IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE TELECOMMUNICATIONS, INC. SHAREHOLDERS LITIGATION	CONSOLIDATED C.A. No. 16470-NC

MEMORANDUM OPINION

Date Submitted: May 28, 2003
Date Decided: July 7, 2003

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CHANDLER, Chancellor

Plaintiffs in this purported class action are shareholders of Series A TCI Group Common Stock ("TCOMA"), a tracking stock reflecting the performance of, the TCI Group division of Tele-Communications, Inc. ("TCI"). The TCOMA shareholders have brought various civil actions, which have now been consolidated into this action, alleging breaches of fiduciary duties by the directors of TCI[1] in relation to a proposed merger with a subsidiary of AT&T Corp. ("AT&T"). In addition, the Consolidated Amended Complaint alleges that AT&T aided and abetted the individual defendants' breaches of fiduciary duty. AT&T has filed a motion to dismiss the aiding & abetting claim under Court of Chancery Rule 12(b)(6). For the reasons detailed in this memorandum opinion, I grant AT&T's motion.

I. STANDARD OF REVIEW

In ruling on a motion to dismiss under Rule 12(b)(6), the Court considers only the allegations in the Consolidated Amended Complaint and any documents incorporated by reference therein.* For this purpose, the Court accepts as true all

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[1] The individual defendants, directors of TCI, are John C. Malone ("Malone"), chairman of the board, and chief executive officer of TCI; Leo J. Hindrey ("Hindrey"), president and chief operating officer of TCI; Donne Fisher ("Fisher"); J.C. Sparkman ("Sparkman"), both Fisher and Sparkman are consultants and former executive vice presidents of TCI; Kim Magness; John W. Gallivan; Paul A. Gould; Jerome H. Kern, special counsel with Baker & Botts, L.L.P., TCI's principal outside counsel; and Robert Nally.

[2] *See Vanderbilt Income & Growth Assocs. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 612–13 (Del. *1996); Orman v. Cullman*, 794 A.2d 5, 15-16 (Del. Ch. 2002).

well-pled factual allegations contained in the Consolidated Amended Complaint,[3] but conclusory statements -those unsupported by well-pled factual allegations— are not accepted as true.[4] The Court will draw all inferences logically flowing from the Consolidated Amended Complaint in favor of the plaintiffs but only if such inferences are reasonable.[5] The Court will not dismiss any claim unless it appears to a reasonable certainty that the plaintiffs cannot prevail on any set of facts that might be proven to support the allegations in the Consolidated Amended Complaint.[6]

II. FACTUAL BACKGROUND[7]

TCI is a Delaware corporation organized into three divisions: TCI Group, TCI Liberty Media Group ("Liberty"), and TCI Ventures Group ("Ventures"). TCI stock is issued in six series of "tracking stocks" with two separate series, designated A and B, tracking the performance of each division. The performance of TCI Group is tracked by TCOMA and TCOMB; the performance of Liberty by

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[3] *See Orman, 794* A.2d at 15.

[4] *Grubow v. Perot, 539* A.2d 180, 187 (Del. 1988) (stating that "conclusionary allegations of fact or law not supported by allegations of specific fact may not be taken as true").

[5] See *id.* (stating that the Court "need not . . . draw all inferences from [the allegations] in plaintiffs' favor unless they are reasonable inferences").

[6] *See Rabkin v. Philip A. Hunt Chem. Corp., 498* A.2d 1099, 1104 (Del. 1985).

[7] The facts are derived from the well-pled allegations of the Consolidated Amended Complaint, unless otherwise indicated. Furthermore, this opinion discusses TCI as a separately existing entity comprised of three divisions in the present tense as used in the Consolidated Amended Complaint even though according to briefs on this motion, TCI shareholders approved the merger, which closed on March 9, 1999.

LBTYA and LBTYB; and the performance of Ventures by TCIVA and TCIVB. For each division's two series of stock, the A shares are entitled to one vote per share on all matters subject to shareholder vote and the B shares are entitled to ten votes per share. Otherwise the rights of A and B shareholders for each division are identical.

Defendant John C. Malone ("Malone") is a director of TCI, and its chief executive officer and chairman of the board. Malone and his wife together own approximately 47% of the outstanding TCOMB shares and approximately 45% of the outstanding LBTYB and TCIVB shares. It appears from the Consolidated Amended Complaint that Malone may own some number of A shares,[8] but it is not clear the extent (if any) of Malone's ownership of any of the A series shares.

Sometime in May of 1998 the management of TCI and AT&T began to discuss the possibility of a combination between TCI Group's cable business and AT&T's consumer services telecom business. On June 14, 1998, TCI and AT&T began discussing the merger of TCI into a subsidiary of AT&T. The following day, June 15, TCI management informed the board of directors about the merger discussions. The board formed a special committee comprised of John W. Gallivan

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[8] The Consolidated Amended Complaint alleges that Malone has a right to acquire additional TCOMB shares "in exchange for [TCOMA] shares on a one-for-one basis or for cash." Consol. Am. Compl. ¶ 28. In addition, the Consolidated Amended Complaint excludes from the plaintiff class of TCOMA shareholders all defendants including Malone.

("Gallivan")[9] and Paul A. Gould ("Gould")[10] to evaluate the merger and advise the board whether to recommend it to the shareholders. At the same board meeting, TCI management proposed a combination of Liberty and Ventures to form New Liberty. New Liberty shareholders would be issued new tracking stock after the AT&T-TCI merger. The special committee was also charged with evaluating the exchange ratio in the Liberty-Ventures combination. Also at the June 15 meeting, the TCI board authorized the retention of Donaldson Lufkin & Jenrette Securities Corp. ("DLJ") to act as financial advisors to TCI and the special committee to evaluate the proposed merger and the exchange ratio in the proposed combination of Liberty and Ventures. On June 23, the special committee recommended that the board approve the merger and the combination and the deal was publicly announced the following day.

Under the terms of the merger agreement, TCOMA shareholders will receive .7757 shares of AT&T common stock for each TCOMA share and TCOMB shareholders will receive .8533 AT&T shares per TCOMB share. Based on the June 22, 1998 trading prices of TCOMA, TCOMB, and AT&T, the exchange rate represents a premium-to-market price of greater than 40% to both TCOMA and

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[9] Gallivan's ownership of TCI stock is uncertain from the allegations in the Consolidated Amended Complaint.

[10] As of December 3 1, 1997, Gould had owned more TCOMB than TCOMA shares (roughly 2.5:1).

TCOMB shareholders. TCOMA and TCOMB apparently trade at similar prices. The June 22, 1998 closing price of TOCMA was $35.69 and of TCOMB was, $35.50. The average closing prices of TCOMA and TCOMB for the preceding 30 days were $34.60 and $34.90 respectively. Thus, for shares similarly valued on the open market, TCOMB shareholders would receive approximately 10% more AT&T common stock than would TCOMA shareholders. This difference, representing a premium paid to the TCOMB shareholders for their "supervoting" rights, redounds largely to the benefit of TCI management (collectively the owners of 84.4% of TCOMB shares), while concurrently benefiting the non-management owners of TCOMB shares.

III. ANALYSIS

In order to state a claim for aiding and abetting a breach of fiduciary duty, the plaintiffs must allege (1) a fiduciary relationship; (2) a breach of that relationship; and (3) that the alleged aider and abettor knowingly participated in the fiduciary's breach of duty." Defendant AT&T asserts that the plaintiffs have failed to plead facts from which the Court may infer the third element that it knowingly participated in any breach of fiduciary duty by the directors of TCI.

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[11] *In re Santa Fe Pac.' Corp. S'holder Litig., 669* A.2d 59, 72 (Del. 1995).

Plaintiffs are not required to plead knowing participation with particularity.[12] This element is subject to the ordinary notice pleading standard on a motion to dismiss under Court of Chancery Rule 12(b)(6).[13] Still, it is necessary that the plaintiffs make factual allegations from which knowing participation may be inferred in order to survive a motion to dismiss.[14] For example, knowing participation may be inferred where the terms of the transaction are so egregious or the magnitude of side deals is so excessive as to be inherently wrongful." In addition, the Court may infer knowing participation if it appears that the defendant may have used knowledge of the breach to gain a bargaining advantage in the negotiations.[16] The plaintiffs burden of pleading knowing participation may also be met through direct factual allegations supporting a theory that the defendant

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[12] *McGowan v. Ferro*, 2002 Del. Ch. LEXIS *3*, at *8 (Del. Ch.); *Jackson Nat'l Life Ins. v. Kennedy,* 741 A.2d *377,391* (Del. Ch. 1999); *L A Partners, L.P. v. Allegis Corp.,* 1987 Del. Ch. LEXIS 501, at *22 (Del. Ch.).

[13] *See L A Partners, L.P.,* 1987 Del. Ch. LEXIS 501, at *22.

[14] ***Id.***

[15] See *McGowan,* 2002 Del. Ch. LEXIS *3,* at *8-10; *Crescent/Mach I Partners v. Turner, 2000* Del. Ch. LEXIS 145, at *69-74* (Del. Ch.); *Jackson Nat 'l Life Ins.,* 741 A.2d at 392; *In re USACafes, L.P. Litig., 600* A.2d 43, 55-56 (Del. Ch. 1991).

[16] *See Zirn* v. *VLI* Corp., 1989 Del Ch. LEXIS 83, at * 16-18 (Del. Ch.) (denying motion to dismiss aiding and abetting claim because it was reasonable to infer that a potential acquiror may have used knowledge of the target company's directors exposure to fiduciary duty liability in order to gain some bargaining advantage in negotiations).

sought to induce the breach of fiduciary duty, such as through the offer of side payments intended as incentives for the fiduciaries to ignore their duties.[17]

The terms of the merger, as alleged, do not seem to be sufficiently troubling that TCI's merger partner could be fairly charged with knowing participation in any breach of fiduciary duty by Malone or TCI's directors simply because AT&T agreed to the terms of the merger. Before I go farther, let me be clear about what I am not saying. I am not saying that the breach of fiduciary duty claim against the director-defendants is unmeritorious. AT&T does not assert for purposes of this motion that the plaintiffs have failed to state a claim for breach of fiduciary duty against the TCI directors. Consequently, this motion does not require such a determination and, thus, it would be inappropriate to opine in any detailed manner on the merits of the underlying claim of breach. That said, the level of egregiousness of the terms of the merger, here alleged to constitute the breach of duty to the TCOMA shareholders, is pertinent to AT&T's assertion that plaintiffs have not alleged that it knowingly participated in a breach of fiduciary duty. When the allegations of breach are based upon the specifics of the terms of the merger agreement, the more outrageous those terms are, the less plausible it becomes for a

[17] See *McGowan* v. *Ferro,* 2002 Del. Ch. LEXIS *3,* at *9-10; *Crescent/Mach I Partners,* 2000 Del. Ch. LEXIS 145, at **69-72; Jackson Nat'l Life Ins., 741* A.2d at *392-93; In re USACafes, L.P. Litig., 600* A.2d 43, 55–56.

merger partner accused of aiding and abetting to assert that its participation was not "knowing."

By agreeing to pay a "supervoting premium" whereby the TCOMB' shareholders would receive consideration that is 10% higher than that to be received by the TCOMA shareholders, AT&T, according to the plaintiffs, knowingly participated in Malone and the other directors breaching their fiduciary duties to the TCOMA shareholders. Plaintiffs offer two general propositions to support this theory. First, the plaintiffs contend that they will prove at trial that the payment of a higher control premium for super-voting stock is the rare exception in mergers of this sort. In oral argument on this motion, plaintiffs ask the court to accept that by virtue of the counsel of their investment bankers and legal advisors, AT&T would or should have known this to be the case. I accept for purposes of ruling on this motion that the plaintiffs will be able to produce evidence of the rarity of control premiums like the one to be paid to TCOMB shareholders at the appropriate time. I also anticipate that the defendants will seek to introduce evidence to the contrary. Assuming that enhanced premiums for supervoting stock are the rare exception in stock-for-stock mergers, it is not clear that AT&T did know or should have known that this premium was extraordinary.[18] In any event,

[18] In at least one case, this Court approved a settlement in which a single controlling block of supervoting B shares would be purchased for $135 per share whereas A shareholders

the fact that a particular provision is uncommon does not create a presumption that it was adopted in breach of fiduciary duty. The plaintiffs' second argument is that there is no case in Delaware law addressing the legality of a control premium paid to a class of supervoting shares when the whole company is acquired. At best, this lack of decisional authority provides a basis for suggesting that the ***receipt of*** such a premium *could* constitute a breach of fiduciary duty. At worst, from the plaintiffs' perspective, it bolsters AT&T's assertion that it had no reason to believe that Malone or the other directors were in breach of any fiduciary duty by accepting or even insisting upon such a premium.

The 10% difference in consideration paid to the TCOMA and TCOMB shareholders is not a "side deal" with Malone and management. The plaintiff alleges that management owns just under 85% of the B shares. Under these terms the managers are treated the same as all B shareholders. In addition, a 10% difference in consideration between two classes of shareholders that are each receiving upwards of a 40% premium on the trading price of their shares, is not so grossly excessive that without more it leads to an inference that the difference was

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(and any remaining B shareholders who failed to opt out of the class) would receive only $36 per share. *See In re Resorts Int'l S'holders Litig.*, 1988 Del. Ch. LEXIS 130, at *13-14 (Del. Ch.). In addition, the court specifically permitted B shareholders to opt out of the class because it seemed possible that they "might be entitled to a higher price for their shares than the $36" to be paid under the agreement. See *id.*, at *25-3 1.

intended as an inducement to ignore fiduciary duties. AT&T's agreement to the terms of the merger is insufficient alone to meet the plaintiffs' burden to plead knowing participation by AT&T in Malone and the TCI board's alleged breach of fiduciary duty.

Nor does the fact that AT&T negotiated with Malone and the TCI management team provide a sufficient basis for inferring that AT&T knowingly participated in any breach of fiduciary duty that may have occurred. It is alleged that on June 14, 1998, the negotiations transformed from AT&T seeking to buy TCI Group's cable business into discussions of a merger of all of TCI into an AT&T subsidiary. It is alleged that the terms of the merger were agreed to that same day. I note that this leaves little time for AT&T and Malone to engage in any extended "wheeling and dealing" to benefit Malone and harm 'TCOMA shareholders. Nor does it raise the suspicion that AT&T had to work very hard to court Malone's favor because it appears that the first round of negotiations produced a transaction acceptable to both parties. The following day, the directors of TCI formed a special committee to evaluate the terms of the merger and authorized retention of investment bankers to evaluate the merger. Nine days later the merger was publicly announced under substantially the same terms initially agreed to on June 14. The plaintiffs challenge the qualifications of the special committee members to act in a disinterested and independent manner; challenge

the limitations placed on the authority of the special committee; challenge the incentives of the investment bankers; and complain that no one provided a separate analysis of the fairness of the merger to TCOMA shareholders. Assuming the truth of these allegations, as I must in ruling on this motion, I nonetheless see no basis upon which AT&T could be charged with knowledge of (much less participation in) any failures of the internal workings of the TCI board of directors.

IV. CONCLUSION

In sum, the plaintiffs fail to allege specifically how AT&T may have aided and abetted the TCI directors' breach of fiduciary duty and fail to allege facts from which the court may infer knowing participation. For this reason the Consolidated Amended Complaint fails to state a claim for aiding and abetting breach of fiduciary duty and AT&T's motion to dismiss is GRANTED.

IT IS SO ORDERED.