

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

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Decided: June 7, 2010

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Re: *Monroe County Employees' Retire. Sys. v. Carlson, et al.*
Civil Action No. 4587-CC

Dear Counsel:

Before the Court are defendants' motions to dismiss plaintiff's complaint under Rule 12(b)(6). After carefully considering plaintiff's complaint, the briefing on defendants' motions, and the contentions made at oral argument, I conclude that plaintiff fails to allege facts that, if proven, would support its claims for breach of fiduciary duty and unjust enrichment. Accordingly, defendants' motions to dismiss are GRANTED.

This dispute is driven by the performance of a contract (the "Intercompany Agreement") between Telephone and Data Systems, Inc. ("TDS") and United States Cellular Corporation ("USCC"). At present, TDS is a controlling shareholder of USCC, owning approximately 81% of its common shares. TDS and

USCC executed the Intercompany Agreement in 1987 in contemplation of the initial public offering that resulted in a class of public minority shareholders in USCC stock. The companies have been carrying out the terms of the Intercompany Agreement since 1987.

The Intercompany Agreement sets forth a panoply of services that TDS is to provide to USCC, including services related to operations, marketing, human resources, accounting, customer service, and finance. The price USCC pays for these services is not set in stone. Rather, services provided to USCC are “charged and paid for in conformity with the customary practices of [TDS] for charging TDS’s non-telephone company [s]ubsidiaries for [s]ervices at the time the [s]ervices are provided.”¹ In addition to services, the Intercompany Agreement requires USCC to purchase equipment from TDS. The price for equipment purchases also is not static; USCC is to purchase equipment on the same terms as other TDS affiliates. According to plaintiff’s complaint, in the last three years USCC has paid TDS \$292.6 million for services and \$44.2 million for equipment.

Plaintiff is a USCC shareholder who brings this action derivatively on USCC’s behalf. Plaintiff’s complaint lodges three counts against defendants. Count I asserts that USCC’s nine directors breached their duty of loyalty by favoring their own and TDS’s interests over USCC’s interests by permitting USCC to pay hundreds of millions of dollars to TDS under the Intercompany Agreement, at prices set by TDS, without performing any substantive determination of whether the Intercompany Agreement was fair to USCC. Count II asserts that TDS, as a controlling shareholder, breached its fiduciary duties by carrying out the Intercompany Agreement with USCC on terms that were unfair. Count III asserts that TDS was unjustly enriched by the payments under the Intercompany Agreement.

Both parties agree that entire fairness is the standard of review for transactions carried out under the Intercompany Agreement. Under Delaware law, transactions between a controlling shareholder and the corporation it controls are reviewed for entire fairness.² At the proof stage of the proceedings, the controlling shareholder bears the burden of proving two things about a transaction subject to entire fairness review: fair dealing and fair price.³ Fair dealing involves such

¹ Intercompany Agreement § 2.04.

² *T. Rowe Price Recovery Fund, L.P. v. Rubin*, 770 A.2d 536, 552 (Del. Ch. 2000).

³ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

aspects of the transaction as its timing, initiation, structure, negotiation, etc.⁴ Fair price is concerned with the economics of the transaction, particularly the price.⁵

None of the above is controversial to the parties. They agree about defendants' burden at the *proof* stage of the proceedings. The parties sharply disagree, however, about plaintiff's burden at the *pleading* stage of the proceedings; the stage in which we find ourselves situated. Plaintiff argues that to survive a motion to dismiss the complaint need only allege that a transaction between the controlling shareholder and the company exists. Defendants argue that this is insufficient, that plaintiff must make factual allegations in its complaint that, if proved, would establish that the challenged transactions are not entirely fair. Defendants have the winning argument on this point. Delaware law is clear that even where a transaction between the controlling shareholder and the company is involved—such that entire fairness review is in play—plaintiff must make factual allegations about the transaction in the complaint that demonstrate the absence of fairness.⁶ Simply put, a plaintiff who fails to do this has not stated a claim. Transactions between a controlling shareholder and the company are not *per se* invalid under Delaware law.⁷ Such transactions are perfectly acceptable if they are entirely fair, and so plaintiff must allege facts that demonstrate a lack of fairness.

Plaintiff's fallback position is that, in any event, the complaint alleges facts that demonstrate unfairness. The problem with plaintiff's complaint, however, is that it only alleges facts geared towards demonstrating unfair dealing. This is insufficient to meet the requisite pleading standard. The entire fairness test is not a bifurcated one; dealing and price must both be considered.⁸ Quite frankly,

⁴ *Id.*

⁵ *See id.*

⁶ *Solomon v. Pathe Commc'ns Corp.*, 1995 WL 250374, at *5 (Del. Ch. Apr. 21, 1995) (“Even in a self-interested transaction in order to state a claim a shareholder must allege some facts that tend to show that the transaction was not fair.”); *In re Boston Celtics Ltd. P'ship S'holders Litig.*, 1999 WL 641902, at *4 (Del. Ch. Aug. 6, 1999) (“[I]t is also necessary for the plaintiff to allege specific items of misconduct that demonstrate unfairness, in order to survive a motion to dismiss.”).

⁷ *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993) (“Application of the entire fairness rule does not, however, always implicate liability of the conflicted corporate decision maker, nor does it necessarily render the decision void.”); *cf.* 8 *Del. C.* § 144 (statutory authority that permits interested transactions under certain conditions, impliedly recognizing that such transactions can be beneficial to corporations).

⁸ *Weinberger*, 457 A.2d at 711.

Delaware law focuses on fair dealing in controlling shareholder transactions primarily because a fair price is more likely to follow fair dealing.⁹ Fair price, however, is often the paramount consideration.¹⁰

When defendants filed their motions to dismiss they argued that plaintiff's complaint suffered from a dearth of factual allegations demonstrating that the Intercompany Agreement transactions were unfair. Defendants argued that plaintiff's complaint was conclusory, describing the Intercompany Agreement as "substantively unfair to US[CC]" but lacking any factual allegations demonstrating *why* that was so.¹¹ In response, plaintiff's answering brief contends that the complaint adequately alleges facts challenging the *process* by which the Intercompany Agreement transactions were carried out.¹² A thorough reading of the complaint, and of plaintiff's answering brief illuminating the complaint, confirms that there are *no* factual allegations geared towards proving that the Intercompany Agreement transactions were executed at an unfair price. Unfair dealing is the sole theme of the factual allegations.¹³ As to price, the complaint

⁹ See *Delaware Open MRI Radiology Assoc's, P.A. v. Kessler*, 898 A.2d 290, 311 (Del. Ch. 2006) (noting that the requirement of procedural and substantive fairness "is more than a bit of a misnomer, as the overriding consideration is whether the substantive terms of the transaction were fair.").

¹⁰ See *Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 748 (Del. Ch. 2007) ("The court's finding that [defendants] used an unfair process to authorize the bonuses does not end the court's inquiry because it is possible that the pricing terms were so fair as to render the transaction entirely fair."); *Weinberger*, 457 A.2d at 711 ("[I]n a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger.").

¹¹ See, e.g., Compl. ¶¶ 47, 52.

¹² Pl.'s Answer Br. 10 ("[T]o the extent a shareholder can be said to have a burden to plead facts tending to show unfairness, the shareholder may do so by challenging the process that leads to the transaction."); *id.* 10-12.

¹³ The thrust of the unfair dealing allegations are that the USCC board has never reviewed the Intercompany Agreement transactions for their substantive fairness even though TDS unilaterally sets the prices. Defendants counter that responsibility for overseeing the Intercompany Agreement transactions has been delegated to the audit committee and, thus, the board as a whole has no duty to review the transactions. Defendants also argue that USCC's 2009 proxy statement, cited repeatedly in plaintiff's complaint, demonstrates that the audit committee in fact has reviewed the transactions for fairness. The proxy represents that the audit committee "exercised oversight over related-party transactions, but did not take any formal action to approve any related-party transactions." Inside Directors' & TDS's Opening Br. Ex. B at 13. The parties argue over the meaning of this sentence; plaintiff characterizes it as an admission that the audit committee did not conduct a substantive review, defendants characterize it as representing that a review was performed but no formal action taken because the Intercompany

cites the amounts USCC paid to TDS and makes the conclusory assertion that those amounts were unfair, but makes no factual allegations about those amounts to put them into perspective. For example, the complaint does not allege that USCC could obtain services at a better price elsewhere. Nor does the complaint allege anything about what TDS's services are worth relative to the price USCC paid. Thus, even if plaintiff's factual allegations prove unfair dealing, the complaint posits no basis for concluding that the Intercompany Agreement transactions were priced unfairly. Accordingly, plaintiff has failed to state a claim for breach of fiduciary duty against the USCC directors or TDS and Counts I and II must be dismissed. In addition, Count III must be dismissed because the unjust enrichment claim asserted therein depends on the success of the breach of fiduciary duty claim alleged in Count II. Because plaintiff chose to stand on its complaint in response to defendants' motions to dismiss rather than seek leave to amend its complaint this case is dismissed with prejudice.¹⁴

Before closing I note that even if the complaint had sufficiently plead a claim for which relief could be granted, this case would have been dismissed under *In re Coca-Cola Enterprises, Inc. Shareholders Litigation*¹⁵ as barred by analogy to the statute of limitations. The salient facts in that case are virtually identical to this case.

For the foregoing reasons defendants' motions to dismiss are GRANTED.

Agreement is perpetual and did not need a new approval in 2009. If it were necessary for me to resolve this dispute to decide this motion I would have been sorely tempted not to accept plaintiff's characterization because its allegation that the audit committee wholly abdicated its duties in bad faith is largely based on this sentence from the proxy statement which, in my view, contradicts plaintiff's theory that *no* review was performed. *H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 139 (Del. Ch. 2003) (“[A] complaint may, despite allegations to the contrary, be dismissed where the unambiguous language of documents upon which the claims are based contradict the complaint's allegations.”). Had plaintiff availed itself of 8 *Del. C.* § 220 and obtained copies of the audit committee minutes before bringing this action it would have had a better basis upon which to make allegations about what the audit committee did or did not do. This Court has emphasized repeatedly the importance of 8 *Del. C.* § 220 as a tool shareholder's should use before bringing a derivative claim. *See, e.g., Litt v. Wycoff*, 2003 WL 1794724, at *7 (Del. Ch. Mar. 28, 2003) (“[P]laintiffs are encouraged to invoke 8 *Del. C.* § 220 in order to establish whether the records of the corporation support or refute the suspicion of wrongdoing prior to filing a derivative action.”).

¹⁴ CT. CH. R. 15(aaa).

¹⁵ 2007 WL 3122370 (Del. Ch. Oct. 17, 2007).

IT IS SO ORDERED.

Very truly yours,

A handwritten signature in cursive script that reads "William B. Chandler III". The signature is written in black ink and includes a horizontal line under the "III" at the end.

William B. Chandler III

WBCIII:arh