper sharing of, privileged and confidential information; this, however, was rejected by the Court, above.

FN358. Pls.' Ans. Br. to Mot. to Disqualify at 27-28; *see also* Toll Aff., Ex. C at 3; Amended Compl. at ¶ 3 n. 1.

FN359. *See IMC Global, Inc. v. Moffett,* 1998 WL 842312, at *3 (Del. Ch. Nov. 12, 1998) (“Where, as officers of the Court, attorneys can represent the full extent of information flow between them to the Court it is within the Court's discretion to rely on those representations where there is seemingly no danger of intrusion on the fairness of the adjudication process.").

FN360. *See, e.g., Canadian Commercial Workers Indus. Pension Plan,* 2006 WL 456786, at *10. The issue of whether Sams is, and has been, represented by separate counsel may, for example, present a matter for the Court's further consideration with respect to his adequacy as plaintiff when the record on this point is clarified.

X. CONCLUSION

For the reasons stated above, the Defendants' motions to dismiss are granted as to Counts I, II, III, V, VII, VIII, IX, and X of the Amended Complaint; the motions are, however, denied as to Counts IV and VI.[FN361] Khanna is dismissed as a representative plaintiff. In addition, Covad's motion to continue to seal the record is denied and the Plaintiffs' cross-motion to unseal the record is granted. Finally, Covad's motion to strike is denied.

FN361. Crosspoint's motion to dismiss is, however, granted as to the Certive Claims asserted in Count VI.

***45** IT IS SO ORDERED.

Del.Ch.,2006.
Khanna v. McMinn
Not Reported in A.2d, 2006 WL 1388744 (Del.Ch.)

END OF DOCUMENT

EXHIBIT 5

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE SOUTHERN PERU COPPER CORPORATION : Consolidated
SHAREHOLDER DERIVATIVE LITIGATION : Civil Action
: No. 961-VCS

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Chancery Courtroom No. 12A
New Castle County Courthouse
500 North King Street
Wilmington, Delaware
Tuesday, July 12, 2011
10:02 a.m.

\- - -

BEFORE: HON. LEO E. STRINE, JR., Chancellor.

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POST-TRIAL ARGUMENT

\- - -

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- - -

THE COURT: Good morning, everyone.
MR. BROWN: Good morning, Chancellor.
MR. STONE: Good morning, Chancellor.
MR. BROWN: Good morning, Your Honor. I am kind of assuming we are dispensing with the introductions, since we have been through this.
THE COURT: Sure, unless someone has had an identity change or, you know, feels --
MR. BROWN: Your Honor, this is the time set by the Court for the post-trial argument in this case following trial and pretrial and post-trial briefing. We are now ready to have our final argument and get the decision.

I will just sort of get right into it, Your Honor. Obviously, it is an entire fairness case. The issues are price and process. With respect, you know, price always does seem to be a big issue in these type of cases, and I do think here there is a preliminary question, issue. Whether it is a legal issue, an expert issue or factual issue, I am not entirely sure. But, I mean, to me the real question, the starting point is how do you evaluate whether a transaction like the one at issue here is economically fair.

And so what is the transaction? I mean, the transaction is a large New York Stock Exchange company issuing shares of its common stock to its controlling shareholder to acquire a business owned by the controlling shareholder. And so how do you determine whether that was a fair deal?

And there is sort of three methodologies that are argued or floating around. One is ours, which I consider to be sort of the obvious way. And it was the way Grupo was approaching it through its presentation of the transaction, which is you take the value of the shares. They are New York Stock Exchange shares. Their value on the valuation date that the defendants want to use about when the transaction was approved in late October of 2004 was $3.1 billion. And you compare that to the value, applying generally accepted valuation techniques, of the company to be acquired. And so our expert did that, and you come up with a fairly big disparity.

The value, you know, under a discounted cash flow valuation and a comparable company valuation of Minera Mexico, they are coming in, you know, no more than 2 billion, and that doesn't equal $3.1 billion worth of stock. And so, you know, that's how it was done in Associated Imports. And we think that is the appropriate approach to --

THE COURT: Yes. Your expert, though, blinded himself to an application of his valuation methodology to Southern Peru itself; correct?

MR. BROWN: No. And "blinded" is kind of a pejorative term, so that's -- I mean, he did not do, obviously, a discounted cash flow valuation of Southern Peru. That is correct.

THE COURT: You know, what would you call -- I used it as a verb because it seemed to be what he intentionally did to himself. And so, I mean, if you want to call it pejorative or not, he seems to have -- for example, what was his explanation, if any, for the reason that Southern Peru's stock was trading at the level it was?

MR. BROWN: The reason it was trading at the level it was? I am not sure there is a reason. That is the market price.

THE COURT: Well, you see, no. These things matter because there was a market price for one company; right?

MR. BROWN: Correct.

THE COURT: One of the things we got

clarity about, this is not a situation where your friends are contending that Southern Peru is overvalued in the market; right?

MR. BROWN: In fact, Mr. Handelsman testified it is undervalued.

THE COURT: Right. So what I am saying is they are not disputing that the shares that were paid to Grupo Mexico were not worth, you know, essentially taking whatever the trading price was times the number of shares. That's not something I need to -- my mind is easily confused, but I get to start with that level of I don't need to worry about that.

The problem is you have got to look at what you are buying on the other side of this; right?

MR. BROWN: Exactly.

THE COURT: And what you say is, oh, it doesn't matter why Southern Peru's stock was worth $3 billion. It doesn't matter; that even if you apply in some consistent way your own expert's approach to the DCF model and applied it to Southern Peru and it would suggest a market -- a value for Southern Peru materially less than the market price, that has no bearing on the fairness of this transaction. And that's where I am not sure you have got me.

And where I am also -- I want to hear what you have to say about this. For you then to write in your briefs things like the reason why what your friends did and what the committee did can't be considered is because really Southern Peru should have had its cash flows updated, there should have been all this other sorts of stuff, you brought in, you know, someone you believe to be a qualified valuation expert, and he said not one, as I recall it, not one helpful word about that subject matter. You know, you don't address whether some of those factors were considered in the market.

And I am just trying to figure out, is it just this is some sort of, I guess, law school moot court or -- you know, and they have some of the willful blindness kind of issue on their side a little bit, too. But, you know, your expert here didn't apply his methodology to both sides of the transaction.

MR. BROWN: Well, and his testimony was that in the financial community that's not what you would do, because from Southern Peru's perspective, regardless of why the market is attaching that value to their shares, they are. You know, if this was a cash transaction, we would be just valuing Southern Peru. But the currency, because the currency is not cash, it is stock, you don't do a different analysis --

THE COURT: Well, that's again -- what is his name? Beaulne?

MR. BROWN: Beaulne.

THE COURT: Beaulne.

MR. BROWN: B-O-N-E is how you pronounce it.

THE COURT: I am not really sure that is expert testimony that this is the way the market does it, because again, it is a listed-company acquisition of a nonlisted company. So I am not applauding -- I mean, I have serious questions about things I am going to ask of Mr. Stone.

And it is an odd transaction, and I am in no way, you know, naive to the powerful self-interest involved. But the idea of symmetrically looking at common factors that affect the valuation of each company and making sure that you have equalized them doesn't seem to be something that Warren Buffett would probably blind himself to. Mr. Beaulne might, and appears to have intentionally done so, and I don't really get that.

MR. BROWN: But can I ask --

THE COURT: For example, the comparable companies. If you apply the comparable company multiple that you applied to Southern Peru -- I mean, that you applied to Minera Mexico, did you apply that to Southern Peru itself? Or was that one of the multiples you used?

MR. BROWN: That's one of the comps.

THE COURT: Where was that level of -- where was that at?

MR. BROWN: 1.8 billion.

THE COURT: For Minera?

MR. BROWN: The comparable company valuation, you know, there is four pure-play copper companies, and they were -- the proxy statement admits they are comparable. I mean, the defendants are sort of really trying to say they are not really comparable, but it says in the proxy they are comparable.

THE COURT: Right.

MR. BROWN: And so the multiples they trade at, the EBITDA multiples were in a pretty tight range. And so it wasn't -- that's not a complicated analysis. I mean, you apply that to Minera Mexico and you don't get, you know -- and one of the criticisms was, well, you should have -- those are minority multiples. You need to add 20 percent. I mean, even if you do that, it is still far off.

There were two valuations done of Minera Mexico. Our expert's position was the approach, the appropriate approach is even if you did a discounted cash flow valuation or some other valuation of Southern Peru and it was way below the market price, that wouldn't matter in the analysis because the value to Southern Peru of its stock is its market price. The value to Grupo of getting that stock is its measurable value. And so when you are analyzing whether it is fair to Grupo, I mean, you look at what they are getting.

And why, you know, the market is valuing it at that honestly doesn't really matter, except -- now, I understand the point that where -- I think one of the arguments that is kind of floating out there is, well, if you did a discounted cash flow valuation of Southern Peru and it turns out it is nowhere even close to the market price even manipulating it the best you can, then that somehow shows that Minera Mexico must be worth more than its discounted cash flow valuation, too. I mean, I think that's where this is headed; right?

THE COURT: No, no. I think part of the issue that we heard from your friends on the other side, their witnesses, was this: This was a good space to be in. The underlying metal at issue seemed to be one that humans were going to demand more of; that Minera Mexico had a lot of potential to extract that, and that if you looked at both companies on similar metrics, they had a lot of similar valuation things, and that they weren't focused -- what they were focused on was was this going to be a good deal for Southern Peru from this following perspective: Can we capitalize -- can we make money by bringing Minera Mexico in and capitalize on these growing markets?

And you are right. One of the oddments of this is they sat around and did things with a 90-cent -- right? -- copper price.

MR. BROWN: Long-term copper price assumptions that the company used and that were used in the --

THE COURT: Right. Which turns into a bizarre analysis, because if I understand, what you are saying is if you kind of untangle the analysis -- right?

MR. BROWN: Yes.

THE COURT: -- what Goldman Sachs opined was fair was paying $3.1 billion for something worth 2 billion; right?

MR. BROWN: It is --

THE COURT: Because what it is is what they said was -- I mean, another way of saying it is they should have also bargained, frankly, for them to have to suffer some of their discount in the negotiations because they hadn't proven that they would get the same market multiple as Southern Peru; right?

MR. BROWN: Yes. I mean, there is about 15 points in the things you said that I --

THE COURT: Yes. I want to hear your take on it. But I also need you to take on what they say they did in a sophisticated way. And Mr. Beaulne just saying that no one would ever look at it this way, that's a very confident position. I hope he cites, you know, a lot of bigtime investors for it.

But it is not necessarily the most deeply engaging refutation of what they did.

MR. BROWN: Well, it is -- but wouldn't you agree, Your Honor, it is the obvious approach? It is the approach that Goldman took at first. You know, we are a big company. We have got these shares. They are worth 3.1 billion. That's what they are asking for. Grupo is asking for the shares to be valued at the market price. They want 3.1 billion. They have come to us with a sort of weird terminology, I think, saying and we are giving you -- essentially we are delivering a company with an equity value of 3.1 billion. That's our valuation of what we are giving you.

And so to analyze it that way, it doesn't seem unfair to Grupo. That's how they were presenting it. And so, you know, Goldman applied generally accepted valuation techniques or tried to, and they didn't come up with a value -- and they had A&S come in because, you know, Grupo was in sale mode. They had gotten Mintec to come in and do updated certifications of the mines, and, you know, they came up with their aggressive projections. They are sellers. And the committee got A&S to come in and said some of this stuff is just indefensible, so we have to make some corrections to it. But the valuation you get if you value Minera Mexico is not close to 3.1 billion. That's just -- I don't think -- there is no one here --

THE COURT: If, if you used a 1.30 copper price, was it?

MR. BROWN: No. Now, let me explain that. And that's a big issue in this case. And I think it is important to understand, like, how it slots into the arguments as they sequence.

THE COURT: Okay.

MR. BROWN: And so, you know, our argument is -- you understand our argument. You know, this is the appropriate approach --

THE COURT: Right.

MR. BROWN: -- to assessing whether it is fair. They have done -- now, Grupo, it is odd, because this is a case against Grupo. The committee is out. They are not the defendants here. But Grupo didn't come, and there was no Grupo witness saying --

THE COURT: You find that odd?

MR. BROWN: I do. They were the ones that put out a proposal, Your Honor --

THE COURT: Well, you could have called them, I guess; right? Or, I mean, these are the defendants. The defendants are obviously going to put on the people that they viewed most central, and they are going to make the argument the special committee had bargaining power and tell the committee story. I don't know that it is anything odd other than that.

If you want to put the evil controller on, that's probably more your case.

MR. BROWN: But if you are the defendant in an entire fairness case and you either might have the burden or have the burden and you offered up a $3.1 billion valuation, that's the position you took, wouldn't you want to come and say, "Well, here is how we came up with that and it is reasonable, and that's what we are arguing"?

They didn't do that. They dropped the argument they were making during the negotiations and they now switched to what the special committee's advisors were doing. So to me that's a little odd.

So in response to our argument, Grupo comes in with an expert witness that essentially has done something very similar to what Goldman did, which is do -- he only did a discounted cash flow valuation. He didn't do any other methodologies to check them, which is also flawed, I think, as he admitted at trial, that, you know, normally you would want to do other -- apply some other methodologies as checks. But he did, you know, a discounted cash flow valuation of Minera, came up with a value that was less than -- actually less than our expert did, and he did a discounted cash flow valuation of Southern Peru.

Now, the critical assumption to make that work is that changes in the price of copper affect both companies equally, and that is just not true. The one tagline they have left off is changes in the prices of copper affect both companies equally or benefit Southern because Grupo's value changes more, assuming you hold production constant.

And the big -- there is all this talk of reserves, reserves, reserves. Reserves are inextricably related to your long-term copper price assumption.

THE COURT: Because -- and this is what we talked about at trial. This is because the higher the price is, the more things that might not be characterized as reserves at a lower price, the more they become reserves, and the more economically viable it is to actually go out to them and extract them.

MR. BROWN: And it is not more economically -- the definition of reserves -- and there was a lot of trial testimony about this -- is copper that can be extracted from the ground at a profit. So the company is required to make its best, you know, long-term copper price assumption and disclose what its copper reserves are under that price. And actually, you know, the rules were changing as to what copper price assumptions and what other alternative scenarios they are required to disclose in their SEC filings --

THE COURT: And part of this you are making here. This is both the process and a price point, isn't it?

MR. BROWN: Yes, yes. Let me just say --

THE COURT: I mean, I take it what you are saying about your friends is they want to have it both ways a little bit, which is they did these metrics at the time that they did them and it doesn't yield anything close to the market price of Southern Peru. What they say, though, is, well, what you have got to really do is pump in other metrics.

But what we can't recreate in time is when they were creating these metrics, that on the things like updated reserve estimates, all those sorts of things, they intensely focused on the Minera Mexico side of the equation -- I mean on the Minera Mexico side of the equation to get those things updated, with an incentive on the part of Grupo Mexico to make Minera's picture as profitable -- but what they didn't do is do the same analysis on Southern Peru and say if we are going to really look at these metrics and apply them in a way and this is going to be what drives our process, then let's genuinely do it equally on each side of the equation.

MR. BROWN: Right. And really, again, I would like to put all these different arguments in what I think is the sequence that it takes to really, at least for me, to understand them. But that point goes to -- you know, when they say, well, you know, the DCF of Southern Copper is less than the market price, well, there is one obvious reason it could be less: That the projections are conservative. And the evidence actually showed it, Your Honor, because in 2004 Southern blew away their projections. They couldn't even project one year. Minera was basically spot on.

So, you know, the reality is there is a reason to believe --

THE COURT: Can I look at that? I mean, I am tempted to actually make you all write me a five-page letter on temporal blinders.

MR. BROWN: This was done before the closing.

THE COURT: Okay. Because each of your briefs have some stuff that peeks into the future.

MR. BROWN: And that's a whole 'nother issue, and we will talk about that. But there is kind of a weird issue here, because the defendants have argued that the valuation date should be October 21, but the closing was April 1, so I think things -- honestly, I think things that happened that were knowable on April 1 kind of ought to be fair game. I mean, that was before the deal closed.

Mr. Handelsman testified that he went back to Goldman and asked them to tell him it was fair. That's a whole 'nother issue.

But back to the 90-cent issue; okay?

The critical assumption for this so-called relative valuation analysis to work is that copper prices affect both companies equally. And, I mean, we have explained, I tried to explain, reserves are not just some scan of what is in the ground and so we know what is there. It is an analysis of what is there and how much it cost to get it out --

THE COURT: Right.

MR. BROWN: -- and what we expect to be able to sell it for, you know, into -- for the life of the mine and --

THE COURT: And so it matches up in a way. That in some ways becomes your projections, assuming a certain estimate of long-term copper price.

MR. BROWN: Right. So -- because the projections are built on some long-term copper price assumption. I mean, in the projections --

THE COURT: And investment banks we know have all these things, certainly Goldman Sachs did, where they could do sensitivity analysis when they have an updated thing --

MR. BROWN: But here --

THE COURT: -- where they could take -- as I take it, the moving parts would be here is the potential different quality; right? In oil, they have different levels of, you know, proven, probable, all this kind of stuff. I take it this is slightly different. But I am assuming you could, when you did the necessary work on it, you can match up -- you can take Minera Mexico, you can take Southern Peru, you can look at their reserves on an updated basis, sort of the quality of the things, and then you can apply a sensitivity analysis of different assumptions about copper pricing -- right? -- to come up with your projections.

MR. BROWN: It is a little more complicated, because if you change -- but let me explain. I wanted to get my point out.

THE COURT: Okay.

MR. BROWN: It is a little more complicated because you have to change a production plan. And so the investment bankers can't just -- like Mr. Beaulne testified, "I can't just change a production plan."

THE COURT: Because what you are saying --

MR. BROWN: Here is what happens. At 90 cents, the reserves are disclosed. That's the copper in the ground they can take out at a profit. For Minera Mexico it was about 20 million tons. For Southern Peru it was about 13 million tons. Those were the reserves, and that's at the 90-cent level that the company uses for its long-term planning. It is disclosed in the proxy, and, you know, those are the reserves.

If you say, well, what if we plug in $1.30, well, if you plug in a $1.30 long-term copper price assumption, the reserve profile changes. And it was in our brief, but the defendants helpfully put it in an exhibit to their post-trial answering brief. It is the very, very last page.

But the relative reserves change dramatically. And if you assume -- here it is $1.26 because that is what was disclosed in the SEC filings. They are required to do a 20 percent -- show 20 percent up and down off the base number in the SEC filings, which they did. And reserves go for Southern Peru from 13 million tons to 28.3 million tons, for -- and this is in 2005, and for Minera Mexico, 20 to 29. So it goes from, you know, Minera having a lot more reserves -- and again, this means copper you can take out of the ground at a profit -- to being the same.

The relative values, if you change your long-term copper price assumption, cannot stay the same. I mean, their expert testified that, you know, valuing a copper company, it is about the reserves. That's what they have. So you -- and what they are saying is, well, but we are assuming you don't change the production plan. But that is, I have to say -- I mean, I hate to use my own perjorative words, but it is kind of ridiculous, because if you are a business --

THE COURT: Right.

MR. BROWN: -- and you went from 13 million tons of copper you can take out of the ground at a profit to more than double that, you wouldn't take it out or change your plan at all?

And so -- and Minera went up, too, but by a much smaller percentage.

So the whole relative valuation analysis has a gigantic factual flaw, which is -- and I think it is critical to understanding the case.

THE COURT: What we don't know is, you know -- and this is where your guy Mr. Beaulne getting into the game a little bit would have been somewhat helpful to me -- is are there industry metrics or other things that -- you know, what you say here is if you use this -- you know, there is actually a bigger Minera is what you are saying in the first year of this chart; right? Southern Peru reserves go up at a much higher clip than Minera Mexico's; right?

MR. BROWN: Well, that's what they are arguing. They are saying -- I mean, here is where it fits in. The other years --

THE COURT: Is that what they are saying?

MR. BROWN: No.

THE COURT: I think that's your argument.

MR. BROWN: They said we will just use $1.30.

THE COURT: What I am saying is that's your best -- that year is actually good for you, as I understand.

MR. BROWN: But I don't know where the other -- honestly, I don't know where the other numbers came from, and I don't think they were -- they weren't disclosed or knowable on the valuation date.

THE COURT: No. No. I mean, you do know because there is a note, and they weren't -- I mean, you may have, again, chosen not to -- you may not have read beyond the 2005, but it basically looks like it is from, you know, their annual --

MR. BROWN: I know, but their point is --

THE COURT: What I am trying to do, and I am trying to understand your argument as it goes along here. And I thought this was something that was helpful to you.

What you are pointing out to me is, okay, you know, the reserves go up a lot; right?

MR. BROWN: In proportion --

THE COURT: Well, let me get my point out so you can -- because I think it relates to exactly what you are saying, but I need your help here to translate it into something if I am going to, you know, make it as something, a criterion in my decision-making.

You are saying here, okay, you have gone up to $1.26 in your assumption about the price of copper. That more than doubles Southern Peru's reserves. What did you do, special committee, to take into account that increased production? And you are saying, as I understand it, you are saying my expert couldn't come up with that, but they are clearly going to produce a lot more copper because you can do that productively, and this is twice as much in terms of reserves.

Is that -- I mean, I take it that is part of your point; right?

MR. BROWN: Yes.

THE COURT: And what I am asking is, you know, what are the metrics about how much an increase in reserves turns into production. Do you know?

MR. BROWN: No.

THE COURT: Is there an industry knowledge out there or anything? I mean, or is that part of your point, that the committee didn't do that?

MR. BROWN: The committee didn't do it. Their assumption in their model is that is the basis for the whole model, and if that assumption is wrong, the model is not valid, and that is, copper price changes affect both companies equally, and they do -- or they benefit Minera more if you hold production constant, according to them.

But our response to that argument is but you --

THE COURT: But that's why -- that's the whole basis why they become reserves --

MR. BROWN: Yes.

THE COURT: -- is because you can now produce them profitably, and so production is what wouldn't remain constant.

MR. BROWN: Exactly. And so really, we are not -- I didn't -- this was in the sequence of things, you know, we made our argument. They come back with a relative valuation, and then our point about the relative valuation is, well, there is something seriously flawed with this because your DCF value is way off the market price. You have got to -- there has got to be some explanation of that. Anytime a valuation person does a DCF, you know, you at least check it against the market to see what -- see where it stands. And it is way off. And we said it is way off. You haven't checked it against anything. You haven't given any explanation for it.

Our explanation is you are using conservative projections compared to optimized projections for the seller. But their response is, well, you know, the market must be using a $1.30 copper price. That's the explanation. And that's not correct, because if you change -- and they say, well, if we use $1.30 copper prices in both models, you know, it is still fair. But you can't just make that one change, because a change in your long-term copper price assumption is inextricably related to the calculation of your reserves. So the whole model changes, and it is not valid anymore.

So where this came into the argument, as far as I was concerned, was, you know, in response to their arguments, their expert's point, well, just use $1.30. You can't just use $1.30. There is other reasons, too, why you can't just use $1.30, which is the company wasn't using it. It is all over their SEC filings and the limited SEC filings Minera made that they were using it to assist and it is the analysts' consensus and that is how valuation people do it.

Now, they point out, well, there is, you know, reasons copper prices are higher. Well, that is accounted for in the model. I mean, in the first few years higher prices are used based on different issues. But one big point is what is the long-term copper price to use.

THE COURT: Well, and one of those points is what they might say, though, in terms of reconciling Southern Peru's market price to the DCF is that in some ways the copper price thing does it for you alone because, you know, in a complex dynamic the market values that. The market does the translation in its head that you are talking about -- right? -- which said at $1.30 their reserves are going up, their production is going up, and that explains why, you know, the market was valuing Southern Peru at what it did. You get my drift.

MR. BROWN: Well, that's just a guess.

THE COURT: Well, it is, but, you see, the things with Mr. Beaulne -- experts, most of the time what they do is a guess, and I have got to deal with someone who chose not to guess on a rather critical part of the case.

MR. BROWN: But I understand that Your Honor thinks that that's critical, but here is why I don't think it is. And this is my best argument.

THE COURT: You know, I am not saying it was critical or not. I am saying it is unhelpful.

MR. BROWN: Because in an entire fairness case -- that's why I get back to the question of how do you decide if it is fair, because really what you are saying is in this transaction we know what the fiduciary got. They got 3.1 billion. I mean, it is no different from getting cash, honestly. That's my approach.

I mean, I think their whole approach assumes you have to do a different analysis versus cash and stock, and I don't think that's legally defensible.

We know what they got, so whether -- why it is worth that doesn't matter. That's what it is actually worth. That's what it is worth to Southern Copper. I mean, they could do a public offering, generate the 3.1 billion in cash or something around there, maybe more, according to Handelsman. And, you know, so that's what the value of these shares are to the company that is issuing them, and that's what the value is to Grupo, and that's the value -- in fact, they attached --

THE COURT: Again, you are assuming that they looked at it that way, because it is not clear that they looked at it at all like it was, you know -- they are looking at the upside of what they are getting from Minera Mexico; right?

MR. BROWN: I don't think so. I think they did a valuation of Minera Mexico -- I mean, what

Mr. Handelsman testified to I think to me was somewhat remarkable. You know, their initial reaction, I think everybody looking at something like this is, well, they are asking for 3.1 billion in stock at the market price. Let's do a valuation of Minera. It is not coming out anywhere near it, instead of saying let's go back to Minera and argue about this valuation and try to figure out --

THE COURT: Right.

MR. BROWN: -- what is wrong with Minera.

THE COURT: We can only get to 2.2 billion. That's what we will give for you.

MR. BROWN: We will give you 2.2. If you were authorized to make counteroffers -- and two of the committee members thought they weren't.

Let me just ask a hypothetical, Your Honor. If you or me or anyone else was the 55 percent shareholder of Southern Peru and the rest was public, and Grupo, who is now a third party, came to you and made the same proposal, "We would like to sell you Minera Mexico, its mining operations. Now, there is no synergies for you. It is in a totally different part of the world, but it is what you do. And, you know, we would like to move it out of, you know, the Mexican stock market into the U.S. stock market. And our valuation is 3.1 billion. We will do it if you will issue us $3.1 billion of stock," I mean, is there any thought that you would do a discounted cash flow valuation, try to justify it on the basis that my stock is really only worth half of the market price? No. You would say, "Right. The consideration going out is 3.1 billion. Let's talk about -- let's argue this and negotiate this based on the value of Minera." You apply generally accepted valuation techniques.

Now, there is this one argument that is kind of floating out there that I did want to address a little bit on this point, which is -- and it kinds of relates to your argument -- your questions on the DCF on both sides. I mean, they sort of point out based on one document that is kind of hearsay, but that one of their bankers sort of did an analysis and said, "Well, these copper companies, they are trading at a premium to their DCF, and so that's really what is going on here. There is a DCF, but it is just being valued in the market more than that."

And again, there is two flaws in that. One, you can't just compare unknown DCFs. The one we know about and that has been scrutinized by the committee and the lawyers and in the litigation is the Minera DCF. And, you know, it was optimized, and it was real aggressive, and they even tried -- it was even stepped back by the committee. So that's the real DCF, you know.

But the fundamental point is that's not a valid valuation methodology. I mean, all they are doing in that argument is a comparable company valuation. But the metric they are using isn't EBITDA. It is, you know, 1.5 times your DCF valuation. And as Mr. Beaulne testified, "And I have never seen in any financial literature or in any case that that's a methodology you use." If you want to value Minera by looking at comparable companies, the metric you use isn't something times the DCF. It is something times its EBITDA.

THE COURT: Plus if you were doing that on that logic, one would hope you would look at the sustainability of something like that. I mean, I remember what was it? Web, Webvan? What was the one that was going to deliver Mars bars to yuppies in Greenwich Village when they had the munchies for whatever reason at 2:00 a.m? I am sure it was trading at some ginormous multiple to its DCF.

If you were buying a company when you thought the only reason to buy it at that point was to see whether you could take advantage of the bubble for some period of time and then sell it -- right? -- you would actually be kind of suspicious of, you know, being a victim of what you are currently benefiting from, if you get my drift, which is typically you would want to buy something at a discount to its DCF or something like that and not a multiple.

I think, though -- how do you deal with -- what if they were just using the 90 cents as just a conservative leveler to make sure that the assets were kind of equally valuable, but in their mindset they actually believed that the market was a more bullish one, that the value of copper was $1.30, that when you applied that metric, Minera Mexico's value would equal or exceed the value of the currency being used, and that because of the positive direction of the marketplace, putting together these two assets and being able to combine them and take advantage of them in the public marketplace at their valuation is a really good deal.

MR. BROWN: Well, first, that's not

what the committee did. I mean, if you want to say, well -- if you are having an intellectually honest approach to this and acting as if you are a third party, you know, you may say, gee, 90 cents, you know, but it is a complicated analysis. If you just increase the price, the long-term price to $1.30, I mean, you have to change everything in the model, so -- and they didn't do that. And I don't know what it would have come out to be, whether it would be more than 3.1 billion or not. You know, I think you just can't do that. But --

THE COURT: Isn't it the case, though, in terms of Southern Peru, when you look at its own metrics, though, something has to explain the market price? And one of the things that explains the market price is that the market had more bullish expectations for Southern Peru than were reflected in Southern Peru's publicly disclosed reserve plan or projections, and that what the market believed was that, frankly, the demand for copper was going to grow such that the price would get higher, that Southern Peru would benefit from that because its reserves would increase and its production would go up, and that the gap -- you know, you are clinging to the market price as the evidence of its real value; right?

MR. BROWN: Well, that's -- no.

THE COURT: But wait. You are suggesting -- you are not suggesting that Southern Peru was somehow trading at a discount to intrinsic value. I hate that term. You know, to some sort of measure of --

MR. BROWN: Yes, that's what Mr. Handelsman testified to.

THE COURT: No. But your side of the V and Mr. Beaulne are not pushing that point.

MR. BROWN: Because here is our argument, and it has to do with going back to my initial question or theory, which is how do you analyze it, because this is a transaction where the controlling shareholder got something of a measurable economic value, and so we are trying to decide if that's fair. And so what it is worth and what they are -- that's why I don't think --

THE COURT: But, see, again, I mean, just for future cases, gentlemen -- and I will note for the record that it is all gentlemen -- actually, men. I don't know if they are gentlemen or not. I suppose some of them are rogues or fancy themselves so.

But it is not the most helpful way to present a case to a court, because, news to you all, I am not on either side of the V. And you have left me in a situation where you are not trying to argue -- you don't embrace -- for example, you do not embrace -- I think you just parodied and believe it is not true -- the multiple to DCF; right?

MR. BROWN: Correct. It is not a valid methodology.

THE COURT: See, you know, everybody can get in little rigid boxes. Here is something. Valuation people are not scientists. The idea that this market necessarily trades on long-term expected cash flows is ridiculous given trading velocities. Cash flows change just by the moment. It trades on the greater fool theory and what people think something is going to sell at in a month.

MR. BROWN: Or some other crazy stuff. I mean, who can explain Internet stocks --

THE COURT: Fine. But there has to be something. And the Internet, people expect the Internet to -- generally demand is going to go up, but they also know generally people get excited about this in the early stages; that if you can get in early and get in at the right time, you can make a lot of money, and people get excited about that sort of thing, which is why I think there tends to be some evidence out there that markets tend to overvalue things rather than undervalue them.

But you have ultimately got to win not only the case but you have got to have me come in with a remedy, and I have got to measure that remedy. And you don't like -- you don't think Southern Peru was trading at one and a half times its genuine -- its best estimate of future cash flow value; right? You don't think that's right.

MR. BROWN: Correct.

THE COURT: But you also don't embrace the defendants' basic perception that the marketplace seems to have been likely looking at Southern Peru and others believing that there was more demand for copper than was used in the business plans of these companies, perhaps the business plans being conservative, because you want to -- you would rather err on the, you know, low side.

You know, you want to play the Jack Welch technique -- right? -- which is I would rather always deliver more. You know, for 27 years I have always delivered more than I promised, every quarter -- right? -- which made me -- I wasn't really promising all of what I could probably deliver. I was holding some back so that you would be surprised rather than disappointed -- right? -- every quarter. You know, it is difficult to be so, you know, predictively, you know, delivering wonderful, you know, gains to people.

But I am just trying to figure substantively what is wrong with their argument. I mean, it seems to be right.

And the market also -- one of the great things about the market is it doesn't have to actually think about reserves different from increases in production different from increases in copper prices. What the market does, or people who focus on it, is a $1.30 copper price. That's going to provide a lot more room for companies like Southern Peru to produce more at a profitable level.

You look at the reserves for the same reason. The reserves are measured as an economic thing; right? What is the amount of copper -- what is the copper, you know, ore that is profitable to produce? So the market is making a general assessment. And what they are saying is if you look at a $1.30 copper price, if you want to focus on a single variable, that alone does an awful lot to explain, you know, the market price of Southern Peru. And if you apply that same metric to Minera Mexico --

MR. BROWN: It is not fair --

THE COURT: Okay.

MR. BROWN: -- because, you know, their expert came in, Your Honor, and he is not -- it is not fair by a lot. It isn't fair by 67 point something million shares. I mean, it is real close to where it is. So a little difference in the relative value and it is not fair, according to their expert.

And so if you change the assumption about copper prices, you have to redo the model. And again, he testified that the model isn't valid unless you are having this same effect. And it doesn't have the same effect.

THE COURT: Now, do I have some version of Gonzales here from you in terms of a remedy, which is were I to conclude that they have the ultimate -- they have the burden of fairness -- and I guess there will be issues about whether we did this sort of fairness L-I-T-E shifting. We should spend some time on that before you get down in terms of whether you are really mounting some process challenge to the committee or whether you are just saying, frankly, they weren't that wise, because I am not sure that that's -- I don't think -- I am not sure we should talk about it the second way, that you don't get a burden-shift just because you don't think somebody was -- as I said, let's stick to Warren Buffett as opposed to somebody else.

But how do I -- what I mean by Gonzales, as you remember, Chancellor Allen said in Gonzales we get all these men and women in valuation science, they supposedly apply the same thing, and they come in with these ridiculously disparate approaches to valuation. What he just said -- that was in an appraisal context -- "I am just going to pick one. I am going to make a decision about who was more credible in the end, and I am not going to play games with all of it. I am going to pick one over the other." And the Supreme Court said, "You can't do that. You have got to come up with your own estimate of value."

To some extent what you are telling

me, Mr. Brown, is if they were going to do what they did, you had to be -- you know, you had to play it straight. You need to get updated reserve estimates and all that kind of stuff for Southern Peru and do everything that you could on the Southern Peru side of the equation if you are the special committee to make sure that you had accurate and responsibly optimistic in the sense of we are representing the stockholders of Southern Peru, the minority stockholders. We need to be responsibly aggressive about that and make sure that we are at least as responsibly aggressive, if not more so, than the other side of this analysis, and that that was not done.

MR. BROWN: Correct. It was --

THE COURT: Okay. If that is the case, if I were to find, for example, that your rather simplistic thing that doesn't sway me, that they are stuck with their 90 cents and that the real damages here are the difference between the undisputed -- what they now say the undisputed market value of what they gave up -- right? -- and their DCF, as they did it, as you can unpack it from their analysis -- right? -- I mean, isn't that kind of a Gonzales choice? I mean, because you are not giving me anything --

MR. BROWN: No.

THE COURT: -- that is more nuanced.

MR. BROWN: Well, and I know. And because of the -- we shortchanged ourselves on the briefs. You know, we were focusing on liability.

THE COURT: But I am not sure there is anything in the record. Again, this is where Mr. Beaulne and you all decided to really --

MR. BROWN: Go all or nothing?

THE COURT: Yes, and also almost purposely avoid, you know, some of the more interesting gray areas.

MR. BROWN: There was no purposeful intent to avoid it.

THE COURT: Okay.

MR. BROWN: This was -- if it was not -- it turns out to be, you know, a strategy, litigation plan that doesn't work out -- I mean, we make a good-faith effort to sort of figure out how to present our case in the best way we can, and, you know, this is what was done. And --

THE COURT: Sure.

MR. BROWN: -- obviously, you know, in every case, if we had the comments of the Court and we knew that --

THE COURT: No. I am saying --

MR. BROWN: -- we would do it differently.

THE COURT: But embedded in your own arguments, though, coming out from your own arguments is the obvious question that someone like me would ask, which is, okay, you say that this should have been done on the Southern Peru side of the analysis. Now having held discovery and experts, how would it have affected the analysis if it had been done?

MR. BROWN: But that's the problem for us, because we can't do it. I mean, we can't, you know, change the copper price assumptions and optimize the model and figure out what the different production -- it is just not possible for us to do. You know, nobody other than the company with all their personnel and knowledge could do that.

So what we are pointing out --

THE COURT: No, but you had Mr. Beaulne. For example, the multiples. You are telling me there is no way of using, you know, a multiples analysis looking at different copper prices and how the markets tended to react over time when copper prices go up or down in terms of what people -- you know, how people view these kind of companies?

MR. BROWN: You are going a little over my head. I mean, I don't know what that analysis would be. I mean --

THE COURT: Well, what I am saying is if you expect -- if you have got companies that are, say, pure-play copper companies, multiples are just an indirect way of -- you know, if you believe in the capital asset pricing model, everybody is supposed to be looking at the companies to see what their production of long-term cash flows will be; right? And then you discount it back to present value.

One way the market does that, the one way you can measure the market's expectation is multiples. The multiples are supposed to embed -- right? -- the optimism you have about future cash flows. So if you have a higher copper price -- right? -- expectation in the marketplace, you might think that the copper companies would be trading at a higher multiple than if you had a more bearish outlook for copper pricing; right?

MR. BROWN: Okay.

THE COURT: Don't you think?

MR. BROWN: Okay.

THE COURT: I mean, does that make sense to you?

MR. BROWN: Well --

THE COURT: And if it does -- what I am trying to yearn for here is, like, this is a case, pretty obviously, where there are vulnerabilities for both sides, but measuring -- and maybe you should feel good that you are up here and the judge is actually inquiring into the things that may get into remedial aspects of the case. Like, obviously, if I don't rule for you, I don't have to get into any of this. But if I do, there is the possibility that, frankly, I am just not as starkly convinced by the other side's recitation as you would like, and that with respect to measuring the level of any unfairness, I am going to look at these sorts of things.

And part of what I am yearning for -- and I don't think it is because the briefs are shorter -- is where in the record do I find anything helpful from your side on this.

MR. BROWN: Well, we have presented the analysis that we think is appropriate. And I hate to fall back on this, but obviously, and we acknowledge, the Court has broad discretion to fashion any form of relief the Court thinks is appropriate. So you don't have to mix -- you can sort of do anything you want really: If you say, "I think they haven't passed the entire fairness test, but, you know, I am not going to say that they have to give back 26 million shares." You can say that it was -- you know, it was inappropriate to ignore the market price, and so the valuation here, the valuation that was used shouldn't have been, you know, 100 percent, the DCF valuation of Southern Peru. It should have been 5 percent or 10 percent of the market price. And if you use that, you know, the share issuance is off by a little bit or whatever. I mean, it is hard for us to sort of give all different alternatives of what you can do, because you can look at it and say -- essentially come out wherever you want by saying, you know, different things.

And, you know, one fundamental point here is -- and they dispute it, but their relative valuation analysis does not really give any weight to the market price.

By the way, on the $1.30 point, the market believed that, well, it is equally plausible that the market simply believed that Southern's projections were conservative. I mean, that's why when we are all talking about --

THE COURT: But, see, here is one of the problems I am having with this, which is you are doing a really good job, I mean, of helping someone who is not that complex a thinker about these things kind of understand the relationship between these reserves and future profitability. Where I think we are talking past each other is I am not sure that you are not speaking exactly the same language as, substantive economic language, as your friends, but they have just used a sort of simple metric to explain an interrelated phenomenon, which is, as I understand it, what you say is higher prices equals higher reserves equals a more aggressive production plan; right? So you put those three together. Higher prices increases your reserves, translates into more aggressive production plan, results in, bottom line, higher future expected cash flows.

MR. BROWN: Right. And it changed.

THE COURT: And what your friends say is even if you are right -- and part of the premise of their case is you are right. Their own witnesses said you are right in this regard, and this may be a shocking insight, but I believe confessed you are right in this. They can't be justifying this on the basis that the price of copper at that time they really believed was 90 cents, I don't think, because then it was a stupid deal.

I mean, one thing that has gotten in my dullard mind for sure, this would be a genuinely dumb deal if you were bearish on copper, because you would have been -- instead of capitalizing on the market multiple you were getting and monetizing it and doing a special dividend, you would have essentially bought into something you knew was overpriced.

MR. BROWN: You are --

THE COURT: But, see, let's isolate this. I am really focusing here for you, I mean, part of it, there are elements of this case that there are a lot of questions asked about the defendants. But if I am going to get to a remedy for you, you know me well enough that it is probably unlikely to be as usefully simplistic for you as you would like. And I might hunger to actually follow up on exactly what you said they should have done, which is a more sophisticated dynamic analysis of the effect of higher copper prices on the actual future cash flows of the two companies involved. That strikes me as something that, you know, I am going to ask about. It seems to me, frankly, something quite plausible for a banker suggesting a valuation move of the kind they made to have actually insisted upon if they were giving a fairness opinion to a special committee.

Where in the record, though -- say I go with you on that. Then you make -- and your brief does make this argument. I am then supposed to go with you and saying if you do that, that would comparatively turn out better for Southern Peru than what Goldman Sachs did. Where do I find evidence for that in the record that is helpful?

MR. BROWN: Of the quantification of it?

THE COURT: Quantification, the reason. I mean, really, I hunger for --

MR. BROWN: That's why -- there isn't the specific evidence that you are asking for. But let me try to explain where it fits in, because, again, I think the sequence of the arguments is important to understand what is being asserted for what reason.

We have our analysis. They have their relative valuation. We point out that it is flawed. It is so far off from the market, there is something wrong with it. Their response is, well, we could use $1.30, and our response to that is you can only use $1.30, you can only change copper prices in your relative valuation model -- and this is your own theory -- if it affects both companies equally. Now, and we can show that it doesn't. It changed -- the reserves change out of proportion to each other. And so the whole -- the argument is made to take down their analysis.

We were not capable of saying but, you know, if you had done the analysis, I mean, if you really thought $1.30 was the appropriate price to use, you know, here is what you would have come out with. We just were not capable of doing that. And so there isn't any evidence in the record of that. But the point --

THE COURT: Well, are there things -- what I was trying to ask you about the multiples analysis and other things like that is this: Are there things from which I can derive from market evidence general rough judgments about how the marketplace views the effect of higher, you know, reserves or higher, you know, copper prices on multiples? I doubt the market knows -- the market is stuck with what you have, what you said, which is they don't know exactly what the increased production plans are going to be; right?

And, you know, one of the things we will get into is, you know, there is all kinds of complexity, the difference between mining in Mexico and its political environment and its climate and geography versus mining in Peru versus mining in West Virginia. Markets probably, though, have some, you know, translation, some rough sorts of things. They smooth out things. You know, it is not exactly comparable but pretty close.

And, I mean -- and I will let you sit down, too. What I am saying is I do need, you know -- one of the things I admire about you as a practitioner is you are admirably candid, and you seek an economic objective for your client, which is what you should get if you are entitled to it, because that's what your client wants. I mean, to turn around to your client, Vice Chancellor Strine or now Chancellor Strine -- it is hard for me. As most of you know, the vice will never come entirely out of me. It is just not something that is likely to happen.

You know, you want to equally get an award that you think compensates your client fairly for the unfairness, and, you know, I am going to need to come up with a remedy for you then. And I don't like to guess. I mean, one of the reasons I don't like about appraisal cases, because it is a lot of guess, and so you know that.

And what I am saying -- when you sit down, you may want -- and I may give you some follow-up in a letter. But this is really kind of a gap that kind of concerns me. And you know they are going to pile into this in a second on you.

MR. BROWN: I know. And honestly, as I am standing here, I am being handed pieces of paper. I really don't know the answer to that --

THE COURT: Okay. That is fine.

MR. BROWN: -- as I am standing here. I mean, we can --

THE COURT: It is tough now doing it without -- do you want to talk a little bit about the process?

MR. BROWN: Let me talk about the

process, Your Honor. And I mentioned something at the beginning, you know, a little bit before, what I consider to be the basic test of process going back to Weinberger, which is have you done something that approximates what would have occurred in an arm's-length transaction, and if you set up a process and did it actually work. You don't just look at the resumes of the committee. You have to look at what they did. I mean, otherwise, in Van Gorkom, there never would have been a liability. They had the longest list of the most qualified people, and, you know, sometimes people make mistakes.

Now, here, so really the question is -- I mean, I think you ought to start off with, well, if I was the owner, would I have done it this way. And clearly, I don't think -- you know, and a third party wouldn't be turning to a valuation, you know, or a methodology that valued its stock at that time less than its market price. They would be focusing on the Minera valuation, which really wasn't done here.

But I think the ultimate test, you know, of the process is let's talk about the facts of what happened. Their main point is they thought they did a fantastic job. They got a lot of things. And so there is basically five things that they say they got that show that they were an effectively functioning committee, an informed committee. And really, when you go through them -- it is not going to take me all that long, but when you go through them, they didn't get anything of all that great significance. I mean, giving them the benefit of the doubt, even if you consider some of the things they got to have some value, they really don't amount to anything. So this was not a committee that functioned properly, that obtained anything.

And the most important point, obviously, is the price. I mean, this has been mentioned ad nauseum. They asked for 3.1 billion. They got on -- at the time the defendants contend is the valuation date, October 21, they got 3.1 billion.

THE COURT: And so the ask there -- one of the things, you know, what judges always love is the ability of parties to disagree on just virtually anything. And as I understand it, your point is they actually did basically the same or slightly worse than if they had just accepted the initial bid; right?

MR. BROWN: Yes. It is not slightly worse. I mean, actually --

THE COURT: But isn't here what you place an emphasis on is the value, the economic value that Grupo Mexico referred to in its offer; right? Is the difference between you and the defendants that they focus on the indicative number of shares?

MR. BROWN: Yes. And let me try to explain it, because there is a lot of sort of people talking about different numbers.

THE COURT: Right. But just so I -- you are saying -- their ask really was, you know, $3 billion and 50 million. You know, it wasn't even 3.1. It was 3 -- it was a very specific economic number. And that was their ask; right?

MR. BROWN: To be valued at the market price during a window right before closing.

THE COURT: Right.

MR. BROWN: That was the --

THE COURT: And so when you are talking about the difference between if they had just simply signed up that deal; right?

MR. BROWN: Or if they had accepted that pricing term. Obviously, other terms would be negotiated. But that was the pricing term they were proposing. The methodology determined the number of shares. If it accepted the pricing term, it said we will do that pricing term, and, you know, here is the other things --

THE COURT: And, I mean, this is a very -- I am going to ask Mr. Stone the same thing. You argue that if they had accepted that, that would have been better off -- they would have been better off than if they did the deal they did. Mr. Stone says no, we actually did a lot better than that, because what they asked for was 72.3 million shares, and they ultimately only got 67 million; right?

MR. BROWN: Right.

THE COURT: And what I am saying is the explanation there is he is focused on the 72.3 million indicative figure, and you are focused on the economic number and saying that indicative is indicative of the fact they weren't focused on the number of shares. They were focused on an economic value, and that's really what matters here.

MR. BROWN: Yes. And the 72 million is just 3.1 billion divided by the market price earlier.

THE COURT: Right. And that's why -- exactly.

MR. BROWN: Our point is -- you know, and this requires some explanation. But really, they asked for 3.1 billion in stock and valued at the market at a certain time, and they wanted to do it during a 20-day window before the closing. The committee said from the outset that's a nonstarter. We don't like this fluctuating. It is not really fluctuating. It is just we don't like that date for setting the value because it is far in the future and we don't know how many shares it will be. And so they ultimately agreed to 67 million shares, which is all it is is a difference in timing of when you are valuing them, because 67 million shares at, you know, October 21 or, you know, the price around that time was 3.1 billion. And so, you know, I mean, they didn't change the price.

In fact, our point is if they had accepted that term, which was 3.1 billion valued at the 20-day average above the closing, there would have been 52 million shares issued versus 67. I mean, they cost them 15 million shares by going -- by this change.

Now, you can say, Your Honor, well, just because, you know -- it is not ipso facto. Because in the negotiations they did something that didn't work out, that doesn't mean they did something wrong. I agree. So the real issue is why did they do it and did they have an informed basis for doing it and was it a reasonable decision to want to change this pricing term in this way that worked out to be a disaster on the price. And I know they said, well, there is other things, and I will get to those. But they didn't. From Day One they said it is a nonstarter.

Well, you only are concerned about the so-called floating exchange ratio if you expect the stock price to go down. If it is going to go up, it works to your advantage and you want it. And they brought Raul Jacobs in here, and he testified that the stock price was trending up and we expected it to trend up.

THE COURT: Right. So what you are saying is now there is a little cognitive dissonance there because you are saying the committee is getting this relative valuation analysis, and the copper pricing numbers that they are using are south of a dollar, but the sell to -- I don't mean that pejoratively, but the sell to me about the rationale for this was copper is going gangbusters.

We are now dealing with the controller. The controller has been pretty rigid about what it says Minera is worth. But we decide to do a floating exchange ratio, which can only --

MR. BROWN: Fixed.

THE COURT: Okay. We do a fixed.

MR. BROWN: It is sort of -- I think the floating versus fixed is kind of a misnomer. It is the date you use to set the number of shares --

THE COURT: Right.

MR. BROWN: -- the date you divide the market price by to figure out the number of shares. But that is our point. It is an inexplicable decision. If you think copper is going gangbusters, obviously --

THE COURT: Well, they are going to make -- aren't they going to make the argument about their way of looking at the world is that -- because they viewed these companies so similar that there really isn't any --

MR. BROWN: Well, but the third party,

what would a third party do, Your Honor? They made a proposal that they wanted to have 3, whatever the number is, 3.1 billion of stock valued at the market.

THE COURT: If this was so junky, if this was such a junky deal -- and this gets back to the merits, because I do want to stay on process and let you finish and ask our good reporter if she wants a five-minute break before we come to Mr. Stone and his stentorian comments.

If the market -- if this was so materially mispriced, why didn't that blunt the stock price momentum for Southern Peru?

MR. BROWN: Well, and because we don't know that it didn't is my answer. Because that's --

THE COURT: I mean, I understand that. And again, I know that you are going to say this is a fairness thing and all. But, you know, it is quite common for the buy side of these type of deals to suffer, you know, a durable diminution in their stock price for some time when they announce this sort of acquisition. Let's go to the late '90's-style CEO love match mergers of equals -- right? -- where they were all -- you know, the relationship could not be torn asunder, all this stuff. You know, they could each go on "The Bachelor" and they would never be unfaithful to the other, that kind of, you know, late '90's thing. There was typically a market discount.

Here you have got one of these things where you could easily see the market going, "Well, wait a minute. You are buying this from the controller. You know, we are really high on you, and you are just way overpaying."

And what you are saying is we don't know that there wasn't because there wasn't an events study or anything done; right?

MR. BROWN: Right.

THE COURT: You didn't do an events study either; right?

MR. BROWN: Your Honor, it is not possible to do an events study of that nature over a four-month window or longer. You could do it over a day or two. You can't factor out all the other information that is affecting this company other than this transaction over a four-month period.

THE COURT: Well, all we are saying, though, if we had a durably -- you are talking about -- the high end of what you say -- I mean, what is your high ask here from me?

MR. BROWN: Do you mean on the remedy?

THE COURT: Yes.

MR. BROWN: It is they were overpaid by 26 million shares. They should be given back.

THE COURT: Okay. Tell me about that, what that translates into in dollar terms. A billion?

MR. BROWN: It is into the billions, yes.

THE COURT: Yes. So, I mean, it is not the sort of thing where you should say, like, a one-day price drop and a billion-dollar loss in value.

MR. BROWN: Well, let me kind of address this, come at this a different way. Really what you are saying is there is the third methodology to decide whether it is fair, which is it turned out good. Okay? And I think there is two problems with that at least. One is we are not saying that they shouldn't have done this transaction under any circumstance. It was required to be fair. The question is, you know, of the value that was created, was it shared in a fair proportion between Grupo and the minority shareholders.

THE COURT: But what we are saying is, you see, for it to be -- you know, again, we credit markets with this thinking that they obviously don't do. But they do do some rough thinking.

If you overpaid for Minera Mexico to the tune you are talking about, the deal shouldn't make sense. That if what you are saying is you bought something, you know, at a billion dollars above its expected cash flows, there is still enough difference between zero and a billion to have an effect on a market float of this nature. A half-billion-dollar impact would still be a pretty big drag on a stock price. We don't see any over the period that you are talking about, even putting aside turning out well, turning out good, whatever it is. I don't really know how it turned out, and that's why you guys can send me letters about that.

But I am saying even over the period you are talking about -- right? -- between when they sign up the deal and the announcement, there is very positive stock growth, stock price growth.

MR. BROWN: Twenty percent.

THE COURT: Yes.

MR. BROWN: Twenty percent.

THE COURT: And --

MR. BROWN: And the comps all went up

by 24, 25 percent.

THE COURT: Went up by less.

MR. BROWN: It went up by less during that window, yes. That's correct.

THE COURT: Well, and is that a measure? And what would that translate into?

MR. BROWN: I don't know. We can do that calculation.

THE COURT: No. That's what I am talking about. Because it could obviously have been a drag but not to the billion-dollar level; right?

MR. BROWN: Yes.

THE COURT: And now get back to process. Kahn v. Lynch, burden-shifting lite. The special committee had a lot of process. Obviously, they had some weird things where they had meetings where they did a minimum, but they met a lot of times. They didn't hire your typical advisors, the typical, you know -- I should not say "typical." That's not the right word. Let's just say they hired some fancy type of advisors who tend to, you know, often advise controllers themselves or things like that. They seemed to be pretty smart folks. They made some judgments that you don't believe were wise, but they had good answers for them, why they did them. They had explanations.

Do you not get a fairness -- do you not get a burden-shift based on a post hoc assessment of effectiveness, or is it really in the first instance is this a credible special committee? Did they have bargaining power? Did they have quality advisors? Did they have the proper motivations? And if they did, you get the burden shift. And you still get the chance to show, frankly, under a favorable -- a preponderance standard, but you still get the substantive chance to get right into fairness.

If I am looking back and in order to determine the burden-shift I am looking into things like fixed versus floating, you know, things about this valuation --

MR. BROWN: Well, I think here is -- first of all, the structure, you are talking about sort of the structure of it versus what they actually did. I mean, they are arguing both. They are saying we had the proper structure and we obtained real benefits, so we actually had a meaningful contribution.

Our argument on the structure is, I

mean, the structure was flawed from the beginning. I mean, they didn't have a resolution setting up a true third-party situation where they were authorized to negotiate and reject the transaction. Like I said, it says "evaluate" in the resolution. Two of the committee members testified that they didn't think they had authority to make counteroffers. I mean, that's not the kind of committee that approximates arm's-length negotiation. And I will tell you --

THE COURT: So you are saying actually the confusion about their mandate is one of the issues about the burden-shift to begin with.

MR. BROWN: And that creates an issue. I mean, that is not a giant point. That is not my main point, but that is that point. There is a fact here that I have never seen, honestly. One of the committee members, one of the four abstained from voting on the transaction that he worked on. I mean, at the end --

THE COURT: No. I get that. I am not sure what to make of that, because you get these skittish members of our profession with skittish members of the investment banking community, and so at this end of the process they say let's just make this as Ivory Soap as we can by having that person not vote so that it is clear that his vote didn't carry the day, even though you have never excluded him from the process, even though he has been substantively part of the discussions. You know, what does that really do?

MR. BROWN: I don't know, but to me it is bizarre. And that's the --

THE COURT: Is it bizarre or is it just easily explainable by -- lawyers, we get sometimes caught up in things, and so what we do is, you know, we can't disqualify him but let's make sure -- look, there are instructions on this in Sarbanes-Oxley, like excuse the people from the meeting. Some of those things are real. I don't know whether they voted for the deal in his absence. I mean, if you were actually going to worry about something like this, you probably should have an executive session without the person and you should talk about the issue of concern, about whether anybody has any concerns about this, if there is any reason to believe that the process has been tainted by this person's involvement.

Did he leave the room? Do we know?

MR. BROWN: I don't know. He didn't

vote on it.

THE COURT: Right. But was he sitting in the room? Because, I mean, even under the psychological theories under which this stuff matters, having him sit there in the room still doesn't really cleanse the issue, because nobody could talk about the problem that gave rise to the abstention, to the extent it was a problem. But how much of a problem was it?

MR. BROWN: Well, I just think it is another factor.

THE COURT: But was the substance of it a problem? Because --

MR. BROWN: It was because -- here is why. He is the guy that at the same time he is supposedly negotiating, you know, the deal to acquire Minera Mexico, he is negotiating his client's exit from the company. And so that's not a conflict that creates a loyalty issue. Your Honor has already held that. But it is an issue. This is not a clean -- this was not a pristine committee.

You know, there was a guy that has a different agenda, and the extent to which it really conflicts with the minority's goals, I mean, can be argued about, but there is a difference. And I think I have to get back to -- I don't think you can just not look at what they did.

I mean, on price, our point is they didn't get anything. They lost ground.

THE COURT: No, no. I am looking -- this is on the burden-shift point? I am trying -- you know, sometimes the law makes you do things, and I have got this -- one of my whole issues with Kahn v. Lynch is I have really never quite understood the burden-shift and what all the momentum is about, you know, who gets the win if I land on the -- you know, if I fall off my bike seat onto the bar and I get stuck there, besides it being very painful to be stuck there, if I am stuck there, which way -- if the wind blows, which side of the bike I fall off depends on who wins. I mean, it is a preponderance standard. But our law purports to do this; right?

And, you know, the first thing I am supposed to do in the analysis is determine who has the burden of proof.

MR. BROWN: But I don't think you -- I think, Your Honor, if you can go through the evidence and say the preponderance of the evidence here indicates unfairness to me, then it doesn't matter if the burden has shifted. Then you can assume it shifted. The preponderance has under either standard, you know --

THE COURT: Yes. Analytically, as a person who grew up as a pretty traditional jurist who believes that standards of review are used to decide cases and not labels, it just always is frustrating for me to just not know. And I think formally speaking, I am supposed to go through this kind of -- they have applied for a burden-shift; right? I believe there has been an application for a --

MR. BROWN: Correct.

THE COURT: -- burden-shift.

MR. BROWN: I mean, my view of it is, honestly, I mean, I kind of -- I think I have a similar approach to Your Honor, which is it doesn't seem all that significant. You know, if you are going to say it is 50-50, you lose, because you had the burden, I mean, I don't think we would have won anyway. You know, in a case where we are seeking this, I mean, you have to be convinced.

THE COURT: I know, and that's why I am really -- I mean, I am taking up your time mostly for my own purposes, because again, I do have a different role. And I think one of the things about the burden-shift part of Kahn v. Lynch is that nobody really tends to want to spend a whole lot of time on it because the effect of it in the end is so minimal.

But why don't I let you stand down. I think it probably does make sense for everybody to stretch their legs and take a break. Can we come back -- is ten minutes long enough?

(Recess taken.)

MR. STONE: Good morning, Your Honor. Your Honor, I just want to frame, I think, the analysis here, and then I want to go to some of the specific points that Your Honor discussed with Mr. Brown.

First, I really think the plaintiffs both in their briefs and in their presentation today really shied away from, if not ignored, the process part of this test. I think the starting point for this analysis has to be the process, because not only, as Your Honor mentioned in the latter part of Mr. Brown's argument, does it determine who has the burden here, but it also colors the pricing inquiry.

And I think the question here today is

whether we are going to find that four highly qualified independent directors who acted in good faith, who relied on a leading investment advisor to determine fairness, did so in error and whether they, in fact, missed by billions of dollars. And the fact that there really is no discernible motive, there is no evidence in the record that they had any motive other than to get the best price possible I think is key to answering the question about whether this was a fair deal. So I think we need to make sure that we view the evidence through that prism.

There is one point, Your Honor, that I want to address first, because I think it is really a misconception, as I hear it from Your Honor's questions, about what was done with respect to SPCC.

THE COURT: Yes. I mean, that is important, because I do think, you know, we have all been around enough to see things shift in how you look at a valuation analysis, and they always tend to shift in a certain way. Even when there is no discernible motives, there seems to be a tendency to justify the deal. And there are some powerful incentives even for high-quality advisors to come out with a deal. And, you know, so I do want to hear about that, because as

I understand it, it is conceded that, you know, your clients didn't really buy 90 cents as the copper price; right? Correct?

MR. STONE: Well --

THE COURT: That the company was using that -- you know, as I said, there is always kind -- but we always create a certain amount of cognitive dissonance in life. That the company is using 90 cents as its planning metric, that that is a conservative assumption, and that is not the basis on which the deal got done. And if that was the basis of looking at the world, this was a really dumb deal; right?

MR. STONE: No.

THE COURT: No?

MR. STONE: No.

THE COURT: Okay. Then --

MR. STONE: On a relative basis 90 cents works. Ninety cents is fair.

THE COURT: On a relative basis, if I have an overvalued asset and I know it to be overvalued and I can turn it into cash, I would not buy another similar asset and then jack its value up by what I believe to be market foolishness and, instead of monetizing my good fortune to be holding onto an asset that the market is improvidently valuing, engaging in the same foolishness, unless I thought I could then turn around and sell immediately the combined thing for an even more foolish thing.

So that's why I really don't get the 90-cent story, because it can't cohere with your clients believing that the market price of Southern Peru was real, which means you could have gone out and done a secondary offering of stock and gotten 3 billion bucks. And if you do a deal where you give away 3 billion bucks to get back two, that is stupid; right?

MR. STONE: Right, Your Honor.

THE COURT: And that's why Mr. Handelsman, who is a sharp cookie, who has been hired by really -- he worked for very sharp cookies in Chicago; right?

MR. STONE: Right.

THE COURT: They don't hire -- I don't think the Pritzker family is kind of keeping a fool around for decades. And his sell to me, and again, not being pejorative, but his sell to me was, no, it wasn't 90 cents. This is a bull market for copper.

Minera Mexico is even -- is probably even more undervalued than us. This is a great chance to buy an undervalued, you know, asset that we can bring together with us and take advantage of a great ride in the copper market. That was his sell; right?

And if that's his sell, he is not saying he ever evaluated this deal like 90 cents per share was the right copper price, and it makes sense. I mean, I understand how people can get into --

MR. STONE: No, no. That's correct, Your Honor. You are right. We hoped that, certainly the directors hoped 90 cents would not be the price. I think they believed, as Your Honor said, that demand for copper was increasing.

Our point is that the deal works if you use that 90 cents. But let me get back to the point that I was trying to address on SPCC. So it is not the case that the advisors didn't look at SPCC.

THE COURT: Okay.

MR. STONE: So two things about that. Number one, first of all, Minera was controlled by Grupo. The advisors had to be more skeptical of their projections and their numbers and everything else, and they spent a lot more time on it. No question about it. They had confidence in people like Raul Jacob, who they dealt with every day, who was in charge of projections for SPCC, so they had a certain level of confidence going in. But certainly --

THE COURT: Grupo Mexico already controlled Southern Peru, though, too.

MR. STONE: They did, indeed. They did.

THE COURT: And Raul Jacob, I mean, again, you are an independent director of a controlled company.

MR. STONE: Right.

THE COURT: That doesn't mean you should be hostile --

MR. STONE: Right.

THE COURT: -- to management.

MR. STONE: But they were separately managed entities. There is no question about that. But the real point is Anderson & Schwab went in and did the same analysis as they did on Minera and they did on SPCC, and I can show you --

THE COURT: Okay. Yes, where in the record is that?

MR. STONE: Okay. This is the

deposition of Thomas Parker, who was the main copper analyst with Anderson & Schwab. And the plaintiffs asked him a number of questions about his due diligence, and they were focusing mostly on the Mintec reports for Minera, and he was talking about the fact that they went through and analyzed those in detail, taking geologic information, ore reserves, designing a pit, looking at the assumptions underlying these things.

And he was asked a question on page 41 of his deposition: "So is it fair to say that your work was focused more on assessing the reliability of the geostatistical program that Mintec was using?

"Answer: I wouldn't characterize it as the reliability of the program. The programs are, you know, they are commercial software. What we were doing, the geostatistical package and hence the ore reserves that drives the mine plan was just one piece of what we were reviewing. In a general sense we were verifying that the assumptions that go into the forward plans for both companies were reasonable and supported by historical data."

And that's just one example of his testimony.

And Goldman Sachs, there is testimony from Mr. Sanchez as well that they did due diligence on SPCC. So it is not as if they didn't do the same level of analysis on SPCC, and I am not sure where that misconception arose.

THE COURT: Well, I mean, you know, obviously, in litigation misconceptions can arise, you know, I mean, obviously, the point of no incentives to share your conceptions of the world or vice versa.

MR. STONE: The only thing --

THE COURT: But what I am saying is were there reports generated on the reserves, the changes in reserves, on the reserve levels at Minera Mexico and other aspects of what is going on at Minera Mexico which were not done at Southern Peru by independent people?

MR. STONE: We don't know the detail, but we only know that they looked at both. And I don't think the record reflects any particular --

THE COURT: What you are saying is the plaintiffs can't stand up with a report in their hand and say, "Look, this is a fully updated report from Minera Mexico done by independent advisors employed by the special committee specifically for that purpose, and there is no comparable report for Southern Peru itself"?

MR. STONE: That's right. And, in fact, the record reflects that A&S made adjustments to both the projections of Minera and the projections of SPCC, and those were accepted by Goldman and by the special committee. So they certainly looked at both companies.

And one of the things also, Your Honor, I think it is important to understand is -- and this goes back to a question that Your Honor asked our expert on the stand, which I want to make sure Your Honor understands what he was saying. You asked Professor Schwartz whether he had reviewed the projections of SPCC in detail, and he said, "No, I haven't." He relied on A&S. And he had to. And the reason is these studies take six years. I think Your Honor can take judicial notice of what is in the 10-K. It took six years for them to update the reserves at SPCC. They are longitudinal studies. They do drilling programs. They analyze those. They do seismic data. They do lots of geological studies. It takes six years.

Now, I suppose Professor Schwartz

could have done that. He would have needed an army of people to go in and do that to make sure that he in detail had confidence in the projections of either of the companies. But it is just not possible in the time -- I guess we have been at this six years, so maybe if he started at Day One, he could have done it. But it is not as simple as the typical DCF that you do when you look at the projections and you get behind the assumptions. And, I mean, it is not that kind of a company. It is much, much more complicated than that.

And so Professor Schwartz certainly did all the economic analysis, and that's reflected in his report. He looked at those projections. He just didn't get down to the level of detail that he as a mining expert and someone who worked with a mining company for ten years could have done but didn't have the time to do.

THE COURT: But what I am really, I think, focused on is symmetry. And so you are telling me there is really no "there" there when it comes to the plaintiff's assertion that there was this big update of everything that was done at Minera by independent advisors to the special committee and, frankly, with Grupo Mexico pushing a valuation of Minera that's aggressive and that there was nothing done comparable on the Southern Peru side. This is not the case.

MR. STONE: This is not the case. And there were independent consultants at SPCC working, just as there were at Mintec, on updating reserves.

THE COURT: Were they the same consultants?

MR. STONE: I don't know if it was Mintec that was hired at SPCC as well that --

THE COURT: Who were they under the control of, these people being hired?

MR. STONE: Well, they are paid ultimately by SPCC or by Minera.

THE COURT: So Mintec was working for Minera Mexico.

MR. STONE: Correct. I don't know who the consultant was at SPCC. But the plaintiffs make a big point of the fact that the reserve estimates --

THE COURT: I think what your friends are saying is Grupo Mexico is trying to, you know -- imagine it is a house; right? They have hired the expert to go in and, like, go through and say let's make the house look as spiffy as we can when we are going to sell it. And they have got people under their control doing that.

What comparable effort is there of the special committee to say, "Well, that's nice that you are doing that, but if we are going to be apples to apples here and we are going to look at everything current, then our currency is even more valuable, because if you look at our reserves, if you look at what we have to offer, we get more valuable under those things, and so you shouldn't be -- you can't justify this ask."

MR. STONE: Right.

THE COURT: That's what I think they are saying.

MR. STONE: That's what they are saying, and I think what they are saying is completely unsupported by the record. In fact, what is in the record is that Anderson & Schwab did due diligence on both companies, and there is no evidence that they did a deeper level of --

THE COURT: And who was Anderson & Schwab working for? The special committee?

MR. STONE: The special committee.

They were independent consultants hired by the special committee.

The other point I wanted to make with regard to that is Your Honor had several questions about, okay, so how do I translate reserves into production. And I think that's an excellent question, but it is a very complicated question. It is not, again -- it is true that, you know, Goldman in their sensitivity analysis did not take into account what would happen at higher copper prices. But again, that is a very, very complicated analysis, and it has to take into account things like capital expenditures and capacity.

I think you heard some testimony, and I forget whether it was from Professor Schwartz or from one of the directors, these companies are capacity-constrained. They can only produce so much copper. So as the reserves go up, they may have lots of reserves that they can tap, but they can only tap so much if it is filling up the capacity in their plant every single day. And the only option then is to build a new plant, which is huge capital expenditures and several years.

So it is not as easy as, you know,

saying that, oh, we are necessarily going to change a production plan, because, in fact, it may not change at all.

THE COURT: Right. It may not. But it might well.

MR. STONE: It might well.

THE COURT: And the definitions of reserves are really set to some sort of economic viability factor; right?

MR. STONE: Correct. They are.

THE COURT: And that's determined a lot by pricing, isn't it?

MR. STONE: It is determined by pricing, but when the price goes up -- for instance, every year when the company has to do its SEC filings, they have to go back to their production people and they have to say, "All right, at this new price that the SEC is requiring us to use, how does that change your production plan?" And it may not change it at all. It depends. It just depends on what the circumstances are.

So you can make assumptions about that, but, you know, what we do have in the record? The only evidence in the record on increase in reserves I think is Mr. Sanchez in his deposition saying that Minera Mexico increases faster than Southern Peru; the directors, who both testified, Minera Mexico increases faster than Southern Peru; and then we have the 10-Ks, which we have summarized in a chart, that shows that, in fact, Minera Mexico increases faster.

And, Your Honor, just so it is clear, that chart also takes into account the update in reserves on the Southern Peru side as of 2006, which had not yet happened at the Minera Mexico side. So, in fact, without that updated study and if you would -- or alternatively, if you have included Minera Mexico's updated study, which I think came out several years later, you would see that Minera actually increases even faster.

THE COURT: Talk to me about how much -- it is almost a philosophical discussion, but how much of this chart can I consider?

MR. STONE: Well, Your Honor, I think that if this were a point that we were talking about that, for instance, if this were an input into a DCF, I think we would have trouble, based on the current case law, considering it, because it certainly is not something that was known or knowable as of the time of the valuation.

THE COURT: No. That's right. So we have this where we say, look, the committee has got to justify -- as I understand, your point on this is the following: My clients, I mean -- or you represent somebody else. But the special committee had a way of looking at this, and they have explained what they did based on what they knew at the time.

MR. STONE: Right.

THE COURT: The plaintiffs want to say it caused grievous harm and that the committee had no basis to make any rough judgments about this. Well, so long as the committee has -- if you are just trying to -- if you are trying to sort of get to the point where you say, you know, something unfair was done and the committee has a basis for what it is saying and what it knew at the time, why should the Court blind itself to the fact that, frankly, the way things turned out were consistent with what the committee's assumptions are?

MR. STONE: That's what I am getting to, Your Honor. This is corroborative of the advice that the committee was given by Goldman Sachs and ultimately of the view that the committee formed. And the fact we had price increases --

THE COURT: But what I am talking about -- and I did this to Mr. Brown, and it is a difference between ultimately our roles and the way it affects you, because there is ultimately an appellate court that looks at these things. Where in the law is this distinction? Because intuitively it makes sense that you say he is not going to give a damage award to someone without considering whether there is any damage.

You know, we wouldn't say like a doctor says, "Here is all the things I took into account," and the patient has another credible side of the story, but then it turns out that the doctor's treatment plan pans out, and, you know -- but where in our law do we get this distinction? Are there cases that make it?

MR. STONE: Well, there are cases certainly, Your Honor, that would hold that for valuation purposes, the valuation analyst in an appraisal action or in entire fairness actions needs to look at what is known or knowable as of the valuation date.

THE COURT: Right.

MR. STONE: And I think that's pretty well established. I do think, however, that if you are going to present post-transaction evidence that is designed not necessarily to an evaluation as it is to corroborate or support other types of evidence, I don't think there is anything wrong with that.

And what we are doing here, even though I understand this has numbers and it is arguably economic, is showing -- and, look, if there had been price increases leading up to the time of the transaction, we may have had some pre-transaction data to make precisely the same point. The problem is that the copper prices were in the doldrums for several years, and we didn't have any recent data that would be indicative of this point, but lo and behold, since this case has taken six or seven years, we had post-transaction data to show the same point. And so, I mean, my view is philosophically that this ought to be accepted and viewed and considered by the Court.

THE COURT: Well, and I get that, and that's a plausible thing. But there is not a case or something that you can cite to for that proposition.

MR. STONE: I think that there are

cases where courts have taken into account post-transaction information. I don't know that there is a case that would precisely articulate a standard that says it is not okay for valuation but that it is okay for other types of things.

THE COURT: Well, how do -- don't I really do have -- don't I have to look at this as if the special committee -- that Mr. Handelsman's story is the story, which is that, you know, Goldman -- that this 90-cent thing was not what anybody believed; that what they believed was when you had the appropriately bullish perspective on the marketplace, Minera Mexico was a good deal to buy.

Why isn't Goldman doing an analysis that actually is based on the underlying premise given by the committee for its actions? Well, because as I understand it, the relative valuation used a 90-cent copper price.

MR. STONE: It used prices between 90 cents and $1.20.

THE COURT: Right. But it yields -- when you, you know, untangle it all, it yields values for Minera Mexico which don't support the deal being particularly apt, being a good deal; right?

MR. STONE: No.

THE COURT: Well, then walk me through why at 90 cents per share -- tell me what Minera Mexico is worth. And I don't want to hear about this relative stuff.

MR. STONE: Okay. I am not going to tell you about relative stuff. I am going to tell you about a DCF analysis of SPCC; okay? So Goldman did one, but they weren't the only ones who did analyses of SPCC. Analysts did them as well. And you know what? Goldman's numbers came out very similar to what the analysts' numbers came out at. And they were about half of the market price. The analysts' numbers were 21 and $20 a share when the stock was trading at 40. That's something that Goldman took a look at. That's something that UBS took a look at. That was shared with the special committee.

THE COURT: Okay. And what I am saying there, you know, because you are an excellent lawyer, and you know a little bit about the business side of things because you have been an excellent business lawyer for years, is the committee had to be believing that the DCF was wrong, that it was not an appropriately realistic assessment of the future of

Southern Peru and that it was artificially low, because otherwise, if it believed that Southern Peru was trading at twice -- you said it to be twice its DCF.

MR. STONE: It was its NAV, yes.

THE COURT: They should have immediately done a secondary offering and never bought another company, much less take your market valuation and let's buy another company for twice its DCF value?

MR. STONE: Right. But, Your Honor, I think --

THE COURT: But, see, this is important. Your clients conceded that they could monetize what was given to Grupo Mexico at the market price, that you could get $3 billion.

MR. STONE: Not all at once maybe, but yes.

THE COURT: Well, but even getting close, it is not -- even Strine doesn't give $3 billion -- tell me, I have got a piece of paper that the market is valuing twice as much as what it is worth. I could go get the market price. Somebody else is in my situation, but they don't have any market for what they have, and I know this is the situation. So rather than sell my asset at twice its fundamental earnings worth, I buy someone else. That's called charity. And when it is done towards the controlling stockholder, it is called unfairness.

So your client's story can't work at 90 cents because at 90 cents Mr. Brown's case, it is pretty slam dunk. You can't do that. No matter how nice the CEO of Grupo Mexico is, you know, and however excited you are about Mexico winning the under-17 World Cup, they cannot be rewarded with public company stockholders' money in that way. And that's why I am saying I don't understand your committee's story to hold up at 90 cents per share and why they weren't asking the banker, "This is really weird. Why haven't you -- if we believe that the market -- if Mr. Handelsman really believed the long-term copper price was $1.20, $1.30, why aren't we doing the relative valuation on those metrics? And if we can't and, Goldman, if you are telling us you won't give us a DCF value at that level, then we are not doing the deal."

How do you answer that? Why isn't --

MR. STONE: I mean, I think that's in some ways precisely consistent with what happened, because Goldman first did a DCF of Minera, and the committee looked at it and they said, "Wow, that's really a lot lower than the 3.1 billion that Grupo pegged it to. How do you explain that?" And the number they came out with was 1.7 billion or something like that. And, in fact, Goldman explained that to them, and they said a billion dollars of the difference is due to assumptions about copper price. If you use the $1 that is in Minera Mexico's projections, it accounts for a billion dollars. You are almost up to the $3 billion.

THE COURT: All right. Wait a minute. Let's start with that.

MR. STONE: Okay.

THE COURT: So if you use the $1, you said you are almost up to -- you close the gap.

MR. STONE: Almost.

THE COURT: So what that means is in normalizing the way you look at this, they are saying we are paying with this. This is our market multiple. We are paying with this. We know the cash value of this. Minera Mexico is only a billion-seven under a buck --

MR. STONE: No. No. Under 85 cents,

which is what Goldman used.

THE COURT: Okay. If you bring it up to a buck --

MR. STONE: If you bring up to a buck, you are at 2.7 billion.

THE COURT: You are at 2.7.

MR. STONE: Right.

THE COURT: And the market at that time for Southern Peru would be what; about 3? Do we know?

MR. STONE: The market capitalization?

THE COURT: Whatever the ask was.

MR. STONE: Yes, 3.1 billion; that's right. And the other two factors which took it actually well over 3.1 billion were an assumption about taxes and the downward adjustments that Anderson & Schwab had made on the projections of Minera. And if you add all of those up, you actually get up to $3.7 billion. So --

THE COURT: No. The Anderson & Schwab, that's your own advisors.

MR. STONE: I understand. That's our own advisors. So you take that out of the equation, though; you are still up over the 3.1 just with the tax assumption, which is something that, as we found out, came true. So I think that was Step 1.

Then they went to doing a DCF of SPCC, and they came out with numbers, as Mr. Handelsman testified, that were well below the market price that were again sort of within the range of Minera Mexico. And they said, "What is the deal here?" And they looked at it and said this is the way the market is treating these companies. This is the way it is trading.

THE COURT: But how do they get to where -- how do I get to what their belief is? Because 2.7 is still a fairly big gap from 3.1.

MR. STONE: There is no gap if you take into account the tax credit that Minera had.

THE COURT: Well, how did the special committee treat the tax credit?

MR. STONE: Well, Goldman did a sensitivity analysis on it in the end, but -- and they actually did it in their DCF of Minera as well. It was worth, in the middle, half a billion dollars.

THE COURT: If the committee -- at a dollar what was the DCF model for Southern Peru?

MR. STONE: If they did it at a

dollar?

THE COURT: Yes. What was Southern Peru worth --

MR. STONE: I can look it up.

THE COURT: -- under the Goldman model?

MR. STONE: At a dollar it looks like it was about $2-1/2 billion. All right? And it was trading at roughly 3.1 at the time.

THE COURT: And then at a dollar Minera Mexico they are saying is worth more than the DCF value of Southern Peru?

MR. STONE: Correct.

THE COURT: But not as much as the market value of Southern Peru.

MR. STONE: Correct.

THE COURT: And it is still not a good deal to do that deal; right?

MR. STONE: At a dollar?

THE COURT: Your clients testified that, you know, you can factor all the things -- basically, you could get the market price.

MR. STONE: I think what my client testified was for the whole company.

THE COURT: Well, see, a control overlay doesn't help.

MR. STONE: I know it doesn't help. I am just telling you that's what the testimony was.

THE COURT: No. I mean, constraining options. I mean, this was a very large block of -- you know, and no one -- it would be very strange to think it was selling at a control premium.

MR. STONE: I am not saying that it was. I am just saying -- what he is saying is the price was what it was and he believed it, yes.

THE COURT: Exactly. Which meant that you could do a secondary offering of some kind.

MR. STONE: Well, I don't know that anyone opined on that, Your Honor, because there are lots of --

THE COURT: All I am saying is --

MR. STONE: There are lots of factors that go into whether a secondary offering with dilution will actually get you the benefit that you expect from it.

THE COURT: I understand that dilution -- you know, one of your arguments, as you know, out of this case is the float. And so I am not really understanding how having a more diversified stockholder base with a bigger, you know, public float is going to be worse for everybody than what was done. And it gets back to the point is if your clients basically tell me the market price is the market price, and the market price is 3.1 billion and you are only up to 2.7 billion, and you are trading at a multiple to DCF and you are buying something else at a multiple to DCF, that sounds like a pretty classic dumb deal.

MR. STONE: That's not what my clients believed.

THE COURT: Well, that's what I am trying --

MR. STONE: They believed, as they testified, that they were getting a bargain; that Minera was worth more than the consideration that Grupo received.

THE COURT: And I thought that's what I was -- I thought I was engaging you on your own argument by saying that's why your clients must have believed -- right? -- that really the long-term copper price was higher, materially higher than 90 cents per share.

MR. STONE: I don't think there is any doubt about that. I think --

THE COURT: But that's why -- why didn't they say to their advisors, "Get this straight and figure it out" and say to Southern Peru and, frankly, to Grupo Mexico, "We are not getting it. We are telling the public that our long-term prospects are 90 cents per share -- the long-term copper price is 90 cents per share. We are not doing this. If you want to do this relative valuation, if you are really telling us we are trading at twice DCF, then we are not going to be a buyer at twice DCF because I am Mr. Handelsman and I work for the Pritzkers."

MR. STONE: Your Honor --

THE COURT: And I want to get this straight. And that's where I am trying to figure out, you know, he has got liquidity issues. There is this issue, and you mentioned about liquidity. They are locked up; right?

MR. STONE: Not locked up.

THE COURT: What are they?

MR. STONE: Restricted.

THE COURT: So how much can they sell, you know --

MR. STONE: I don't know. They could dribble it out over time.

THE COURT: Over a long time.

MR. STONE: Yes.

THE COURT: As long as this case; right?

MR. STONE: Maybe longer.

THE COURT: Maybe even longer.

MR. STONE: Your Honor, this really goes back to the same point. And it is a good question. But from a negotiation standpoint -- and I think Mr. Palomino made this very clear -- the committee considered it to be in their best interest in the negotiations to push for lower copper prices. And the reason that they did that is because they believed that as you increase the copper prices, the value of Minera goes up faster than SPCC.

So maybe they were wrong about that. They were advised that by their advisors, and they held that firm belief. And so in the negotiations they didn't want to say, "Hey, let's do the DCF at a buck 20."

THE COURT: Well, we are not at this level of subtlety. It brings to mind Bismarck or

Kissinger or something.

What you are saying is that from a business standpoint, the strategic rationale for this deal was, frankly, very bullish copper prices, much great demand for copper. Get another asset that will be able to take advantage of that and get it at a good price. That's their ultimate business objective.

MR. STONE: Right. Get reserves.

THE COURT: In order to do that, because the target of that objective was actually more price-sensitive than the buyer and would value -- would benefit in negotiations more from a more bullish thing, incurs the use of valuation metrics that on their face look really idiotic. Well, they look idiotic in this way is what we talked about. It tends to suggest that the market -- that this was a great time to monetize whatever you had in Southern Peru or some of it, because if you are getting twice what a DCF is in the market and it is not something new, you probably ought to get some cash out of it at this point.

MR. STONE: And, Your Honor, I mean --

THE COURT: But then it gets to this thing, so okay; say I am indulging that and I don't have any conflict. The committee -- explain to me the floating exchange ratio.

MR. STONE: The floating exchange ratio.

THE COURT: Or whatever it was.

MR. STONE: They wanted a fixed exchange ratio.

THE COURT: The fixed. Explain to me that part of the deal.

MR. STONE: Okay. So Grupo Mexico originally offered 72 million shares. They said that's what they wanted the consideration to be. But they said it is a floating exchange ratio, so it is going to rise --

THE COURT: Right.

MR. STONE: -- or fall depending on the stock price of SPCC.

The committee said no. We would like to have a fixed number of shares so that we are not subject to the vagaries and the volatility, frankly, of the market. Nobody knew when this first started out where the market was going to go. As it turned out, it started going up pretty rapidly. But even then, as of the time of the closing, nobody knew how sustainable that was. So, you know, their idea was let's get a fixed number of shares so we are not subject to the ups and downs of the marketplace.

THE COURT: And what was ultimately done, though, was what?

MR. STONE: A fixed exchange ratio.

THE COURT: But then the value went up.

MR. STONE: The value went up significantly, because copper prices went up significantly.

THE COURT: That's my point. Which is --

MR. STONE: Right. They couldn't --

THE COURT: I want to unwind the analytical road with your clients.

MR. STONE: I am sorry?

THE COURT: Well, Step 1 was strategically this deal only makes sense economically if you have got a bullish sense of copper pricing.

MR. STONE: Well, you can do that, but -- okay.

THE COURT: Well, again, then you are back to you don't pay $3 billion that's real

$3 billion for something --

MR. STONE: If you are paying $3 billion. In other words, if during the term of the due diligence and the negotiations the copper price had gone down and the stock price had gone down --

THE COURT: Let me just say my simplistic view of this is if your clients are not going to challenge, as they did not challenge, the market value of Southern Peru stock, then Southern Peru, the stock they gave up was basically worth the market price with some sort of factoring discount that nobody in the case has come up with, but I am not going to price it hundreds of millions of dollars.

MR. STONE: Right. And that went up and down over time.

THE COURT: It went up and down. But the first premise has to be -- so my first premise is you don't give $3 billion for overpriced assets that you think are trading at an artificially high price. You know, when the market is artificially high-valuing assets, you monetize them. You don't go deeper into that asset class.

MR. STONE: But that's not --

THE COURT: Right. So the premise was

these were not dumb people.

MR. STONE: Right.

THE COURT: So the first step is no, we are bullish on copper.

MR. STONE: Well, they were somewhat bullish on copper, but I think everyone was uncertain about it. But, Your Honor, in terms of the market being --

THE COURT: Again, if they are --

MR. STONE: In terms of the market being --

THE COURT: If they are not bullish on copper, this deal makes no sense; right? They have to be bullish on the prospects of Minera Mexico, and the primary thing that you focused on here with that is their copper.

MR. STONE: And getting the copper at a price --

THE COURT: And so Step 1 that that's --

MR. STONE: Getting the copper at a price that makes sense makes this deal make sense, and that depends --

THE COURT: And your second point --

MR. STONE: -- and that depends on your view of the world going forward.

THE COURT: But what I am saying is the second subtle thing is the deal -- at least the way I am seeing it is the only thing that makes sense is what Handelsman said. In a bullish world the deal makes sense.

MR. STONE: Okay.

THE COURT: The second step is negotiating dynamic. Though we may not necessarily want to be so transparent about what -- how we look at this, and then when we bargain, we actually -- let's use lower copper price metrics because that's actually better for us, because it obscures the fact that we think Minera Mexico in a world of increased copper prices is actually going to increase in value even more than we will on a relative basis.

MR. STONE: Right.

THE COURT: Step 2.

MR. STONE: Yes.

THE COURT: Step 3 is this exchange thing where, you know, they get a fixed number of shares; right?

MR. STONE: Right.

THE COURT: And we are the public market company, which means if our Premise 1 is bought by the marketplace, then we are going to rise in value, not fall in value. Therefore, as our price rises during the course between signing this up and closure, we pay more. And we should do -- we should lock this in now. What was the thinking around that?

MR. STONE: The thinking was, as the directors testified, they wanted to protect the downside. It is okay to be optimistic. It is okay to say we think that SPCC and Minera and every other copper company are using conservative long-term copper prices. We actually think the price is higher. But it is also okay at the same time to say I want to protect my downside. What if the price goes down? I can't predict it. Copper is volatile. Yes, we are enjoying an increase in copper now. Yes, we hope it continues. Yes, this deal makes sense if it continues to go up. But if between the time of signing and closing it goes down, I am going to look like a real idiot if I haven't done something to protect myself.

THE COURT: Well, did they negotiate for -- I mean, you could do asymmetrical collars. Did they negotiate for one?

MR. STONE: Well, they asked for a collar, but they already had their fixed exchange ratio, and they believed that that combined with the fact that they thought that these two companies would rise and fall relatively the same would protect them.

THE COURT: Well, that's what I said. So that's another -- so if you are assuming an artificial world, I mean, again, we are back to World 1, where we, see, in our heart of hearts believe that the price of copper is going up, that actually Minera Mexico is actually becoming comparatively more valuable even though our actual cost of acquisition is going up. But our negotiating adversary, you know, originally was willing to take just a chunk fixed; right?

MR. STONE: No.

THE COURT: No?

MR. STONE: They wanted a floating number. They originally offered 72 million shares as --

THE COURT: So we will go --

MR. STONE: And that 72 million shares on the date of the closing was worth over 4 billion.

THE COURT: But that's why you

can't -- and that gets back to another issue I asked Mr. Brown about. You two fundamentally disagree on whether the committee made any progress from the opening bid.

MR. STONE: Correct.

THE COURT: He focuses on the economic number. You focus on the indicative number of shares.

MR. STONE: Correct. And I, frankly, find his argument silly. I mean, it is a coincidence that the market price was such that ultimately those 67 million shares were worth $3.1 billion, approximately. And the fact is that this was a robust process. There were 24 meetings. People attended them.

THE COURT: But if it is silly, it is silly in both directions, isn't it?

MR. STONE: Well, no, no. Because ultimately the amount of SPCC -- the chunk of the equity that SPCC had to give up in order to get Minera Mexico was smaller.

THE COURT: Well --

MR. STONE: Yes. It was 67 million shares instead of 72. That's a reduction in the amount of equity that they gave up. And I think that's the appropriate way to look at it.

THE COURT: But I think what Mr. Brown was saying is what they were focused on was saying Minera Mexico was worth approximately the $3.1 billion.

MR. STONE: That's what Grupo said.

THE COURT: Well, that's a deal, and Grupo wanted 3 to 3.1 billion, and what they ultimately got was between 3 and 3.1 billion in your stock.

MR. STONE: Right. And that's coincidental.

THE COURT: And that the reason why it is called an indicative figure is that the key focus was, from Grupo Mexico, is we want $3.1 billion. What turns out to equal 3.1 billion -- I am just figuring why it is indicative -- is the number of shares.

MR. STONE: Right.

THE COURT: And at the end of the negotiation they got pretty much exactly their ask.

MR. STONE: They got a smaller amount of the equity of Southern Peru Copper Company.

THE COURT: So you are translating their ask --

MR. STONE: I am not translating their ask. I am saying that's what they got.

THE COURT: What was their ask was --

MR. STONE: 72 million shares on a --

THE COURT: But their ask was -- you are then translating it by a future market price for something.

MR. STONE: No.

THE COURT: The 72.3 million shares was come up with by Grupo Mexico by saying we have something we consider to be worth between 3 and 3.1 billion and we want currency from you equal to that value.

MR. STONE: Okay.

THE COURT: Right?

MR. STONE: Right. But as a percentage of the equity, that was a smaller -- ultimately what was given was a smaller number.

THE COURT: Well, ultimately, yes, because the stock price had gone up.

MR. STONE: That's right. So now the company was more valuable.

THE COURT: Well, right. But there is not -- and what I have to assume about that is Minera

Mexico's value went up, too; right?

MR. STONE: That's correct.

THE COURT: So it is still the same deal.

MR. STONE: It is not, Your Honor. The percentage of the equity that Grupo ultimately received from Minera Mexico was smaller than what they asked for originally.

THE COURT: So you are saying actually this is a really good deal because a fewer number of shares equaled the 3 billion, and Minera Mexico actually probably increased in value above 3 billion, and therefore, we got a better deal.

MR. STONE: We certainly did. But, Your Honor, again, I mean, all of this focus on the back and forth and the idea that Mr. Handelsman and Mr. Palomino and the other two directors who didn't testify, who are also very sophisticated investment bankers, who took their jobs very seriously, went through eight months and 24 meetings of window dressing to arrive in the same place is just preposterous. I mean, what were they doing? They spent hours and hours analyzing this, meeting with their investors, several presentations from Goldman

Sachs. I mean, this was not window dressing. This was an actual negotiation.

And getting back to another point about the process, which is, I think Your Honor called it, you know, they misconstrued their charge or something, I don't think they misconstrued anything.

THE COURT: Well, then why doesn't the committee charter plainly say that they have the ability to negotiate?

MR. STONE: I think the committee charter -- I don't know why. The answer is I don't think that the record reflects why exactly those words were used, but --

THE COURT: Well, but see, one of the things that special committees can ask for is clarity in their mandate and bargaining power. And there is some deposition testimony, is there not, where the special committee members are not exactly necessarily all on the same page about what flexibility they have?

MR. STONE: I don't know. I would disagree with that. I think that they all had understood that they had the right to say no, and the evidence is consistent that they said no over and over and over again. And, in fact, they made a counteroffer at the end once they got within striking distance. That was their strategy.

And I don't know that there is a huge difference between someone offering you something and you saying no or making them bid against themselves and instead negotiating in a way where they give you an offer, you give them a counteroffer, and you go back and forth. Those are two different ways of negotiating. And I don't think that our courts have come to the point where they are going to micromanage the way that independent directors on a special committee determine to negotiate.

But the fact is regardless of what the charge said in the resolution --

THE COURT: I think, when you are talking about micromanage, I mean, I don't think the Court micromanages -- I mean, it is a weird kind of '80's term that we came up with that does violence to the English language's beauty.

But for the Court in evaluating whether to give credence to a special committee to expect clarity about that it has the power to negotiate and is not just expected to evaluate specific proposals, I mean, I don't really think that's if you want to use the term micromanaging.

And I think there was some deposition testimony where the committee wasn't exactly clear whether they could bargain; right? They couldn't consider alternatives. You agree with that; right?

MR. STONE: Yes. They could not consider alternatives.

THE COURT: The only alternative is this one.

MR. STONE: Right, right. But they clearly -- again, regardless of what the resolution said, the fact is that they did negotiate.

THE COURT: Why this change in rubric by Goldman from the original look? Don't you think Goldman would have done this on a pretty simple basis if it could have generated a DCF for Minera Mexico that was equal to the market price of Southern Peru?

MR. STONE: I don't know the answer to that, Your Honor. I don't know what was in their mind in terms -- I mean, it is a complete hypothetical.

THE COURT: Well, they did take -- that was their first --

MR. STONE: They were very methodical. Their first step was to do a DCF of Minera. The second step was to do a DCF of SPCC. And they were very methodical about it.

THE COURT: Right. But their first step wasn't to jump to a relative valuation, was it?

MR. STONE: No, it was not. But I am not sure where that goes, Your Honor, simply because --

THE COURT: Well, I think where it goes --

MR. STONE: -- simply because they ultimately arrived at it and decided that was the right way to do it --

THE COURT: Well, again, that's where you get into incentives. See, the right way to do it --

MR. STONE: What incentive? What incentive did they have to do it in any other way?

THE COURT: Well, there is a huge incentive. I mean, what was the bulk of the compensation of the bankers in the case?

MR. STONE: I frankly don't know, Your Honor.

THE COURT: How much of it was contingent on a deal?

MR. STONE: I don't know that either, Your Honor.

THE COURT: All I know is if your first step is to do it the right way, and since most banks start with their football field looking approximately like their final fairness opinion and they just tweak the inputs as they get closer -- frankly, their first presentation to the special committee looks a lot like their pitch book, and they all ultimately look the same, and that's why you get into these things, you have got to look very carefully at how the numbers move. Where in the first presentation to the special committee was this is a relative valuation case and the first thing we need to do is get a DCF value of each of these companies? That wasn't their first move; right?

MR. STONE: It was not their first move.

THE COURT: And the first move they made was fairly simple, which is let's see whether the target -- what the target is worth, because we know what our currency is worth. And it was only when the target DCF value was astonishingly lower than the currency that we move into relative valuation territory; right?

And what evidence is there that the committee used its negotiating leverage with the controller to say, "Hey, pal, you are going to pay a discount for this. We have a proven market for our currency. You don't have a proven market for what you are. Under a very traditional way of valuing this, if we were paying cash for this, Grupo Mexico, we wouldn't do a DCF of the cash"?

MR. STONE: Well, Your Honor, there is evidence that after they did the first DCF of SPCC, the one that was lower, and then they asked for an explanation, those same minutes talk about the fact that Mr. Ruiz was going to go back to Mr. Larrea and tell him that the $3.1 billion price on Minera was much too high, and he did.

THE COURT: Okay.

MR. STONE: And so --

THE COURT: And what Mr. Brown is going to say is in the end he went back and he said 3.1 billion is too high, and then when the transaction was approved --

MR. STONE: Right.

THE COURT: -- the special committee

apparently agreed that 3.021 billion --

MR. STONE: Right.

THE COURT: -- was just right.

MR. STONE: And two significant things, Your Honor. Copper prices were very different, number one, and number two, it was a negotiation. In other words, Mr. Ruiz knew that you could make up most of that difference by using a $1 copper price assumption. So this was a negotiation. They were using their leverage. That was the question that Your Honor had.

THE COURT: Yes. But, I mean, if he went back and he focused on a dollar figure, then you are right back to Mr. Brown saying, okay, they didn't negotiate. I mean, there is no doubt there was a lot of motion.

MR. STONE: Right. And --

THE COURT: I mean, there are things --

MR. STONE: -- ultimately they agreed to a $3.1 billion price at a time --

THE COURT: Ultimately --

MR. STONE: -- when Minera was worth even more, because copper prices had gone up.

Circumstances had changed.

THE COURT: Right. Which gets me back to my -- copper prices were up. The valuation models were never updated to reflect them being up. The public markets were never told about that assumption being up; right?

MR. STONE: The public was well aware of copper prices being up.

THE COURT: Okay. But had Southern Peru done anything to look at its own -- you know, what it was telling the marketplace?

MR. STONE: It is required to every year by the SEC.

THE COURT: Right, but --

MR. STONE: And in terms of what the committee knew, they had a sensitivity analysis that went all the way up to $1.20 at least. So they knew what that relative valuation looked like at $1.20, which was even more fair than it was at lower prices.

THE COURT: Okay.

MR. STONE: All right? Okay. I am just -- I guess I didn't know, Your Honor, the Goldman Sachs fee was not contingent on the deal being done.

THE COURT: It was not?

MR. STONE: It was not.

THE COURT: So they got the same fee regardless of whether there was a deal or not? They didn't get a percentage of the deal?

MR. STONE: Goldman Sachs's fees for its services to the special committee are payable regardless of whether the merger is consummated.

THE COURT: That's what I am saying. Okay. That's good to know. It is not a typical -- so they got some sort of flat fee?

MR. STONE: Yes.

THE COURT: No success fee?

MR. STONE: No success fee.

THE COURT: Okay. That is helpful.

MR. STONE: Just checking my notes, Your Honor.

THE COURT: Don't ever let that banker, whoever negotiated that term, do that again.

MR. STONE: He has left the company.

THE COURT: I know I have never seen one. I mean, it is unusual.

MR. STONE: I think that's all I have, Your Honor, unless Your Honor has any other questions.

THE COURT: Tell me about the burden-shift. I assume you are asking for one.

MR. STONE: Yes, Your Honor. I mean, I don't think that there is any serious challenge to independence, disinterestedness, and, I mean, I do think that this was a pristine process. I just don't --

THE COURT: See, I want to hear what pristine -- you mean pristine from the sense of not untainted by improper motive.

MR. STONE: Correct.

THE COURT: Not, you know, Gomer Pyle versus Warren Buffett.

MR. STONE: Right.

THE COURT: It is just --

MR. STONE: Right. And, Your Honor, I do think that the appropriate thing in looking at the burden shift is -- I mean, the Court can consider all the circumstances, but I think that a post hoc look should be far less important than looking at what the process was that was followed here.

THE COURT: No. I am just trying to think, because there is also the other Kahn case.

MR. STONE: Tremont?

THE COURT: Yes.

MR. STONE: Yes.

THE COURT: Which seems to --

MR. STONE: Tremont, though --

THE COURT: -- go fairly deeply. And when you use terms like an "effective" special committee --

MR. STONE: Right.

THE COURT: -- you are bleeding together the substantive analysis of whether there was a fair process and price with whether to give -- how to start to apply the standard of review.

MR. STONE: Right. And Tremont says that the special committee must have functioned in a manner that indicates that the controlling shareholder did not dictate the terms of the transaction and that the committee exercised real bargaining power. And we think both of those things are true.

THE COURT: Real bargaining power being distilled down to not that you use the bargaining power that you had.

MR. STONE: They used -- what they had was the power to say no.

THE COURT: It is if you have the power and have displayed a knowledge of having the power and having no apparent motive not to use it in good faith.

MR. STONE: Well, I think that's true, but I think the committee here used it.

THE COURT: No, no. I understand.

MR. STONE: Yes.

THE COURT: What I am trying to separate out in my own mind is to be useful, this burden-shift has to involve an analytical assessment of the special committee, which is, in fact, different from the actual fairness analysis itself. When one starts using words like "effective" or "real bargaining," you know, an effective, you know, such that it look -- that's when you start going -- I understand the idea of looking at the committee and saying are they qualified people. Can they do this sort of thing? Yes. Absence of improper motive, I get that. Look at it, yes. High-quality advisors, yes. Demonstrated commitment to the process such that -- you know, I don't want to denigrate motive. Motive is important. Motion, there is meetings. There is consideration. Appreciation that they had the power to say no and bargaining, yes, but not getting into the qualitative assessment of whether they were good at it, whether they yielded a high price, you know, whether they -- because then it just becomes one blur. And it is not clear why you actually have any burden-shifting device separate from just saying, frankly, the controller met its entire fairness burden.

MR. STONE: Yes, I think we can go back to Tremont and look at what the Supreme Court looked at there, and you can quibble about whether they were reading the evidence the way they should have. I mean, I thought Chancellor Allen did a fine job below. But the Supreme Court in Tremont was most worried about the fact that two of the three members they found just abdicated their responsibility. I mean, they didn't show up for the meetings. There were only three meetings, and they didn't show up for them. And the one guy who actually did show up and hired the advisors, both the lawyers and the banker, was a guy who had been paid millions of dollars by the company. That was their concern. That's the way they read the evidence.

So I think it is those types of factors that you have to analyze when you are looking at the burden-shift question.

THE COURT: Okay. All right.

MR. STONE: All right?

THE COURT: Thank you, Mr. Stone.

MR. STONE: Thank you.

THE COURT: Mr. Brown.

MR. BROWN: Your Honor, I think there are a couple factual things that I think we disagree with but I think were wrong. First, Mr. Stone said the Minera Mexico DCF analysis that Goldman did, if you use a dollar, it gets to 3 billion. I mean, it is just not true. For the record I will say it is JX-101 at SPCC3375. It has got the two sensitivity analyses at a dollar, and using the Minera Mexico case, it is 2.3 to 3 billion. But that's the Minera Mexico case, depending on the different discount rates from --

THE COURT: Well, and what I am going to do, just to ease anybody's concerns and also for my own purposes, which is make these points, and I will say to both you and to Mr. Stone give me short, nonargumentative letters. Now, if there are some things that came up at argument and you want to say, "Here in the record is what it is, Your Honor," please do that. And maybe we can agree to do that by Friday or by Monday, whatever you agree on.

Don't make them argumentative. Just say on this point that came up at argument we refer Your Honor to this, you know.

MR. BROWN: Okay. And there was a whole bunch that I won't try to mention --

THE COURT: No. Go through it now. But what I am saying is rather than me have to pick it out -- I am going to read the transcript again, but rather than pick it out, sometimes it is convenient to have that kind of compilation of some --

MR. BROWN: So there is the Minera Mexico case and then there is the A&S case. Again, Minera Mexico gave them those aggressive projections. A&S knocked them down a little bit. And a dollar per share for A&S, it is 1.8 to 2.4. I mean, it is not 3.1. You only get close to 3 if you use the projections as provided.

Now, the --

THE COURT: And if you are saying even in the price; right?

MR. BROWN: So even if you said we will take their projections at face value, we won't even adopt any of the modifications that A&S is recommending to us, recommending to the committee, because it is just where they thought the projections were unrealistically aggressive, you know, you get to 3 billion only on the highest discount rate and sort of it is the metric at the far right at the bottom of the chart. But, I mean, on the A&S case, you don't get close to it. So this dollar a share thing gets you to 3 billion, that is just factually wrong.

There was the argument that, well, there is really no proof that the Southern Peru, you know, model wasn't sort of optimized and there is really no proof that the Minera Mexico model was optimized. I mean, it is just wrong. I mean, let me -- I mean, we will quote it in our letter, but I guess it is JX-75, A&S said, "There is expansion potential at both Toquepala and Cuajone." Those are the two Southern Peru mines. "If time permits, the conceptual studies should be expanded, similar to Alternative 3 at Cananea," which is what -- that's the optimization plan, and I will get to the quotes for those in a minute that they did for Minera Mexico. "There is no doubt optimization can be done to the current thinking that will add value at lower capital expenditures."

So A&S looked at it and they said

look, it is okay, but you have to know it is conservative. It is not optimized like Minera is.

And then for Minera in JX-103, which is one of the Goldman presentations, that's when the sort of optimization plan started being, you know, pushed, and it says, "New optimization plan for Cananea," which they call Alternative 3, "recently developed by GM and Mintec was not included in the projections at this point. According to Mintec, such plan could yield 240 million in" nominal "value on a pre-tax. . .basis. . . ." And then later on in subsequent presentations they explain that, you know, the analysis and the projections do include the optimization plan for Cananea, Alternative 3, developed by Grupo Mexico. So they were polishing up the house, you know, putting out their best foot forward, and that wasn't happening with Southern Peru when they are doing these two discounted cash flow valuations.

THE COURT: Well, how do you deal with Mr. Stone's point that the same -- that the special committee had an independent advisor along with Goldman Sachs that was, you know, looking at these things?

MR. BROWN: Yes, A&S was looking at them, and what they said in their analysis were the Minera optimization plan, it is aggressive, and we recommend knocking it down in these ways. With respect to the Southern Peru stuff, they said it is not optimized. It could be. We recommend that you do it. But, you know --

THE COURT: So they recommended optimizing it and it didn't get done.

MR. BROWN: I mean, I just read it to you. And so it is not that they were -- he said, well, they looked at it and they thought it was reasonable. Well, you know, they looked at it and they said these aren't aggressive projections. I mean, they are what they are.

THE COURT: And you are saying in the ultimate fairness opinion they used the more aggressive new one.

MR. BROWN: For Minera Mexico, yes. But as -- and A&S, you know, recommended, you know, modifications to it, and they usually showed both, the Minera Mexico model and the A&S model.

THE COURT: Does the deal come out fair under either scenario?

MR. BROWN: No, it didn't come out to 3.1 billion.

THE COURT: No. Under the -- within their rubric, did it come out fair?

MR. BROWN: I am telling you, if you -- you know, there is a big record here. If you go back and look at the last Goldman Sachs presentation, it is actually really helpful to look at them all, because it is the strangest thing. You know, at first it is the way you expect it to look and they are spelling everything out. By the last book you can't tell what the valuations are. There is nothing but these matrixes of numbers of shares. They don't tell you they took out all the numbers that show what the underlying valuations are. So fair, I mean, they have a giant matrix.

I mean, under the Goldman Sachs valuation, you know, the way they were doing it, any number of shares -- I mean, there was a gigantic range. Any number of shares almost would have been fair, I mean, anything from, you know, 30 to 90 or whatever.

Now, let me -- I just want to try to make it as clear as I can on this, what we are calling the floating versus fixed issue. And Mr. Stone mentioned 72 million. No. And there was testimony about this by the special committee members. The first presentation that they thought or the first term sheet that was real that they could respond to -- before then there was sort of talk and stuff, but there was nothing specific. And at some point, you know, they mentioned 3.1 billion and then the 72 million. But the first term sheet they got that they could respond to, to me that's the opening bid, and that asked for $3.1 billion in stock valued at the market price during a 20-day average before the closing. And so that's what they wanted, $3 billion of stock valued at the market price later on.

And, you know, the committee immediately said, and the testimony was, that was a nonstarter. And again, that's -- if you think copper prices are going to go up, which is the whole basis for the deal, you don't immediately reject something that is going to work to your benefit.

Now, our point is if they had accepted that pricing term -- that is, let's set the number of shares based on the market price during a 20-day window before the closing that equals 3.1 billion --

about 52 million shares would have been issued versus the 67. And, you know, they say 67 is a coincidence. Actually, if you look -- and we tried to spell this out in our brief -- pretty much every time the number of shares changed, you know, from Grupo, if you did the math using the market price about the time -- and we have the whole market price sheet -- it comes out to around 3 billion.

I mean, they were sort of duped -- the committee was focusing on numbers of shares, which really to me that's -- the question is what they are worth. And Mr. Stone says, well --

THE COURT: You are saying that Grupo Mexico had a fixed idea, which is we want $3.1 billion.

MR. BROWN: Yes, as if it was almost -- as if it was cash currency. And he says, well, they got a lower percentage of the entity. If you have a smaller percentage of an entity with a greater value, you have the same thing as a bigger percentage of a smaller entity. I mean, it is value that was the issue.

THE COURT: Especially because they already had voting control; right?

MR. BROWN: Right. Now --

THE COURT: But go through your 52 million, how they would have gotten to 52 million.

MR. BROWN: The original pricing term in the first term sheet -- and we can get that -- was give us $3.1 billion of stock --

THE COURT: Right.

MR. BROWN: -- calculated by taking the 20-day average starting five days before the closing, which was April 1, 2005. And if you do that -- and the stock prices are in the chart -- you get the number of shares based on the stock price at that time would be 52 -- we have it in our brief. It is 52 million shares. It is 15 million shares less than they ended up issuing.

And really what happened was, the way I think of it is, the first real proposal was 3.1 billion of stock valued at the market price but at the market price later on. And what the committee ended up doing was in effect saying, well, we will give you 3.1 billion in stock, but we want to peg it, you know, not at the closing but at the time we are approving the transaction. And to me that was almost an unforgivable mistake, because then the way it was structured, that put all the risk on Southern Peru, because if the stock price went down --

THE COURT: They got more.

MR. BROWN: Well --

THE COURT: No, you didn't get more.

MR. BROWN: It is fixed. If the stock price went down, you would say, well, gee, that would work for us, because we are issuing less value. No. They had the right to vote it down.

THE COURT: Oh, because they could walk.

MR. BROWN: So they had no fear of downside loss. You know, locking in the number of shares to them, because they wanted 3.1 billion, they knew they were going to get at least 3.1 billion and probably more, because by that point everyone was expecting it to go up, so -- but if there was some disaster, they could vote against it.

Southern Peru, from the special committee's perspective, you know, if it went down, they didn't get the benefit of that because --

THE COURT: Remind me why there was a delay anyway.

MR. BROWN: A delay in the closing?

THE COURT: Yes.

MR. BROWN: Well, the agreements were signed, you know, on October 21. I mean, it takes three months or so to get a proxy statement done and have a meeting. I mean, that's my understanding.

THE COURT: Oh, that's right, because of the vote.

MR. BROWN: They had a vote. So it is kind of weird. And if you look, you know, the committee minutes and the testimony was, you know, that they recognized, and they all, I think, testified a collar is critical if we are going to do this, and they asked for a collar, and the answer was "No. Go away." And so they let it go. And, in fact, if they had a collar, the 20 percent collar they had asked for, it would have been triggered.

So, I mean, the way they did this, the pricing, I mean, it is like -- it is inexplicable. And, you know, as you said, the whole theory of their analysis is copper is going to go gangbusters. This company tracks -- you know, the price fluctuates with copper prices. If we think copper prices are going to go up, let's take this risk, because then we can issue a lot less shares. It will still be $3 billion, but it will be, you know, a lot less shares.

I mean, they ended up issuing 67 million shares with a market price, you know, if you use an average near the closing, 3.7 billion. So what they really paid, you know, assuming the valuation date were the closing date, is 3.7, not 3.1.

Now, you might say, and I think they are saying, well, Minera Mexico's value might have gone up, too. But no, that's not what we are talking about. We are talking about the negotiation. They had the chance to get what we call -- I mean, it is called floating exchange ratio. It is really just fixing the number of shares based on the market price close to the closing. They had a chance to get that. It was clearly in their interest to do it. Why they said from Day One it is a nonstarter is inexplicable. That is -- to me that's an uninformed decision by the committee. They didn't have any information in front of them. You know, there is no documents, there is no nothing. There is -- nobody was telling them it is too dangerous, you know, you have got to lock it in. So that's on that point.

And I do want to say, my last point is, Your Honor -- we are talking about copper prices all over the place -- there is a difference --

THE COURT: So basically what you are saying is if they had done basically a fixed value, we will give you stock worth --

MR. BROWN: This at the time of the closing.

THE COURT: They then give you stock worth the initial demand.

MR. BROWN: Three billion.

THE COURT: Then it would have been better than what ultimately happened, because they ultimately delivered value materially in excess of that.

MR. BROWN: Right. Right. In effect, what they -- you know, the point was why would you lock the number of shares in. If you -- in a deal like this, if you have reason to believe your stock price is going to go up, it is to your great benefit to calculate the number of shares in the 3 billion at the time.

THE COURT: Yes. What you are saying might make sense is a lock in the value you deliver.

MR. BROWN: Yes, yes.

THE COURT: But --

MR. BROWN: So instead of issuing 52 million shares worth 3.1 billion, they issued 67 million shares worth 3.7 billion. I mean, but again, we are talking about the different assets. And we have kind of all focused on the date the committee approved it, and the basic point is there is -- as you said, they asked for 3.1 billion in stock. That's what they got. And if you look at the different changes over time, it is always around 3.1 billion. It was never changing.

The committee, if they were actually focused on number of shares being relevant, I think that's hard to believe, because it is not the number; it is the value of your currency. If I have 100 one-hundred-dollar bills and one one-hundred-dollar bill, they would have said, you know, let's only get the one, let's only get the hundred, because if we have to give away all these ones, that's more pieces of paper. I mean, it is the value of the share of stock, not the number of certificates.

My last point, Your Honor, is on the stock price -- on the copper prices. There is a lot of discussion of, you know, 90 cents or $1.30, I think. Just remember, there is a very big difference between short-term copper prices -- that is one, two, three, four years -- and long-term copper prices. So, you know, when someone is saying 90 cents or $1.20, I mean, everyone was using much higher prices for short-term, and in the DCFs, higher prices were used in the short-term. When you are talking about doing the DCF and the long-term number, that's a different calculation. Like, as Mr. Stone said, just because the market is going crazy right now, that doesn't mean, you know, necessarily mean it will continue.

You know, what the company continued to say was for long-term purposes, we use 90 cents. I mean, they continued to use 90 cents into 2007, when the price was 2 to $3 a share, and they finally increased their long-term number to $1.20. So saying we are going to increase the long-term copper price assumption to $1.30 is a humongous move, and, you know, even if they expected short-term prices to go up, I mean, I think --

THE COURT: So what you are saying is there is another thing where there is another -- that they never actually moved to this more bullish thing in running the business after the transaction.

MR. BROWN: Not for years. That's

right.

Okay. Unless Your Honor has any questions, we will leave it at that.

THE COURT: No. Thank you, Mr. Brown.

MR. STONE: Your Honor, just two quick things. Your Honor, they didn't change because the SEC wouldn't let them change. It is a three-year average. You have a three-year look-back, so that's why they didn't change.

But two quick points. I want to read from JX-103.

THE COURT: Is that in the record somewhere?

MR. STONE: What is that? That the SEC required them to use a three-year look-back? I think Mr. Jacob testified to that.

THE COURT: So it takes three years to update your copper prices?

MR. STONE: Essentially, yes. I mean, you have to look back three years. It is an average over the past three years.

Reading from a July 8 presentation of Goldman Sachs to the special committee -- and this just goes to the whole point about what could happen with a floating exchange ratio -- they had had discussions with UBS and Grupo, and it says, "Assuming the share price of SPCC of $40.90 (the closing price on the" NYSE "as of July 2, 2004) and the formula provided in the Term Sheet, SPCC would issue 90.6 million new shares to" Grupo Mexico, "which would result in" Grupo Mexico "owning 78.5 percent of SPCC as compared to 54.2 percent (as of today)."

So that's what the committee was focused on, is that based on the fluctuations of stock, it wasn't just 72 million shares anymore. Now it is 90 million shares. They wanted to lock it in.

The second point, Your Honor, is Mr. Brown, I think, just proved that Anderson & Schwab actually looked at both companies and did their due diligence, but what he cited really is completely misleading. The expansion studies at Toquepala and Cuajone were greenfield studies on mines that had been identified as copper deposits, but that's it. No pre-feasibility studies had been done. They were in the nascent stages of looking at these properties.

You compare that to the Phase 3 at Cananea, which was a brownfield project, meaning the deposit was there. It was tested. They had been through feasibility studies. It was a question of expanding a current mine. That's why it was included ultimately in Goldman Sachs's, because it had been completed, whereas the expansion studies at Toquepala and Cuajone would have taken way more than the eight months that the committee took to evaluate this transaction. So while there may have been some valuing there, I think Anderson & Schwab itself says you couldn't quantify it at this point without a further study, and that study would have taken years.

So there was nobody, you know, trying to, you know, update what was going on at Minera and not at SPCC. It was just a matter of where they were in those projects. They were completely different.

THE COURT: Yes. I think Mr. Brown says there was somebody at Minera trying to update things. It is called Grupo Mexico.

MR. STONE: Well, no, no. They were trying to update both of them. The problem is Toquepala and Cuajone were at a stage where you had to first do a pre-feasibility study, which is where you go out and drill these little pipes into the ground, and then you try to analyze and see how big the reserve is. And it is a very painstaking process. It takes a long time.

The Cananea mine is the largest copper deposit in the world or the second largest. Everybody knew that copper was there. That Phase 3 project that they included ultimately in the final book was something that had been in process for a long time, and it was done by the time that Goldman Sachs did its opinion, so it was able to update it. And it was an existing field. It wasn't -- Toquepala and Cuajone were different locations in Peru. They were untested grounds.

THE COURT: Thank you. Thank you, Mr. Stone, thank you, Mr. Brown, for excellent arguments. It is a case that hurts my head a little bit in all kinds of different ways.

And I appreciate our reporter's patience with the fast-moving questioning.

I would welcome, you know, short, to-the-point letters. I don't want argument. What I am saying is a lot comes up in these things. These are questions I ask, and I care about trying to get it right. And to the extent that you are able to just give me some letters citing to the record things you want me to refer to, I would appreciate it.

The only argument that I would welcome is this one about the temporally what I can take into account and your perspectives on it. I don't want anything long, but each side to some extent has pointed to events that transpired after the closing. You know, interestingly, depending on how you look at the situation, it is not even clear you are supposed to look at closing, I mean, if you think about it; right? I mean, you could be so pure that you can't even see how the deal, you know, got consummated. And I want to be analytically rigorous about it, and I know it matters, and I know it is a little bit different than an appraisal.

And so I would appreciate any -- I don't want 20-page briefs on it. What I am saying is if you have got -- if there is some case law out there that actually puts a point on it from your perspective, you can put that in the letter, too. But keep it short. Talk to each other. I don't want an exchange of replies to the letters. I am saying think about what came up at argument. There might be parts of the record you wish to highlight. And you just simply put, you know, in some organized way, "Your Honor, this came up at argument. I think you might well look at JX-" blank. "The relevant part of the Goldman thing is" blank, you know, and just try to in a nonargumentative way, you know, kind of put before me, you know, some of the evidence that you think is pertinent to the valuable discussion that you were able to provide me with today.

So try to stay as cool as you can. It is a pretty hot bench; right? But, you know, I think today the temperature, it is actually even cooler during the midst of a Chancery argument than it is outside. So maybe you have got, like, air-conditioned vehicles waiting for you. I hope so. And, you know, avoid, you know, Long Island Iced Tea. It is a temporary -- it will taste delicious, but you will pay the price later.

So thank you everyone. Thanks for working through lunch.

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(Court adjourned at 1:16 p.m.)

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CERTIFICATE

I, LORRAINE B. MARINO, Registered Diplomate Reporter and Delaware Notary Public, do hereby certify that the foregoing pages numbered 3 through 147 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I have hereunto set my hand at Wilmington, this 13th day of July, 2011.

/s/Lorraine B. Marino, RDR
Registered Diplomate Reporter
and Delaware Notary Public

EXHIBIT 6

H

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware, New Castle County
Merle THORPE, Jr. and Foundation for Middle East Peace, a District of Columbia Corporation, Plaintiffs,
v.
CERBCO, INC., a Delaware Corporation, Robert W. Erikson, and George Wm. Erikson, Defendants.

Civ. A. No. 11713.
Submtted: July 23, 1993.
Decided Oct. 29, 1993.

****945** Lawrence C. Ashby, Stephen E. Jenkins, and Richard D. Heins of Ashby & Geddes, Wilmington (Joseph M. Hassett, George H. Mernick, III, Albert W. Turnbull, and Christopher P. Gilkerson of Hogan & Hartson, Washington, DC, of counsel), for plaintiffs.

Howard M. Handelman, and John H. Newcomer, Jr. , of Bayard, Handelman & Murdoch, P.A., Wilmington, for Cerbco, Inc.

****946** Michael Hanrahan, and April Caso Ishak, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, for defendants Robert W. Erikson and George Wm. Erikson.

MEMORANDUM OPINION

ALLEN, Chancellor.

***1** In this derivative and individual action holders of class A common stock of CERBCO, Inc., seek damages form Robert and George Erikson. The Eriksons are brothers who own the preponderant part of CERBCO's class B common stock, which stock holds voting control of the company. They are the senior officers of CERBCO and are two of the four members of CERBCO's board of directors. The suit arises out of an alleged opportunity to sell CERBCO's principal asset on advantageous terms. The gist of the plaintiff's complaint is that the Eriksons, in their role as corporate officers, failed to try to secure this advantageous deal for the company and all of its shareholders, but instead indicated that they would thwart any such sale. They then allegedly proposed as an alternative to sell their CERBCO class B stock so that the putative buyer could achieve an objective of controlling CERBCO's asset. Plaintiffs claim this constituted a breach of loyalty, more particularly an attempted usurpation of CERBCO's corporate opportunity.

In the event, and after the filing of this lawsuit, the proposed sale alternative was abandoned and the buyer receded. The lawsuit, which *inter alia* sought an injunction against the contemplated sale of the Erikson's class B stock is, according to plaintiffs, not made moot by the abandonment of the transaction because CERBCO sustained damages in being prevented from pursuing the buyers' interest in its asset in the first instance.

Defendants' motion to dismiss the complaint for failure to state a claim has earlier been denied. *Thorpe v. CERBCO, Inc.*, Del.Ch., 611 A.2d 5 (1991). Substantial discovery having been completed, defendants have now moved for summary judgment of dismissal. They assert that the uncontested facts show that they are guilty of no disloyalty to CERBCO. That they were and are entitled to sell their voting control of CERBCO at a premium and they acted in good faith in negotiating such a transaction. Factually they assert that the potential buyer-Insituform of North America, Inc.-preferred to acquire their controlling stock in CERBCO to acquiring CERBCO's principal asset. They deny that they forced that choice upon the buyer, which is the plaintiff's assertion. They also deny that CERBCO suffered any damages as a result of their activities. ****947** In these circumstances, defendants claim that they are entitled to a dismissal of this litigation.

I start an analysis of the motion with a statement of what appears to be undisputed facts.

I.

CERBCO, Inc. is a holding company the principal asset of which was, at the times involved, voting control of Insituform East, Inc. ("East"). CERBCO also controlled two other operating subsidiaries, neither of which generated significant profits. FN1 East is a sublicensee of Insituform of North America, Inc., ("INA"), which holds the North American rights to exploit a process used in the in-place repair of buried sewer or water pipelines. Throughout the relevant time period, East was under investigation by the S.E.C. for possible criminal insider trading and disclosure violations.FN2

FN1. CERBCO's two additional operating subsidiaries at the time were Cerebronics, Inc., a defense contractor which had not generated profits for the three years preceding 1991, and which has since been terminated, and Capital Copy Products, Inc., a company which operated a copying and facsimile franchise. Capitol Copy, which had substantial interest payments on a purchase money loan, had generated insignificant net profits.

FN2. The S.E.C. during 1989 was conducting a criminal investigation of East, and Arthur Lang, East's former President, and of other officers, for alleged disclosure of inaccurate financial statement and for insider trading. Both CERBCO and East were mindful of the threat of civil suits by shareholders subsequent to any commission action.

2** Both CERBCO and East have a two-tiered capital structure, with voting power concentrated in one class of stock (class B) and enhanced dividend rights in the other (class A).FN3 CERBCO class A stock has one vote per share and also has the right to elect a minority of the board, and class B stock has ten votes per share and the right to elect a majority of the board. In 1990 defendants owned approximately 247,564 shares of CERBCO class B shares or about 78% of the outstanding class B stock, and 111,000 out of 1,457,500 class A shares. Defendants' holdings constituted 24.6% of CERBCO's*948** total equity, but carried voting control of CERBCO. There are 382,100 authorized but unissued shares of CERBCO class B stock.FN4

FN3. CERBCO's capital structure was created in 1982 when CERBCO's predecessor, Cerebronics, Inc., needed to raise capital via public offering, for a government contract it was fulfilling. The Eriksons at this time owned approximately 43% of Cerebronics' common stock, and a straight public offering would have had the effect of diluting their control. By offering the public the newly created class A stock, and allowing existing common stockholders to exchange their stock for the new class B stock, Cerebronics purported to reduce the threat of a hostile takeover attempt.

FN4. There was a discrepancy between the total number of authorized CERBCO class B stock in filings with the S.E.C., which indicated a total of 700,000 shares, and in CERBCO's 1988 certificate of incorporation, which indicated a total of 500,000 shares. This discrepancy was eliminated on September 19, 1990 when CERBCO filed with the Secretary of the State of Delaware a certificate of correction providing that there were 700,000 authorized class B shares. Plaintiffs allege that this is relevant because the higher figure would indicate that CERBCO could have issued new shares to give INA control of CERBCO if that is what INA sought.

CERBCO in turn owned approximately 30% of East's total equity, which, due to CERBCO's class B holdings, gave it voting control of East.FN5

FN5. CERBCO's predecessor obtained

control of East in 1985, after CERBCO lost the government contract for which it had undergone the aforementioned recapitalization in 1982. In 1986, East itself recapitalized in the same fashion as had CERBCO.

In the fall of 1989, INA began preliminary research into the acquisition of one of its sublicensees. It sought through this step to advance its strategy of entering into the installation business. INA retained Drexel, Burnham, Lambert to analyze ways and means of achieving this goal. Although it was not the only possibility, INA and Drexel focused upon East. INA and Drexel were unaware of the capital structure of East or of CERBCO. Drexel's initial analysis focused on acquisition of East shares via a tender offer. Specific transactions considered included a cash tender offer for CERBCO's 1.4 million shares of East from prices ranging from $7.50 per share (representing a 30% premium over the six month average market price of publicly traded East stock), to $10 per share (representing a 74% premium). These studies contemplated $10.5 million and $14.0 million total price for control, respectively.

In January 1990, INA's chairman, James Krugman, met with the Eriksons with respect to INA's interest in acquiring East. At these meetings, INA learned of CERBCO's and East's capital structure. Krugman was surprised and embarrassed at his lack of knowledge concerning CERBCO's capital structure. The record does not foreclose the possibility that at that meeting the Eriksons in effect said that they would and could block an attempt to directly acquire control of East from CERBCO. At this meeting, the Eriksons did outline for INA a transaction by which INA could purchase the ****949** Eriksons' controlling interest in CERBCO rather than purchasing CERBCO's East stock directly.

Thereafter, INA had Drexel perform comparative financial analyses of the potential transactions by which it could gain control of East. In one of these studies dated January 9, 1990, entitled "Project CERBCO," Drexel analyzed three potential transactions: (1) acquiring all of CERBCO's class A and class B stock in East for a total price of $10.5 million or $7.52 per East share; (2) acquiring 247,550 CERBCO class B shares from the Eriksons for $6.0 million or $24.24 per East controlling share; and (3) acquiring all of CERBCO's class A shares via a cash tender offer of $3.8 million and all of CERBCO's class B shares for $7.7 million in cash, for a total acquisition cost of $11.5 million. This analysis suggested that while a direct purchase of CERBCO's stock in East had higher initial upfront costs than a purchase of the Eriksons' holdings, it would be preferable, in certain respects, to a purchase of a controlling interest in CERBCO.[FN6]

FN6. This analysis indicated that purchase of the Eriksons' controlling interest in CERBCO brought with it some risk associated with the assumption of all of CERBCO's liabilities, including a $2.8 million note. That is, a purchase of the Eriksons' stock necessarily required the purchaser, as a practical matter, to stand behind repayment of a $2.8 million CERBCO note, if CERBCO cash flows were inadequate, in order to assure that the controlling East stock owned by CERBCO would not be subject to future creditor liens.

***3** Later in January, the Eriksons proposed selling their class B shares to INA for $6.5 million. On January 10 INA's counsel drafted a letter of intent for INA to purchase these shares.[FN7] One week later, INA's board approved obtaining a $10 million line of credit that could be used for the acquisition of control of East. On January 19, 1990, Krugman represented to the Eriksons and counsel from the law firm of Rogers and Wells (counsel to CERBCO and the Eriksons) that he was not interested in any transaction other than the one proposed.

FN7. The plaintiffs allege that the Eriksons also suggested to Krugman on or around January 4, 1990 that after purchasing the

Eriksons' controlling interest, INA could buy all remaining shares at the market price of $3 1/8 per share. Robert Erikson drafted a memo dated January 4, 1990 which noted the possibility of such a transaction, and Drexel's "Project CERBCO" study seems to analyze it. Furthermore, an internal memorandum from Rogers and Wells also analyzed the Eriksons' potential duties to the minority shareholders in the event of such a tender offer. However, Krugman of INA told the CERBCO board and testified at his deposition, that INA had no interest in such a transaction.

****950** On February 22, 1990, the Eriksons informed the CERBCO board of directors of INA's interest in acquiring control of East. The Eriksons informed the board that INA had made no bid for CERBCO's East shares, and that INA was interested only in pursuing the purchase of their controlling stock in CERBCO. Mr. Ketels of Rogers and Wells testified that he informed the Board that any sale of CERBCO's East stock would require a shareholder vote under Section 271 of the Delaware Corporate Law.[FN8]

FN8. There is a dispute, however, as to what the Eriksons and counsel from Rogers and Wells informed the Board of Directors with respect to their position *vis a vis* the proposed transaction. George Erikson testified that he had indicated merely that he would not support a sale of CERBCO's East holdings at the same price as that offered by INA for their stock. Director Long testified that counsel from Rogers and Wells told him at this meeting that the Eriksons could block a sale of CERBCO's East stock to INA. Long also testified that he had a "definite impression" that the Eriksons would block it. Director Davies testified that based upon conversations with the Eriksons prior to the February 22 meeting he "clearly had the understanding that as stockholders the Eriksons would not vote in favor of the sale of CERBCO's INEI [East] shares." For purposes of this motion I accept the Davies and Long testimony on this point as factual.

At this meeting, the Board apparently entered into a lengthy discussion with respect to the proposed transaction, and the existence of any interests in it by CERBCO and its public shareholders. According to draft minutes of that meeting, Rogers and Wells advised the members of the Board that it was their duty as independent directors to ensure that the proposed transaction was in the interests of CERBCO's stockholders.[FN9] The current record leaves this assertion open to proof in my opinion. The Board was also advised at this meeting that as part of a proposed letter of intent that was being negotiated between the parties, INA would be given access to CERBCO's books and records for its due diligence review. The non-Erikson directors did not object to such disclosure, so long as only non-sensitive information was disclosed and the Board was allowed to review any disclosed material. According to director Long, no such sensitive information was ever disclosed, although the Eriksons did ****951** disclose certain non-sensitive information to INA, prior to getting a signed confidentiality agreement.[FN10]

FN9. The parties dispute whether directors Davies and Long were every informed as to INA's initial consideration of a direct acquisition of East. Later, on July 27, 1990, Krugman did inform the Board that INA was not interested in any deal other than the one with the Eriksons. He announced that INA had not "made, or intended to make, any proposals directly to CERBCO or INEI [East] prior to their [letter of intent] agreement with the Eriksons, nor was INA interested in doing so." Both directors had direct discussions with Mr. Krugman at an INA sublicensee convention in Hawaii shortly after a March letter of intent was signed by INA and the Eriksons.

FN10. Mr. Long testified at his deposition that the Eriksons were "as concerned as we were, if not moreso [sic], about giving sensitive information that could hurt the company and certainly would hurt them, as much or more then [sic] it hurt the company." He also stated, "I don't know of anything we gave them that I would regard as harmful to the company or any information they could use today to our disadvantage."

At this meeting, the Eriksons also sought Board approval of their use of Rogers and Wells, as their personal counsel in their negotiations with INA. Rogers and Wells gave CERBCO its written statement that, in its opinion, there was no conflict of interest between the Eriksons and CERBCO because the proposed transaction was a private deal by the Eriksons that did not implicate CERBCO's interests. The Board then consented to the representation.

On March 12, the Eriksons and INA signed a letter of intent for the sale of the Eriksons' controlling interest in CERBCO at $6.0 million, or $24.24 per CERBCO class B share.FN11 The market valuation of CERBCO's class A common stock at the time was $3 1/8 per share. The letter of intent required the Eriksons to give INA access to CERBCO's books and records, subject to INA's agreement to keep the information confidential, and required INA to indemnify the Eriksons for any costs associated with a lawsuit arising from the consummation of the proposed transaction. It also restricted the Eriksons' activities with respect to other potential buyers:

FN11. The purchase price was reduced from $6.5 million to $.60 million in exchange for INA's agreement to indemnify the Eriksons for costs arising from any challenge to the sale.

***4** The Sellers (or either of them) shall not for a period from the date hereof to the first to occur of (a) April 23, 1990, (b) the Closing or (c) the date of abandonment by INA of negotiations regarding the Stock Purchase Agreement, elicit, enter into, entertain or pursue any discussions or negotiations with any other person or entity with respect to the sale of any of the Shares or any other transaction the effect of which if completed, would frustrate the purposes of this letter.

The letter of intent required that the parties not disclose its terms unless such disclosure was required by law. The non-Erikson directors reviewed the letter at a March 1990 INA sublicensees convention in Hawaii. On May 30, 1990 the Eriksons received $75,000 from INA for extending the letter of intent through August 1, 1990.

****952** On May 11, 1990, plaintiffs lodged a demand with the CERBCO board to rescind the proposed transaction or, alternatively, to demand that the Eriksons provide an accounting for the control premium incorporated in the proposed sale of their class B stock. A special committee, comprising the two non-Erikson directors was constituted and advised by the law firm of Morgan, Lewis and Bockius, to review the demand on July 17, 1990. On July 19, the special committee withdrew its permission for Rogers and Wells to represent both the Eriksons and CERBCO, due to a possible conflict of interest with CERBCO.

On August 24, 1990, plaintiffs brought suit, seeking an injunction against the Eriksons' sale of their class B stock or imposition of a constructive trust upon any premium associated with such a sale.

During September 1990, the special committee and CERBCO continued to investigate whether any corporate opportunity existed. At a September 14, 1990 Board of Directors meeting, the directors considered the feasibility of a transaction in which CERBCO would issue to INA a sufficient number of shares of its authorized but unissued class B stock so that INA could achieve control over East and thus would pay such consideration as could be negotiated to CERBCO itself. The Eriksons objected to the corporation pursuing this possibility. It was suggested that such a transaction would imply that East could pursue a similar arrangement with INA, which, of course, would destroy the control value of CERBCO's controlling interest in East to the detriment of plaintiffs as well as all other CERBCO shareholders.

The proposed transaction between the Eriksons and INA was never consummated, and on September 18, 1990, the letter of intent between the Eriksons and INA expired. The Eriksons informed the corporation on September 19 that the letter of intent had expired without consummation of the transaction with INA, and that they had no further intention of pursuing the proposed transaction. It is claimed that INA and the Eriksons were unable to reach agreement on such issues as indemnification of liabilities that might arise out of the pending S.E.C. investigation of East, and the payment by INA of litigation costs that the Eriksons had already incurred with respect to the proposed transaction. FN12

FN12. The letter agreement restricted indemnification to costs arising from *consummation* of the proposed transaction, not literally from activities preceding consummation. It was this literal interpretation of the contract which Robert Erikson apparently objected to.

***5 **953** After the dissolution of negotiations between the Eriksons and INA, CERBCO, at an October 4, 1990 board meeting, determined that while the company was not interested in affirmatively pursuing a possible transaction with INA, it would consider any approach made by INA.

On October 29, 1990 CERBCO's special committee made a written report. Since the committee considered plaintiff's breach of fiduciary duty charges to have been mooted by the expiration of the letter agreement, it did not address that question any further. The committee did request that the Eriksons provide notice to the Board of Directors of any future negotiations concerning the sale of their control block, so as to allow the Board to consider whether the transaction implied a corporate opportunity to sell CERBCO's East holdings. The committee also noted that after its formation, it was reluctant to pursue any deal with INA due to its concern with interfering with the "no-shop" provision of the INA-Erikson letter agreement, and potentially causing the Eriksons to resign their position at CERBCO.

In November 1991, defendants sought the dismissal of the claims asserted on the ground that the complaint failed to state a claim and upon the ground that the special requirements of Rule 23.1 were neither satisfied nor excused in this instance. The motion was denied. *See* Thorpe v. CERBCO, Del.Ch., 611 A.2d 5 (1991).

In January of this year, the defendants moved for summary judgment as to plaintiff's claim that a proxy statement relating to CERBCO's 1982 recapitalization (by which the dual class capitalization had been authorized) was incomplete and misleading. The court granted defendants' motion on the grounds that plaintiffs had no standing to litigate the claim, since they were not stockholders at the time of the proxy solicitation. *See Thorpe v. CERBCO*, Del.Ch., C.A. No. 11713, Allen, C. (Jan. 26, 1993).

II.

Defendants are entitled to a summary judgment of dismissal only if facts not reasonably disputed in the record entitle them to such a judgment. For the reasons that follow, I cannot find that this is the case. However, I do find that the defendants will be entitled to dismissal as a matter of law, if it is determined that a sale of CERBCO's class B common stock would constitute the sale of substantially all of its assets and would therefore require for its authorization "the majority vote of the outstanding stock of the ****954** corporation entitled to vote thereon ...” 8 *Del.C.* § 271(a) (1991). This conclusion has three premises.

First, I conclude that in their capacity as stockholders of CERBCO, defendants would have had no obligation to approve a sale of all or substantially all of the Company's assets, even if a reasonable director of the Company would conclude that the proposed sale was on fair or even on advantageous terms. *See Bershad v. Curtiss-Wright Corp.,* Del.Supr., 535 A.2d 840 (1987); *Tanzer v. International General Industries, Inc.,* Del.Supr., 379 A.2d 1121 (1977). Therefore, since the law confers a veto right upon the Eriksons *qua* shareholders over any transaction that constitutes a sale of substantially all of the corporation's assets, and since the law permits shareholders *qua* shareholders to act selfishly in deciding how to vote their shares, I conclude that if a sale of CERBCO's class B stock in East constituted a sale of substantially all of CERBCO's assets, then the public shareholders has no right to require them as directors to pursue a transaction over which they rightfully held a veto as shareholders.

***6** Second, I conclude (a) that the Eriksons are entitled to access to the Company's books and records for a proper corporate purpose; (b) that review of corporate books and records to enable a large shareholder to sell its stockholdings is a proper corporate purpose within the meaning of Section 220 of our corporate law, so long as steps to protect the corporate entity from substantial harm arising from such disclosure can be arranged; and (c) that therefore, despite what might be implied in my earlier expressed view in this case, contracting for review of the Company's books and records, in the circumstances alleged, does not so implicate a controlling shareholder in the exploitation of the corporation's property or processes as to provide an independent ground to impose upon that shareholder a duty of entire fairness should that shareholder elect to sell its stock.FN13

FN13. This does represent a more considered view (one that takes into account shareholder statutory rights under Section 220 of our corporate code) than that stated in the opinion of November 15, 1991. *See* Part IV C, below. With respect to this I follow Justice Frankfurter's advice, “Wisdom too often never comes, and so one ought not to reject it merely because it comes late.” *Henslee C.I.R. v. Union Planters National Bank & Trust Co.,* 335, U.S. 595, 600 (dissenting).

Third, I conclude as a matter of fact undisputed in the record, that INA was never interested in a transaction whereby CERBCO would issue its authorized but unissued class B shares to INA in lieu of a direct purchase of East shares or of Eriksons' interest in CERBCO. There is no evidence in the record that would raise ****955** a fact issue on this question and, intuitively, it is extremely far-fetched that INA would freely elect that form of a transaction. Therefore, there was no corporate opportunity for the issuance of new class B stock, that the Eriksons, via their attempted sale of their own class B stock, precluded.

Each of these conclusions is explained more fully below. (*See* Part III). On the assumption that the sale of CERBCO's East stock would require a shareholder vote under Section 271 of the General Corporation Law, these conclusions require granting the motion now pending.

If on the other hand, the East stock held by CERBCO did not constitute all or substantially all of CERBCO's assets, so that the Eriksons had no privileged voting right to block any such transaction, then for the reasons described in detail below, summary judgment is not now appropriate. (*See* Part IV. below).

III.

A. *The alleged opportunity to sell CERBCO's class B stock in East to INA.*

The claim is that the Eriksons attempted to usurp a corporate opportunity by precluding a sale of CERBCO's East holdings to INA in order to pursue a sale of their own stock. If as a factual matter, sale of CERBCO's class B stock in East would constitute a sale of substantially all of CERBCO's assets under Section 271 of the Delaware General Corporation Law, then in order for one to conclude that there was an opportunity for CERBCO to sell it East stock to INA one must recognize an obligation on the part of the Eriksons, as fiduciaries, to support such a transaction *at a shareholder vote.* Delaware law, however, has never imposed such an affirmative duty upon shareholders. Under Delaware law "stockholders in Delaware corporations have a right to control and vote their shares in their own interest." *See Bershad v. Curtiss-Wright Corp.,* Del.Supr., 535 A.2d 840 (1987).FN14 it is also true these rights are limited by any fiduciary duty the stockholder may owe the corporation. Hence, ****956** while in *Bershad,* the controlling shareholder could vote in favor of a freeze-out merger, it still had to satisfy the court that the transaction was entirely fair.

FN14. *See also Tanzer v. International General Industries, Inc.,* Del.Supr., 379 A.2d 1121, 1123 (1977); *Ringling Bros. Barnum & Bailey Com. Shows, Inc. v. Ringling,* Del.Supr., 53 a.2d 441, 447 (1947); *Heil v. Standard Gas & Electric Co.,* 17 Del. Ch., (214) 151 A 303 (1930).

***7** The principle that a controlling shareholder may not utilize his control to deprive minority shareholders of the value of their stock is, however, far different from the proposition that a controlling stockholder *qua* stockholder has an affirmative duty to support a particular transaction, even if it is not in their interest as a shareholder to do so. Hence, in *Bershad*, the court reasoned that the parent company had no obligation to auction the subsidiary to the highest bidder even though, in comparison to a freeze-out, this would have better served the interests of minority shareholders. Controlling shareholders, while not allowed to use their control over corporate property or processes to exploit the minority, are not required to act altruistically towards them. *See Jedwab v. MGM Grand Hotels,* Del.Ch., 509 A.2d 584 (1986). For these reasons, it is my opinion that the Eriksons have a privilege as shareholders in effect conferred by Section 271 to preclude any transaction that requires shareholder approval. Surely as majority shareholders they may not use that privilege to force an unfair transaction on the corporation or its public shareholders, but here it could not be concluded that they did so. It is well established that the Eriksons have a right to sell their stock and with it control over the company.FN15 They breached no duty to CERBCO in pursuing the sale of their stock to INA even if they did threaten to use their stockholder vote to bock a proposed deal between CERBCO and INA.

FN15. They have a duty in doing so (*e.g.*, *Harris v. Carter,* Del. Ch., 582 A.2d 222 (1990); *Insuranceshares Corporation v. Northern Fiscal Corporation,* 35 F.Supp. 22 (E.D.Pa.1940)) but that duty does not include a sharing of the control premium. *Compare In Re Sea-Land Corporation Shareholders Litigation,* Del. Ch., C.A. No. 8453, Jacobs, V.C. (May 22, 1987) *with Brown v. Halbert,* 76 Cal.Rptr. 781 (March 28, 1969).

B. *The alleged opportunity to issue authorized CERBCO class B stock to INA.*

The Eriksons had no statutory veto over the sale to INA of newly issued CERBCO class B stock, however. If it would have been advantageous to CERBCO the board had a duty to consider it. Such a transaction could be pursued without shareholder approval. But the record is clear that INA never considered purchasing such stock. This is no doubt for a fairly obvious reason. Purchasing the ****957** Eriksons' holdings, would have given INA 78% of the CERBCO class B stock, control over the election of a majority of the board of directors, and voting control over the company. Purchasing all of the unissued CERBCO class B stock would provide INA with only a 46.9% voting interest while leaving the Eriksons with about 40%. Plainly this would be a very unsatisfying situation for all concerned. Purchasing all of CERBCO's remaining authorized but unissued class B stock would have required purchasing approximately 134,500 more class B shares than the Erikson transaction, while gaining a smaller voting interest.

There is nothing in the record to contradict evidence that INA had not interest in buying CERBCO's unissued class B stock. There is also evidence that CERBCO itself may not have been willing or able to pursue such a transaction. Thus even assuming the board could act to destroy a controlling shareholders control in order to benefit the corporation,[FN16] there is nothing here to suggest that the buyer would want such an unappealing deal. Finally, I note that the minutes of the September 14, 1990 board of directors meeting indicated that the members were concerned with the potential precedent such a transaction would set for East, which could also issue its own class B stock to INA, and thereby dilute CERBCO's control.

FN16. *See Condec v. Lukenheimer,* Del. Ch., 230 A.2d 769 (1967) (issuance of stock for primary purchase of diluting control of majority shareholder and entrenching existing board of directors is improper); *see also Phillips v. Insituform of North America, Inc.,* Del. Ch., C.A. No. 9173, Allen, C. (Aug. 27, 1987) (issuance of stock for primary reasons of diluting the voting power of an existing voting block may be justified if the issuance is to further a compelling corporate purpose); *Canada Southern Oils, Ltd. v. Manabi Exploration Co., Inc.,* Del. Ch., 96 A.2d 810 (1953); *Freedman v. Restaurant Assoc.,* Del. Ch., C.A. No. 9212, Allen, C. (Oct. 16, 1987).

C. *The disclosure of CERBCO's books and records to INA.*

***8** The allegation is that the Eriksons breached a duty to CERBCO by disclosing to INA information from CERBCO's books and records, thereby utilizing their control over the corporate machinery to benefit themselves at the minority's expense. It is not claimed that CERBCO has been competitively injured in any respect. The point sought to be made, rather is that any use of corporate property or processes must be undertaken in the good faith pursuit of corporate advantage or advantages of all shareholders. As noted above, I find this generalization powerful, but consideration of stockholder's inspection rights lead me to conclude that with respect to right ****958** to inspect corporate books and records, that it is overly-broad. That statute (Section 220 of DGCL) creates rights and duties that need to be taken into account. Namely, it creates a right in every shareholder to inspect the company's books and records “for a proper purpose.”

Under the definition of a proper purpose of Section 220, the Eriksons could, as shareholders, inspect the corporation's books and records in order to facilitate a sale of their stock. *See CM & M Group, Inc. v. Carroll,* Del.Supr., 453 A.2d 788 (1982). Moreover, shareholders have also been allowed to disclose information in the corporation's books and records to bona-fide prospective purchasers, so long as these parties sign a confidentiality agreement. *See id.* at 794. In *Blommer Chocolate Company v. Robert Blommer, Suzann Blommer Love, John Love and Cargill, Inc.,* Del. Ch., C.A. No. 12693, Allen, C. (Sept. 28, 1992) I assumed, for purposes of the motion there under consideration, that disclosure of corporate information to assist a director in a sale of stock constituted a wrong. That case is distinguishable from this case (1) by the fact that the information disclosed was competitively significant and thus it was arguably beyond a Section 220 right and (2) by the fact that the disclosing party used stealth and deception to disclose corporate information. Even so no injunction was entered in *Blommer.*

Since the Eriksons had the right under Section 220 to force CERBCO to afford them reasonable access to the corporation books and records for a proper purpose and since facilitating a sale of their control stock is a proper purpose, one cannot correctly conclude, as I earlier was inclined to do, that providing access to INA (where there was no competitive injury that could be reasonably expected) imposed a duty upon them with respect to the sale they sought to facilitate.

IV.

I turn now to the arguments which, as I interpret the, are dependant upon a finding that the sale of CERBCO's class B stock to INA did not require a shareholder vote. If this were the case, then the Eriksons did not have the capacity, as shareholders, to preclude a transaction with INA. Hence, as officers and directors the defendants had the power, in that capacity alone, to negotiate and vote for a sale by CERBCO of its East stock. In this capacity, if the Eriksons intentionally blocked such a sale in which INA was interested in order to divert a corporate transaction to their personal benefit, they may be held to have breached their duty of loyalty. I turn briefly to a description to the applicable legal standard, and ****959** will then discuss defendants' specific assertions as to why, as a matter of law, no such breach occurred.

***9** Plaintiffs allege a breach of the duty of loyalty under the rubric of the usurpation of a corporate opportunity. While courts have considered a number of criteria in evaluating whether a director has usurped a corporate opportunity, the essence of this doctrine is "that a director may not appropriate something for himself that in all fairness should belong to his corporation." *Equity Corp. v. Milton,* 43 Del. Ch., 160, 221, 221, A.2d 494 (1966). Whether an opportunity belongs to a corporation is to be determined by the particular circumstances of the case *Johnston v. Greene,* Del Supr., 35 Del. Ch., 479 121 a.2d 919 (1956).

Delaware courts have developed particularized rules to guide this determination. *See Guth v. Loft, Inc.,* Del.Supr., 5 A.2d 503, 511 (1939); *Equity Corp. v. Milton,* 43 Del. Ch., 160, 221, 221 A.2d 494 (1966). In order to recover for the corporation, plaintiff must show:

(1) that the transaction falls within the corporation's business and would be of practical advantage to it;

(2) that the transaction presents an opportunity in which the corporation has an interest or legitimate expectancy; and

(3) that the corporation would be able and willing to undertake the transaction.

I turn to defendants' arguments as to why no corporate opportunity existed here.

A. *Defendants' assertion that INA made no formal offer for CERBCO's East stock, and that therefore, no opportunity existed for CERBCO to sell its East holdings.*

While it is undisputed that INA made no offer to CERBCO, the conclusion movants draw from this misconstrues the legal requirements for a corporate opportunity. This gist of the claim is that INA presented an opportunity that could have been developed and seized by CERBCO but that CERBCO was wrongfully precluded from that chance to its damage. If defendants had not privilege to preclude CERBCO from selling its East stock, and if defendants' actions did divert a transaction with INA from CERBCO to themselves, then it is no answer that they did so before discussions could proceed to the stage of a formal offer.

A requirement that a formal offer be made for a finding that a corporate opportunity existed would allow controlling shareholders to use their influence to deter such offers. Indeed, this is precisely ****960** what plaintiffs allege the Eriksons did in this case. There is no good reason for imposing such a requirement when the existence of a potential corporate transaction can be proved through other means, such as internal studies by the acquirer and its retained investment bank, the substance of meetings between the parties, etc.

B. *Defendants' contention that once INA was informed of CERBCO's capital structure, it had no* *desire to, nor was it financially able to purchase control of East directly.*

If such a contention were true, then the claim that the Eriksons had taken for themselves an opportunity which belonged to the corporation would not be viable, since there was no transaction available to the corporation. However, there is a fact issue as to whether that in fact was INA's position, even though Krugman's testimony is consistent with this view.

***10** First, as to whether INA could afford to purchase control of East directly, there is a fact issue as to what the cost of such a purchase would have been. Drexel's "Project CERBCO" analysis of a direct purchase of CERBCO's East holdings suggests that the transaction would have cost $10.5 million, $500,000 over the $10 million dollar line of credit which INA had established in anticipation of the transaction. Plaintiff's argue that utilizing the same premium allegedly incorporated in INA's $6.0 million offer for the Eriksons' stock, and factoring in the additional price per share of CERBCO's East stock, yields an acquisition price of well under $10 million. Furthermore, since no formal negotiations with CERBCO with respect to its East stock ever occurred, it is impossible to know what price the stock would have commanded. It is, however, safe to say that the price of a direct purchase of CERBCO's East holdings is uncertain, and INA's incapacity to pursue such a transaction is not established beyond dispute.

As to which transaction was less costly, Drexel's "Project CERBCO" analysis did suggest that purchasing the Eriksons' stock had the lowest up-front financial cost. However, Drexel's analysis also suggested that a purchase of the Eriksons' holdings might bring with it the additional risk, in effect, of assuming all of CERBCO's liabilities. Therefore, it is to clear beyond dispute that the Eriksons' proposal was the least costly, considering all the relevant factors.

Importantly, there is evidence that a transaction between INA and CERBCO may not have gone forward, not due to cost considerations, but because the Eriksons let it be know that they would ****961** preclude any such transaction. While the Eriksons deny that they indicated that they would preclude any offer for CERBCO's East stock, the two non-Erikson directors' recollections directly contradict this. Directors Davies and Long both testified that they had the impression that the Eriksons would not vote for this transaction.

C. *Defendants' contention that CERBCO's selling its East shares did not further any corporate policy, nor was it of practical advantage to CERBCO.*

Defendants assert that the depressed price of East stock at the time of the negotiations with INA made it a poor time to sell. However, the fact that the defendants thought it was worthwhile to sell their own controlling interest in CERBCO, whose principal asset was its East stock, makes this contention subject to legitimate dispute and thus not a summary judgment point.

As to the existence of a corporate policy that precluded a sale of its East stock, the Eriksons themselves in a February 22, 1990 board meeting noted that the 1994 termination of East's exclusive rights to the Insituform process made combination with INA an effective alliance in an increasingly competitive market. This recognition of the threat of increased competition demonstrates an awareness on the part of the members of the corporate board of threats to East's profitability, and the advantages of a sale to INA.

***11** While defendants cite to the CERBCO Board of Directors' October 4, 1990 conclusion not to pursue a sale of CERBCO's East stock to INA as evidence of the lack of any policy to sell East, the Board also stated at this same meeting that it would consider any approach made by INA with respect to such an acquisition. Furthermore, as the special committee noted in its report, prior to the Eriksons informing them on September 19th as to the expiration of the letter of intent, the CERBCO directors felt constrained from negotiating with INA due to concerns of interfering with the rights set forth in the "no-shop" provision of the letter agreement, and due to fears of causing the Eriksons to resign. Plaintiffs have also alleged that the minutes of the September 14, 1990 Board meeting (in which the directors discussed the idea of CERBCO's issuing its own B stock to INA) indicate that CERBCO was interested in gaining the value of the control premium for itself. There are, therefore, fact issues as to CERBCO's posture with respect to a sale of East during the relevant period.

****962** D. *Defendants' assertion that the S.E.C. investigation would have precluded CERBCO from selling East to INA and that therefore CERBCO was unable to undertake the opportunity.*

This contention rests upon assertions of fact concerning the existence and importance of the S.E.C. investigations that are not settled by the record. There is some evidence consistent with the view that the S.E.C. investigation was not so very vital.

For example, Robert Erikson, shortly after the failure to extend the letter of intent, attributed the breakdown specifically to INA's refusal to advance the Eriksons the costs in the instant litigation. Furthermore, from INA's perspective, the critical issue, at least as of August 1990, seems to have been its concerns that the CERBCO and East class B stock might not, in fact, be able to elect a majority of the respective boards of directors. At an August 23, 1990 meeting, the INA board granted its approval of the transaction with the Eriksons, subject *solely* to the issuance of an opinion letter from counsel to the effect that the class B shares did have the power to elect a majority of the board. Therefore, it is not at all established beyond dispute in this record that INA would not have been able to conclude negotiations with CERBCO because of the on-going S.E.C. investigation.

In addition to alleging that no opportunity for a sale of CERBCO's East holdings to INA existed, defendants also claim, in effect that even if INA was interested in a deal with CERBCO, the Eriksons in no way interfered with such a transaction. However, there plainly are fact issues relating to the Eriksons' good faith with respect to CERBCO in their negotiations with INA. The record offers some support of the view that INA, even after it was aware of CERBCO and East's capital structures, still saw advantages to a direct purchase of East, as revealed in Drexel's "Project CERBCO" analysis. The facts are not unambiguous as to whether INA merely decided that a deal with the Eriksons used their authority as persons in charge of the day-to-day communication of the Company and as controlling persons to in effect tell INA that their sale was the only possibility. Because this is the case, defendants' motion for summary judgment on the grounds that there was no opportunity to arrange a sale of CERBCO's East stock to INA, or, alternatively, that the Eriksons acted in good faith with respect to a potential corporate transaction, must be denied.

****963** V.

***12** I turn finally to movants' second principal ground for requesting summary judgment, their claim that neither CERBCO nor its class A shareholders have suffered actionable damages. This is so, defendants say because plaintiffs have submitted no credible evidence that a hypothetical deal with INA would have offered them consideration in excess of the value of CERBCO's East holdings. FN17 Therefore, defendants assert that there is no basis for plaintiff's claims that the Eriksons' activities caused CERBCO to lose a potentially profitable transaction, even if they did exert their power to preclude CERBCO from negotiating with INA. FN18

FN17. Specifically, defendants contend that the price obtainable in such a deal is pure speculation, and that the $6 million INA was willing to pay is significantly less than the value of CERBCO's stock in East.

FN18. Defendants also dispute plaintiff's claims that the Eriksons must disgorge a payment they received from INA for extending the letter of intent, and that CER-

> BCO should be compensated for the costs of the special committee, salary payments to the Eriksons during the period of their alleged breach of duty, and alleged payments to Rogers and Wells for their services to the Eriksons. Concluding as I do on the main claim, I need not address these points.

It is, of course, fundamental that a fiduciary who breaches his duty is liable for any loss suffered by the beneficiary of his trust. Moreover, given the nature of the right, it is also well established that any profit made through the breach of trust may be disgorged through the device of constructive trust. *See Guth v. Loft,* Del.Supr., 5 A.2d at 510.

While courts will not award damages which require speculation as to the value of unknown future transactions, so long as the court has a basis for a responsible estimate of damages, and plaintiff has suffered some harm, mathematical certainty is not required. *Red Sail Eastern Ltd. Partners, L.P. v. Radio City Music Hall Productions, Inc.*, Del. Ch., C.A. No. 12036 at 14, Allen, C. (Sept. 29, 1992). Furthermore, once a breach of duty is established, uncertainties in awarding damages are generally resolved against the wrongdoer. *Donovan v. Bierwirth,* 754 F.2d 1049, 1056 (3d Cir.1985).

The difficulty of calculating damages is ordinarily no ground for summary judgment. The complete impossibility as a matter of principle would provide a ground to avoid a trial, but that will be a rare case. Here we must await evidence before one can reach a judgment as to whether there are grounds in the record for fixing damages to CERBCO proximately flowing from the proof of the ****964** alleged diversion of a corporate opportunity. Surely one cannot say that this record precludes any responsible estimate of damages being set forth at trial. Therefore this ground for a summary judgment of dismissal is denied.

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Not Reported in A.2d, 1993 WL 443406 (Del.Ch.), 19 Del. J. Corp. L. 942

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