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**COURT OF CHANCERY
OF THE
STATE OF DELAWARE**

COURT OF CHANCERY COURTHOUSE
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GEORGETOWN, DELAWARE 19947

Submitted: April 5, 2005
Decided: May 4, 2005

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Re: *Shintom Co., Ltd. v. Audiovox Corporation*
Civil Action No. 693-N

Dear Counsel:

This is my decision on defendant Audiovox Corporation's ("Audiovox") motion to dismiss plaintiff Shintom Co., Ltd.'s ("Shintom") complaint. Shintom's complaint asserts that shares of preferred stock it currently holds in Audiovox are void because (1) the shares do not pay dividends, and (2) it never approved the merger that created the preferred shares in the first place. For the reasons set forth below, I grant defendant's motion to dismiss plaintiff's complaint in its entirety.

I. BACKGROUND FACTS

Plaintiff Shintom is a Japanese corporation with its principal place of business in Japan. Shintom manufactures and sells electronic products. Defendant Audiovox is a Delaware corporation with its principal place of business in Hauppage, New York. Audiovox designs and markets electronic products. Shintom seeks to recover over $2.5 million in consideration it paid for shares of Audiovox preferred stock on the grounds that the preferred stock is void. Audiovox has moved to dismiss the complaint under Rule 12(b)(6).

In April of 1981, Shintom purchased, for $2.5 million, 50,000 shares of Audiovox New York preferred stock. Audiovox New York was a New York corporation and the predecessor of defendant Audiovox Delaware. The holder of the Audiovox New York preferred stock was entitled to an annual noncumulative 10% dividend of $5 per share, although Audiovox New York never paid any such dividends.

On April 16, 1987, over 18 years ago, and more than 17 years before Shintom filed this complaint, Audiovox New York merged into Audiovox Delaware. Pursuant to 8 *Del. C.* § 252, and *NYBCL* §§ 804(a) and 903, Shintom, as the sole holder of preferred shares of Audiovox New York, had

to have voted in favor of the merger for it to be approved. Nevertheless, Shintom now asserts that it never approved the merger.

Audiovox contends that on April 6, 1987, Shintom was sent timely notice of a special meeting, to be held on April 16, 1987, to consider the merger. Audiovox further contends that Shintom was sent a proxy statement describing the purpose of the special meeting. Finally, Audiovox notes that Shintom overnighted its executed proxy vote, allegedly signed and dated April 14, 1987, in which Shintom voted "yes" to the merger and its attendant provisions.

One feature of the merger agreement was the conversion of each outstanding share of noncumulative preferred stock, par value $50 per share, into an equal number of shares of non-dividend preferred stock, par value $50 per share, of the surviving company (Audiovox Delaware). The new non-dividend preferred stock had a liquidation preference over the common shares. It is these Audiovox Delaware preferred shares that Shintom now alleges are void. It also should be noted that at oral argument, Shintom's counsel admitted that (1) Shintom received the new preferred stock certificates after the merger was completed, (2) Shintom continued to do business with Audiovox Delaware after the merger, and (3) Shintom has

never received dividends on these preferred shares during the more than 17 years before the date the complaint was filed.

In its complaint, Shintom asserts that the preferred shares of Audiovox Delaware that it received pursuant to the merger are void (1) because the preferred shares do not pay dividends as required by 8 *Del. C.* § 151(c), and (2) because Shintom believes that it never approved the merger that occurred 18 years ago in April 1987.

II. ANALYSIS

When considering a motion to dismiss under Rule 12(b)(6), the Court must assume the truthfulness of all well-pled allegations in the complaint and view those facts, and all reasonable inferences drawn from them, in a light most favorable to the plaintiff.[1] Dismissal is appropriate under Rule 12(b)(6) only when it appears with reasonable certainty that the plaintiff would not be entitled to relief under any set of facts that can be inferred from the pleadings.[2] Additionally, "the well-pleaded allegations of the complaint are accepted as true for the purposes of such a motion."[3] Mere vagueness is insufficient to justify the dismissal of a complaint, but "a motion [to dismiss]

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[1] *See Anglo American Sec. Fund, L.P. v. S.R. Global*, 829 A.2d 143, 148-9 (Del. Ch. 2003). *See also Lewis v. Honeywell, Inc.*, 1987 WL 14747, at *1.
[2] *See Leonard Loventhal Account v. Hilton Hotels Corp.*, 2000 WL 1528909, at *3 (Del. Ch. 2000); *Solomon v. Pathe Communications Corp.*, 672 A.2d 35, 38 (Del. 1996).
[3] *Weinberger v. UOP, Inc.*, 409 A.2d 1262, 1264 (Del. Ch. 1979).

does not concede pleaded conclusions of law or fact where there are no allegations of specific facts which would support such conclusions."[4]

A. Are Plaintiff's Shares Void Because of Failure to Provide for Dividends?

Shintom alleges that 8 *Del. C.* § 151(c) mandates that the holders of preferred stock must receive dividend rights, and that because Audiovox Delaware's preferred shares do not pay dividends, they are void as a matter of law. This appears to be a question of first impression, as neither the Court nor the parties have found a case directly on point. The relevant language of § 151(c) reads as follows:

> The holders of preferred or special stock of any class or of any series thereof shall be entitled to receive dividends at such rates, on such conditions and at such times as shall be stated in the certificate of incorporation or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors as hereinabove provided, payable in preference to, or in such relation to, the dividends payable on any other class or classes or of any other series of stock, and cumulative or noncumulative as shall be so stated and expressed.

Shintom's contention that dividends are mandatory is most easily addressed by pointing to the plain language of § 151(c). The corporation is

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[4] *Id. See also Lewis v. Honeywell, Inc.*, 1987 WL 14747, at *4 (Del. Ch.)("Mere vagueness will not justify dismissal of a complaint. On the other hand, a motion to dismiss concedes only well pled allegations of fact. It does not concede conclusory allegations of law or fact where there are no allegations of specific fact that would support such conclusions.").

expressly given the right to set the rates and conditions of dividend payments, and implicit in the right to set the rates and conditions is the ability to choose not to grant dividends at all. Had the drafters of § 151(c) intended for mandatory dividends, they certainly would not have left open the very real possibility that the rates could be set at zero. Choosing to set dividend rates at zero is as much an act of setting rates as choosing a substantive rate. Additionally, the phrase "if any" is used when referring to dividends, acknowledging the possibility that a corporation may choose not to issue dividends with its preferred stock.[5] For these two reasons, I am satisfied that the Legislature did not intend to mandate that all preferred stock include dividend rights.

Shintom also ignores more obvious clues to the Legislature's intent. Shintom argues that because the Legislature chose to use the word *shall*, instead of the word *may*, one must interpret § 151(c) as a mandate to all Delaware corporations that they must, in all issuances of preferred stock,

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[5] The relevant portion of § 151(c) states: "When dividends upon the preferred and special stocks, if any, to the extent of the preferences to which such stocks are entitled, shall have been paid or declared and set apart for payment, a dividend on the remaining classes or series of stock may then be paid out of the remaining assets of the corporation available for dividends as elsewhere in this chapter provided." (Emphasis added). Shintom's counsel argued that the "if any" language actually refers to a situation where the corporation decides to pay dividends, not whether the corporation may choose to grant dividend rights. As stated above, however, I conclude that the "if any" language is the Legislature's acknowledgment that there may be preferred and special stocks that do not grant dividend rights.

grant dividend rights. For the additional reasons stated below, however, I disagree with Shintom's assertion that preferred shares must always include the right (or the "entitlement", as Shintom puts it) to receive dividends.

To understand the term "shall" in § 151(c), one must first look at the entirety of § 151. Section 151 empowers a Delaware corporation to create different classes of stock in derogation of the common law right to have one class of stockholders. Section 151(f) states in part, as follows:

> the powers, designations, preferences and relative, participating, optional, or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class or series of stock.

What this section establishes is that the rights that a preferred stockholder holds against the corporation are formed via contract, and the stockholder can only claim those rights enunciated in the certificate.[6] The entirety of

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[6] There is also a long line of Delaware cases that establishes that the rights of preferred shareholders are contract rights, and that because these rights are in derogation of the common law rights of stockholders the preferred shareholder is only entitled to those rights in the certificate of incorporation and the stock certificate. *See Gaskill v. Gladys Belle Oil Co.*, 146 A. 337, 339 (Del. Ch. 1929); *Ellingwood v. Wolf's Head Oil Refinery Co.*, 38 A.2d 743, 747 (Del. Ch. 1944); *Shanghai Power Co. v. Delaware Trust Co.*, 316 A.2d 589, 593 (Del. Ch. 1974); *Rothschild Int'l Corp. v. Ligget Group, Inc.*, 474 A.2d 133, 136 (Del. 1984); *Warner Communications, Inc. v. Chris-Craft Indus.*, 583 A.2d 962, 966 (Del. Ch. 1989); *Elliot Assoc., L.P. v. Avatex Corp.*, 715 A.2d 843, 853 (Del. 1998); *Telecom-SNI Investors, L.L.C. v. Sorrento Networks, Inc.*, 2001 WL 1117505 (Del. Ch). Although these cases do not address the precise issue before me in this case, they

§ 151 must be viewed as though it is discussing rights that exist between the corporation and preferred stockholders, rights that are found in the certificate of incorporation and are enumerated on the stock certificate.[7]

Turning to Shintom's linguistic may/shall argument, I do not agree that use of the term shall in § 151(c) mandates that all preferred stockholders in a Delaware corporation must have an entitlement to dividends. Shintom has correctly pointed out that may and shall are used throughout § 151, and without question the two words have different meanings. For example, § 151(a) reads "[e]very corporation may issue 1 or more classes of stock," § 151(b) reads "[a]ny stock of any class or series may be made subject to redemption," and § 151(e) reads "[a]ny stock of any class or of any series therefore may be made convertible." Effectively, these provisions give corporations the option to take advantage of the various provisions in § 151 by using the word may. On the other hand, shall also appears a number of times in § 151. For example, § 151(b), when referring to redemption, states

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reinforce the conclusion that preferred stockholders are entitled only to the rights they bargained for, and have no inherent right to dividends, liquidation preferences, convertibility or redeemability.

[7] It should be noted that although the rights of preferred stockholders are determined by the contract, the preferred stockholders must have some preferred right over the common, otherwise the stock is considered illusory. *See Telvest, Inc. v. Olson*, 1979 WL 1759, at *5; *Moran v. Household Intern., Inc.*, 500 A.2d 1346, 1352 (Del. 1985). This problem does not present itself here, however, because the preferred shares in this case have a liquidation preference over the common stock.

that "[a]ny stock which may be made redeemable under this section may be redeemed for cash … as shall be stated in the certificate of incorporation" and § 151(e) states that "[a]ny stock of any class or of any series thereof may be made convertible into shares … of any other class … at such price … as shall be stated in the certificate of incorporation." (Emphasis added). The word shall, when referring to shareholder rights, is used throughout § 151 to ensure that the corporation sets out appropriate rules in its certificate of incorporation to guarantee the rights that the preferred stockholder has contracted for. In other words, the term shall is meant to require the corporation to be both clear regarding rights accorded to the preferred stockholder and to adhere to its contract with the preferred stockholder. In these instances, the use of the word may instead of shall would allow the corporation to escape from its contractual duties. This is exactly how shall is used in § 151(c)—not as a command that forces every corporation to offer dividend rights, but as a guarantee that if it does offer dividend rights, it must fix the rates, conditions and terms of payment in the resolution authorizing the stock issuance or in the corporation's charter so as to afford stockholders an enforceable contract right.

For all these reasons, I cannot agree with Shintom that the Legislature intended to mandate dividend rights for all preferred stockholder and, therefore, I dismiss Shintom's first cause of action.

B. Are Shintom's Shares Void Because of Failure to Approve the Merger?

Shintom alleges that the preferred shares that it now holds are void because it believes that it never approved the merger pursuant to applicable Delaware or New York law. Although the merger occurred in 1987, this is the first time Shintom has sought to challenge the validity of the merger or its participation in the merger. Shintom complains that it never approved the merger, but the complaint is devoid of facts that would support such a claim. Shintom refers to its failure to approve the merger only twice in the entire complaint. In neither instance does Shintom assert more than an unadorned, conclusory fact. Paragraph 12 of Shintom's complaint states that "Shintom did not provide such approval of the Merger or the related conversion of the New York Preferred Stock into the Delaware Preferred Stock." At paragraph 27 of the complaint, Shintom merely repeats paragraph 12. In the

entire complaint, paragraphs 12 and 27 are the only references to Shintom's alleged failure to approve the merger.[8]

As I have already stated, when analyzing a motion to dismiss, all well pled allegations in the complaint are accepted as true. Nonetheless, such a motion does not concede pleaded conclusions of law or fact where there are no allegations of specific facts that would support such conclusions. Although Shintom's complaint is not vague or ambiguous, it utterly fails to set forth any basis for its conclusory assertion that the merger was not lawfully approved. The complaint conclusorily asserts that Shintom did not approve the merger in 1987 and, therefore, the preferred shares issued to it in 1987 are void. The complaint lacks any factual foundation upon which this claim can be based, facts that would appear to rest uniquely with Shintom. Accordingly, I also dismiss Shintom's second cause of action.

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[8] In the briefing on the current motion, Shintom made several more specific allegations of fact concerning its apparent lack of approval of the 1987 merger, including a misspelling of the corporate name on the proxy (it was spelled as Shinton, not Shintom), the validity of the signature of Shintom's then president, Mr. Nobutaro Inoue, and the actual presence of the proxy at the relevant Audiovox shareholders' meeting on April 16, 1987. Audiovox, in similar fashion, attached copies of correspondence and corporate minutes, and asserted that Shintom, having had notice of the transaction and having waited almost 17 years to file its challenge to the merger, is barred from asserting these claims because of laches. As this is a motion to dismiss, however, I am not permitted to look outside of the complaint for facts to support the complaint and, therefore, I do not consider Shintom's additional facts or Audiovox's supporting documents. Although Audiovox's assertion that Shintom's claim is barred by laches is powerful and intuitively appealing, I need not consider it because of my ruling herein.

III. CONCLUSION

For the reasons stated above, I grant defendant's motion to dismiss plaintiff's complaint in its entirety.

IT IS SO ORDERED.

Very truly yours,

/s/ William B. Chandler III

William B. Chandler III

WBCIII:jsm