

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

WILLIAM B. CHANDLER III
CHANCELLOR

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PO. Box 581
GEORGETOWN, DELAWARE 19947
TELEPHONE (302) 856-5424
FASCIMILE (302) 856-5251

Stuart M. Grant
Grant & Eisenhofer, P.A.
1220 N. Market Street Suite 500
Wilmington, DE 1980 1

Henry E. Gallagher
Connolly Bove Lodge & Hutz LLP
P.O. Box 951
Wilmington, DE 1980 1

Steven J. Rothschild
Skadden, Arps, Slate, Meagher
& Flom, LLP
P.O. Box 636
Wilmington, DE 19899

Kevin G. Abrams
Richards, Layton & Finger
P.O. Box 551
Wilmington, DE 1980 1

Robert K. Payson
Potter Anderson & Corroon, LLP
P.O. Box 951
Wilmington, DE 19899

Michael Hanrahan
Prickett, Jones & Elliott
P.O. Box 1328
Wilmington, DE 19899

William O. LaMotte, III
Morris Nichols Arsht & Tunnell
P.O. Box 1347
Wilmington, DE 19899

Re: ***In re Digex, Inc. Shareholders Litigation***
Civil Action No. 18336-NC

Dear Counsel:

I have considered your positions regarding the Motion to Intervene and Clarify and/or Modify this Court's Order and Final Judgment submitted on behalf of Elliot Associates, L.P. ("Elliot"), Elliot International, L.P. ("Elliot International"), and Staro Asset Management, LLC ("Staro") (hereinafter, "Movants"). The Movants make three distinct arguments in support of their

motion. First, they contend they have a right to intervene, under Court of Chancery Rule 24, in this action. Second, they assert that, pursuant to Court of Chancery Rule 60, this Court should clarify or modify the Order and Final Judgment (the “Final Judgment”)’ to correct alleged inequities created by the language of the Stipulation. Third, and finally, the Movants allege that the Stipulation and Final Judgment deprived them of their property without compensation in violation of the constitutions of both the United States and Delaware and in a manner contrary to public policy (the “takings” argument). For the reasons explained below, I deny the motion.

This Court’s April 6, 2001 Final Judgment approved a Stipulation of Settlement (the “Stipulation”),* dated March 2, 2001, that was entered into by the parties after the plaintiff class unsuccessfully sought an injunction against the merger of WorldCom, Inc. (“WorldCom”) and Inter-media Communications, Inc. (“Intermedia”).³ The Final Judgment certified the action as a class action and approved and implemented the Stipulation that provided for the payment of \$165 million (the “Settlement Fund”) to certain members of the plaintiff class. The plaintiff class consisted of “all record and beneficial owners of Digex Class A

¹ *In re Digex, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 18336-NC, Chandler, C. (Apr. 6, 2001) (ORDER AND FINAL JUDGMENT).

² *In re Digex, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 18336-NC (Mar. 2, 2001) (STIPULATION OF SETTLEMENT).

³ *In re Digex, Inc. Shareholders Litig.*, 789 A.2d 1176 (Del. Ch. 2000). The facts concerning the underlying litigation with regard to the **Intermedia/WorldCom** merger are set forth in detail in this Court’s opinion denying plaintiffs’ petition for a preliminary injunction of that merger.

common stock (other than the defendants in the Action and their affiliates) at any time during the period from and including August 31, 2000 through and including the Effective Date [of the merger, July 1, 2001].”⁴ The Stipulation required that the Settlement Fund be distributed to members of the plaintiff class with,

(i) fifty percent (50%) [being] distributed to the record holders of Digex Class A common stock . . . as of the close of business on September 1, 2000, in proportion to the number of shares of Digex Class A common stock held by each such person as of that date and time; and (ii) fifty percent (50%) will be distributed to the record holders of Digex Class A common stock . . . as of . . . the Effective Date of the Merger [on July 1, 2001] . . . in proportion to the number of shares of Digex Class A common stock held by each such person as of that date and **time**.⁵

There is no dispute that WorldCom fulfilled its obligation to fund fully the Settlement Fund or that the Settlement Fund no longer exists as it was distributed to the hundreds (or thousands) of record holders of Digex Class A common stock on the dates specified in, and in the manner contemplated by, the Stipulation. The harm allegedly suffered by the Movants resulted **from** the distribution by the record holders to the beneficial holders of their allotment of the Settlement **Fund**.⁶

The Movants assert that the proceeds of the Settlement Fund were not distributed in the manner provided for in the Stipulation because of the unforeseen result of short selling in Digex stock. The Movants contend that short positions

⁴ Final Judgment at 2-3.

⁵ Stipulation at 25-26.

⁶ Because it is not disputed that the Settlement Fund was distributed to the record holders in accordance with the plain language of the Stipulation, there is no clerical mistake for this Court to correct pursuant to Rule **60(a)**.

they, and others, held in Digex on September 1, 2000 created more beneficial holders of Digex entitled to share in the Settlement Fund than was contemplated by the Stipulation. As a result, the Settlement Fund was insufficient to compensate all of the beneficial holders of Digex stock who were defined to be members of the plaintiff class. The Movants allege that in response to this shortfall, their brokers-record holders with the responsibility of distributing the Settlement Fund to the beneficial owners-improperly augmented the Settlement Fund by surcharging the Movants' brokerage accounts and transferring that surcharge to the "additional" beneficial owners of Digex stock.

The creation of additional beneficial owners of Digex stock was a consequence of the "short sale" of Digex stock by the Movants. "The term 'short sale' means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."⁷ Short selling is a speculative transaction in which the short seller is betting against a stock in a belief that the market price of that stock will fall. A short seller borrows the stock of another and sells it to a third party. To "close" the short position, the short seller purchases, on the open market, a replacement share for the share he borrowed. The expectation of the short seller is that the price of the stock borrowed will go down between the time that he borrows and sells the stock to the third party and the time he closes his short position by purchasing the

⁷ 17 C.F.R. § 240.3b-3.

replacement for the borrowed share. The difference in these prices is the short seller's profit.⁸

Although a short sale does not create additional record holders (there is no increase in the number of issued shares of the company whose stock was borrowed), there is an increase in the number of beneficial holders of the company's stock equal to the number of shares sold short. With regard to the share borrowed, both the shareholder from whom it was borrowed and the third party to whom the share was sold are beneficial owners.⁹ It is probable, if not certain, that neither the issuer nor the beneficial owner from whom the stock was borrowed is aware of the short sale. It is also irrelevant to those two entities. At oral argument, Movants' counsel agreed with opposing counsel that a standard clause in brokerage account contracts requires a short seller to indemnify the lending owner of the share for **any** benefit that accrues to the borrowed share during the short position. For instance, if the issuer pays a dividend of \$1 .00 per share on all its issued shares during the short position, that \$1 .00 dividend will be paid to the third party who bought, and now holds, that share. The shareholder from whom, unbeknownst to him, the stock was borrowed expects to receive that \$1.00 dividend as well. Since

⁸ Of course, this is a speculative transaction and if the price of the stock rises between the time the short seller borrows and sells stock to a third party and purchases the replacement stock to close the short position, he will suffer a loss equal to the differences in those prices.

⁹ Additionally, the borrowed share could be borrowed from the account of the third-party buyer and sold to yet another buyer. This would create an additional, a third, beneficial owner for that one record share. Conceivably, this serial borrowing could create a number of beneficial owners that was a multiple of the number of shares actually issued.

a short sale does not, and can not, create an additional issued share, however, the company is not obligated to pay an additional \$1 .00 dividend. It is the short seller, then, who is required to pay the \$1 .00 to the shareholder from whom he borrowed the share to fulfill his indemnification obligation. That \$1 .00 is merely an additional cost to the short seller of engaging in the transaction.¹⁰

According to the Movants, because short sales of Digex stock created more beneficial owners than record holders, when the record holders received the Settlement Fund, there were not enough fund units to transfer to all of the beneficial owners in accordance with their proportional share of the fund. The Movants allege that their accounts were improperly surcharged to make up this shortfall. The Settlement Fund consisted of WorldCom Group and MCI Group common stock. The surcharge of which the Movants complain was apparently effectuated by the Movants' brokers treating the Movants as if they had executed new short sales of WorldCom and MCI stock from the accounts of the original Digex stock lenders. This new short position created an obligation on the part of the Movants to "replace" the hypothetically shorted WorldCom or MCI shares." In the same way that a short seller would have to indemnify the lender of borrowed

¹⁰ Similarly, were there to be a stock dividend, stock split, share exchange or any other right or benefit redounding to the borrowed share during the period of the short position, the short seller would be required to replace that benefit and make the owner of the borrowed share "whole," thereby leaving him in the identical position he would have been in were his share not borrowed.

¹¹ See Letter from Michael Hanrahan, Esquire, Movants' counsel to the Court dated April 5, 2002.

shares for any cash dividend paid on those shares during the short position by paying that amount of money into the lender's brokerage account, the Movants' brokers appear to have created a mechanism whereby the Movants were required to place into the brokerage accounts of the Digex lenders the precise number of **WorldCom** or MCI shares that these lenders would have received had the Movants not borrowed their Digex shares for short selling. Logically, one of the bundle of rights associated with stock ownership (like the right to receive payment of a declared dividend) is an ongoing inchoate legal right to receive compensation that may mature into an actual legal right to receive compensation upon the entry of an order and final judgment by a competent court. Here, that inchoate legal right matured into an actual legal right upon this Court's Final Judgment approving the Stipulation. Fundamentally, however, the dispute over whether the alleged surcharge was proper or not is a dispute between the Movants and their brokers. The brokers are not parties to this action and there are other *fora* available to the Movants in which that dispute can more properly be settled. ¹²

All the facts pertaining to the motion to intervene make clear that intervention is inappropriate here. As a threshold matter under both Rule 24(a) (intervention of right) and 24(b) (permissive intervention), application for intervention must be "timely." The motion fails for that reason alone. The

¹² As the matter is not properly before me, I express no view as to the merits of the Movants' claim with regard to the actions of their brokers.

Movants were each class members that held long positions in Digex and there is no allegation that they did not receive payment from the Settlement Fund of the proportionate share due them with respect to those long positions. There is no allegation that any class members, including the Movants, did not receive notice of the terms of the Settlement Agreement before that agreement was approved by the Final Judgment. The Movants, who were the only entities with full knowledge of the fact of their short positions and the terms of their brokerage contracts, were certainly in a position to challenge the Settlement Agreement at the April 6, 2001 settlement hearing. Because they did not make that challenge when they had the opportunity to do so, their current motion to intervene and assert those same concerns is untimely.¹³

¹³ Furthermore, although unnecessary for a denial of the motion, intervention is also not warranted as other factors considered by the Court when deciding a motion to intervene weigh against granting this motion. There is no commonality of interest between the underlying action in this litigation and the harm purportedly suffered by the Movants. The litigation concerned alleged breaches of fiduciary duty by corporate directors. The Movants alleged improper action by their brokers, who are not parties to this litigation, in connection with the Movants' brokerage accounts. Those are separate and distinct claims that would not warrant intervention even if the application had been made in a timely manner. Furthermore, there is no prejudice to the Movants upon denial of this motion. There are clearly other avenues available to determine the propriety of their brokers' actions and to pursue any remedies for alleged breaches by those brokers. On the other side, however, the parties to this litigation are entitled to repose. The Final Judgment was entered, the merger has taken place, and the Settlement Fund has been distributed. There would be no practical, or even conceivable, way equitably to unwind the distribution of the Settlement Fund and redistribute that fund even were the Court to agree with the Movants' contention of improper action by their brokers. It is also uncertain that this Court would have jurisdiction over those non-party brokers were a determination made that the brokers should remedy the purported harm suffered by the Movants. For these additional reasons, intervention must be denied.

The notice to, and knowledge of the pertinent facts by, the Movants also support denial of their request for modification of the Final Judgment under Rule 60(b). There could be no surprise, inadvertence or excusable neglect on the part of the Movants in their failure to challenge the Settlement Agreement at the appropriate time when they possessed all of the relevant information at that time. Finally, the decision of the Movants' brokers to surcharge their accounts in no way implicates state action regardless of whether those surcharges were proper. There can be, therefore, no valid takings claim pursuant to either the United States or Delaware constitutions.

For the reasons stated, the motion is DENIED.

Very truly yours,

William B. Chandler III

William B. Chandler

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