IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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GIBRALT CAPITAL CORPORATION, for itself, as class representative and derivatively on behalf of Dmmmond Financial Corporation, a Delaware corporation,

Plaintiff,

v.. C.A. No. 17422

MICHAEL J. SMITH, JIMMY S.H. LEE, ROY ZANATTA, OQ-HYUN CHIN, and MFC BANCORP, LTD.,

and.

DRUMMOND FINANCIAL CORPORATION, a Delaware corporation, solely as a nominal defendant.

MEMORANDUM OPINION

Date Submitted: January 22, 2001
Date Decided: May 8, 2001
Date Revised: May 9. 2001

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JACOBS, VICE CHANCELLOR

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A shareholder of Drummond Financial Corporation ("Drummond" or "the Company") brings this action both individually and derivatively on Drummond's behalf. The plaintiff claims that the defendants, who controlled Drummond, effected numerous self-dealing stock and bond transactions designed specifically to bleed the Company of its cash. The plaintiff also claims that the defendants usurped a corporate opportunity belonging to Drummond. The plaintiff seeks damages and equitable relief, including the appointment of a liquidating receiver.

The defendants have moved to dismiss the complaint for failure to state a claim and for lack of personal jurisdiction over Drummond's controlling stockholder. This is the Opinion of the Court on that motion.

I. FACTUAL BACKGROUND

The facts recited herein are based on the well-pled allegations of the complaint.

This lawsuit grows out of an earlier action brought by the plaintiff, Gibralt Capital Corporation (the "plaintiff" or "Gibralt"), to inspect Drummond's books and records under 8 *Del.* C. § 220. Based on the documents produced in that action, Gibralt commenced this lawsuit. After the defendants moved to dismiss the original complaint, Gibralt filed an Amended and Supplemental Derivative and Class Action Complaint and

Petition For a Receiver (the "complaint"), which is the subject of the pending motion to dismiss.

A. The Parties

Gibralt is a shareholder of Drummond, and at all relevant times has held approximately 2 1 % of Drummond's common stock.

Drummond, which is a nominal defendant, is a Delaware corporation whose principal place of business is currently Geneva, Switzerland. Drummond's business activities have included merchant banking and asset-based commercial lending. Drummond stock is listed on the NASDAQ system, but trades infrequently.

Besides Drummond, Gibralt has named five defendants, four of which are Drummond directors: Michael Smith ("Smith"), Jimmy Lee ("Lee"), Roy Zanatta ("Zanatta"), and Oq-Hyun Chin ("Chin").

Smith is Chairman, President and Chief Financial Officer of Drummond, and has been a director since March 1995. Since June 1996, Smith has also been the President and a director of the corporate defendant, MFC Bancorp, Ltd. ("MFC"), which is Drummond's controlling stockholder. By virtue of those positions, Smith controls Drummond. In late 1996, Mr. Smith became a director of Ichor International ("Ichor"), a publicly traded company that was a controlled subsidiary of Drummond; and

he was also a director of Logan International Corporation ("Logan"), a State of Washington corporation that is controlled by MFC.

Defendant Lee who is a citizen of the Republic of Korea, was appointed to Drummond's board in March 1995, but stepped down in late 1996 or early 1997.' Lee also was a director of Logan.

Defendant Zanatta is a Canadian citizen who at all relevant times was vice president, secretary and one of Drummond's three directors. Zanatta is also an employee and director of MFC, which paid him over $293,000 of compensation in 1998, and awarded him options for 125,000 MFC shares during the three years before this action was filed. Zanatta is also an officer and director of several other companies that Smith controls.

Defendant Chin, a citizen of the Republic of Korea, is the: third current director of Drummond. Chin is also a director of MFC.

The fifth defendant, MFC, is alleged to own a majority of the voting stock of Drummond, and to have exercised actual control over Drummond since at least June 1996. MFC is controlled and dominated by Smith.

[1] Complaint, at ¶ 12.

B. The Challenged Transactions

1. The Preferred Stock Transactions

A major subject of the complaint is a series of transactions by which the defendants gained 76% voting control over the Company. In June 1996, MFC obtained a large minority stock interest that represented effective control over Drummond. MFC could not acquire more than 35% voting control at that point, however, because of an anti-takeover provision in a bond indenture between Drummond and its bondholders. The defendants could gain voting control only by eliminating that indenture provision, which they did by means of the transactions next described.

First, in June 1996, the defendants caused Drummond to issue 3 million shares of preferred voting stock, worth $6 million, to MFC. Simultaneously, the defendants caused Drummond to purchase $6 million of preferred stock in Logan, which MFC effectively controlled. Immediately thereafter, the defendants caused Logan to purchase $6 million of MFC's preferred stock. The end result of this "round robin" was 'that each of these entities ended up with the same amount of capital. that it had before the transaction, yet MFC was able to gain control of Drummond without spending any of its own funds, by virtue of the voting preferred stock Drummond had issued to MFC.

To give this transaction legal effect, MFC caused Drummond to file, with the Delaware Secretary of State, a certificate of designation for the newly-issued preferred stock. That certificate provided that each of those. three million preferred shares had one vote. The certificate further provided, however, that no single stockholder could hold more than 35% of the Company's voting stock unless the indenture was amended.

Next, in the fall of 1996, the defendants caused Drummond to enter. into an agreement with the agent for the Company's bondholders, which permitted the bond indenture to be amended to allow MFC to control up to 49% of the Company's voting stock. Finally, in 1998, MFC acquired all of Drummond's outstanding bonds at a discount, which purchase enabled MFC to amend the indenture to eliminate the voting power restriction altogether. That enabled MFC to increase its voting power in Drummond to its present 76% level.

In this manner, Gibralt claims, MFC acquired absolute control over Drummond without paying a control premium. Indeed, Gibralt argues, by virtue of these circular preferred-stock transactions, MFC effectively acquired absolute control of Drummond for nothing. Gibralt also claims that two material facts, namely, (i) MFC's use of the Drummond preferred stock to acquire absolute control of the Company by modifying the indenture, and

(ii) Logan's acquisition of MFC preferred stock to complete the circular transactions that resulted in MFC obtaining control over Drummond-were not disclosed to Drummond's stockholders.

2. The Ichor Transactions

After the defendants established control over Drummond and Logan, they next effected a series of complex transactions that gave MFC majority control over a Drummond subsidiary, PDG Remediation, Inc., now called Ichor Corporation ("Ichor"). The complaint alleges that the defendants (i) caused Ichor to issue preferred stock to MFC and its affiliates on. questionable terms, and (ii) caused Drummond to sell approximately 17% of its Ichor stock: to the defendants and/or their affiliates at a deep discount. These transactions were not disclosed to Drummond's stockholders either.

3. The Sale of the Environur Loan to Logan

In the fall of 1996, Drummond had an outstanding loan receivable from Enviropur Waste Refining and Technology, Inc. ("Enviropur"). That loan was secured by, among other things, the assets of a waste-oil recycling facility located in Illinois. In December 1996, MFC and Smith caused Logan (then controlled by MFC) to buy the Enviropur loan from Drummond (also controlled by MFC) for $2.4 million.

Logan immediately then sold the loan to Ichor, which then was also majority controlled by Drummond.[2] In exchange, Ichor gave Logan a promissory note for $1.4 million, that carried an 8% interest rate; plus 2.5 million shares of Ichor common stock. As a result, Logan obtained 50.3% voting control of Ichor. Moreover, Logan received from Ichor consideration worth $3 million, for an asset Drummond had sold to Logan only moments before, for $2.4 million.[3] Thus, plaintiff claims, $600,000 of immediate value, as well as voting control of Ichor, were transferred from Drummond to Logan for no consideration in a transaction that could have been structured to lbenefit Drummond. That is, Drummond, rather than Logan, could have received the promissory note and the Xchor stock that Ichor had transferred to Logan to acquire the loan. Had that been done, plaintiff alleges, Drummond would have maintained majority control of Kchor.

The only disclosure of this transaction that was made to Drummond shareholders '(months later, when the Company filed its Form 10Q on February 14, 1997) was the fact that Drummond had sold the loan to Logan. Smith, Zanatta and MFC knew that fact, yet did not cause Drummond to

[2] The boards of all three companies were controlled by MFC, Smith and Zanatta. In addition, Lee sat on the Logan board.

[3] Assuming that the Ichor shares issued to Logan were valued at $.82 per share-the price Drummond paid for its Ichor stock only weeks before this transaction-and that the promissory note was valued at par ($1.4 million).

disclose that Logan had immediately resold the loan to Ichor for a $600,000 profit.

4. The Drummond Bond Transactions

In 1997, the defendants caused the Company to repurchase Drummond bonds from MFC or its affiliates at a substantial premium. That repurchase cost the Company millions of dollars. In addition, in 1998 MFC launched an "exchange offer" whereby MFC offered to exchange its own bonds, having an aggregate par of $16 million, for the outstanding Drummond bonds worth approximately $26 million. Although the Company received no benefit from that exchange offer, Drummond, not MFC, paid the costs of the offer. The party that benefited was MFC, which obtained the bonds at a discount, partly by the use of confidential financial information about the Company.

5. Other Transactions

In addition to the transactions previously described, the complaint claims other breaches of duty allegedly committed by the defendants. Specifically, Smith repeatedly caused Drummond to invest in the securities of MFC and Mercer with no benefit to Drummond; and he also caused Drummond to make large, interest-free loans to affiliates of MFC. For example, in 1997, the Company was caused to make interest-free loans and

"advances" to Sutton Park. On June 30, 199'7 Drummond was caused to make identical $4.7 million advances to "Blake Limited" and "Harping Management," two entities apparently affiliated with Smith. The defendants are also charged with having caused Drummond to pay excessive fees, commissions and other expenses to MFC, Smith, Zanatta and others.

* * *

These transactions form the subject matter of the complaint. The relief that Gibralt requests includes damages, an accounting, and the appointment of a receiver to manage Drummond. As earlier noted, the defendants have responded by moving to dismiss for failure to state a claim and for lack of personal jurisdiction over MFC. The bases for this motion are next discussed.

II. THE PARTIES' CONTENTIONS AND THE GOVERNING LAW

The complaint alleges two sets of claims. The first is that the defendants failed to disclose to the Drummond shareholders material facts relating to the self-dealing transactions described above. The second set of claims attacks the self-dealing transactions themselves, as constituting breaches by the defendants of their fiduciary duties owed to Drummond and its shareholders.

The defendants challenge to the complaint is two-fold. First, the defendants argue that the Court lacks personal jurisdiction over MFC, which is said to be a foreign corporation having no ties to Delaware. Second, the defendants contend that all but two of the nine Counts of the complaint fail to state a claim upon which relief may be granted.[4] Specifically, the defendants urge that Gibralt's disclosure claims should be dismissed because the alleged non-disclosures were not material, and because the pled facts are insufficient to support an inference of materiality. In addition, the defendants argue that the substantive fiduciary duty claims are themselves not legally cognizable.

A motion to dismiss for lack of jurisdiction under Court of Chancery Rule 12(b)(2) presents a factual matter that may be resolved on the basis of the complaint or evidence extrinsic to the complaint. Thus, a Rule 12(b)(2) motion differs from a Rule 12(b)(6) motion in that the Court is not constrained simply to accept the well pleaded allegation of the complaint as true.[5]

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[4] Counts III and IV are not contested by the defendants at this stage, and will therefore not be discussed. In addition, two claims under Court II, found at ¶74 (a) and (f) of the complaint, are similarly not contested or addressed.

[5] *See, Hart Holding Co. v. Drexel Burnham Lambert Inc.*, Del. Ch., 593 A.2d 535,538 (199 1). In this case the motion is resolved on the basis of the allegations of the complaint, as no extrinsic evidence has been presented.

On a motion to dismiss under Court of Chancery Rule 12(b)(6), however, the Court must take the well-pled facts of the complaint as true and construe them in the light most favorable to the non-moving party.[6] A complaint will be dismissed only where it appears with reasonable certainty that under no set of facts that could **be** proven to support the claims asserted, would the plaintiff be entitled to relief? The Rule 12(b)(2) and 12(b)(6) issues are analyzed in accordance with these standards.

III. ANALYSIS

A. Whether This Court Has Personal jurisdiction Over MFC

1. Under the Delaware Long; Arm Statute

The Court first addresses the threshold issue of whether this Court has personal jurisdiction over MFC, the corporate defendant. MFC argues that Gibralt cannot establish personal jurisdiction over it in Delaware, because the complaint fails to allege facts that satisfy any of the six jurisdictional criteria in 10 *Del.* C. § 3 104, Delaware's general long arm statute.

The plaintiffs claim of personal jurisdiction over MFC rests upon only one of the statutory categories, namely, that MFC "transacted business

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[6] ***In re Tri-Star Pictures, Inc. Litig.,*** Del. Supr., 634 A.2d 319, 326 (1993).

[7] ***Id.***

in Delaware."[8] Gibralt argues that by causing Drummond to amend its charter twice, first to expand the Company's authority to engage in other lines of business and second, to designate the terms of the preferred stock; and also by otherwise exercising control over Drummond, MFC "transacted business" in Delaware within the meaning of § 3 104(c)(1).

MFC responds that the 'business" that it allegedly transacted in Delaware, namely, causing Drummond to amend its charter, does not constitute "doing business" within the meaning of the statute. On this issue MFC has the better side of the argument.

As was stated in *United States v. Consolidated Rail Corp.*, "[t]he language of [§ 3 104(c)(l)] requires that some action *by the defendant* occur within the state".[9] Here, it is not alleged that *MFC* took action in Delaware, but only that MFC caused another person to take action in Delaware. The only connection alleged between MFC and Delaware is MFC's ownership of a controlling interest in Drummond stock. As a general rule, ownership of stock in a Delaware corporation, without more, will not suffice to establish general *in personam* jurisdiction." Although transactions between MFC and

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[8] ***10 Del. C. $3104(c)(l).***

[9] 674 F.Supp. 138,142 (D. Del, 1987) (emphasis added).

[10] ***Outokumpu Eng'g Enters., Inc. v. Kvaerner EnviroPower, Inc.,*** Del. Super., 685 A.2d *724* n.1 (1996).

Drummond did occur, none of those transactions are alleged to have taken place in Delaware. For that reason, I conclude that personal jurisdiction over MFC cannot be predicated upon the Delaware long arm statute, unless MFC can be deemed to have transacted business "through an agent" in Delaware."

2. Under the Consniracv Theory

The theory upon which the plaintiff seeks to obtain personal jurisdiction over MFC under the agency standard of § 3 104(c)(1) is predicated on the common law "conspiracy theory" of jurisdiction. Under that theory, a nonresident defendant who conspires with a defendant that is subject to jurisdiction in Delaware, to breach a duty owed to the: plaintiff, would also be subject to ***in personam*** jurisdiction in Delaware."[12] If Gibralt is able to satisfy the conspiracy theory, jurisdiction under the long arm statute would be proper because the acts of MFC's co-conspirators in Delaware would satisfy the agency standard under § 3 104(c)(1).

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[11] 10 *Del. C.* § :3104(c)(l): [A] court may exercise personal jurisdiction over any nonresident . . . who in person ***or through an agent:***

(1) Transacts any business . . . in the State;" (emphasis added).

[12] As this Court has held, "[t]he conspiracy theory works well in tandem with § 3 104 because a conspiracy analysis is relevant to determining whether a person has committed acts satisfying § 3104 'through an agent."' *HMG/Courtland* ***Properties,*** *Inc.* ***v. Gray,*** Del. Ch., 729 A.2d 300, 307 (1999).

To establish personal jurisdiction over MFC under the conspiracy theory, a plaintiff must show that:

> (1) a conspiracy to defraud existed; (2) the defendant was a member of that conspiracy; (3) a substantial act or substantial effect -in furtherance of the conspiracy occurred in the forum state; (4) the defendant knew or had reason to know of the act in the forum state or that acts outside the forum state would have an effect in the forum state; and (5) the act in, or effect on, the forum state was a direct and foreseeable result of the conduct in furtherance of the conspiracy.[13]

I am satisfied, for the following reasons that the plaintiff has established that MFC meets all of these requirements.

First, the complaint alleges that a conspiracy existed to obtain majority control of Drummond by amending Drummond's charter to authorize the creation of new preferred stock, tiling the certificate of designation in Delaware, and then issuing the preferred stock to MFC. Specifically, MFC first caused Drummond to amend its charter to allow it to engage in "any lawful activities." That amendment was required to enable Drummond to enter into the merchant banking business. The existence and significance of the conspiracy is alleged to be as follows:

[13] ***Instituto Bancario*** *Italiano SpA* ***v. Hunter*** *Eng'g* ***Co.,*** Dep. Supr., 449 A.2d 210,225 (1982).

> as a crucial part of their stripping of Drummond's assets, . . . MFC . . . caused Drummond to amend its certificate of incorporation to allow the Company to engage in 'any lawful activity.' The . . . primary purpose for this amendment was to allow MFC to gain access to Drummond's cash."[14]

Next, MFC caused Drummond to amend its charter a second time, by its filing a certificate of designation defining the terms of the preferred stock that the defendants caused Drummond to issue to MFC.

Second, the complaint alleges that MFC was a member of the conspiracy. It was MFC that is claimed to have caused the Drummond board to undertake the charter amendment and file the certificate of designation.

Third, the filing of the certificate of amendment and the certificate of designation "constituted . . . act[s] within the State of Delaware and one step in a part of a conspiracy that allowed the defendants to take other wrongful acts that allowed them to gut Drummond."[15] That is, the filing of the two certificates were substantial acts in furtherance of the conspiracy-acts that took place in Delaware and satisfy § 3 104(c)(1).

[14] Complaint, at ¶ 17.

[15] Complaint, at ¶ 17.

Fourth, it is alleged that MFC knew of the acts that occurred in Delaware and knew that those acts would have an effect in the forum state; otherwise, MFC would have had no reason to cause Drummond to amend its charter.

Fifth, those amendments are what enabled the defendants to exercise control over Drummond and, ultimately to accomplish the self-dealing transactions by which Drummond was stripped of its assets. Specifically, the complaint alleges that in 1996, MFC acquire 48% of the outstanding common stock of Logan. In mid-1996, MFC gained effective control over Drummond, and thereafter, used its control over Logan and Drummond to gain absolute voting control of both corporations, by having each company issue new preferred shares having almost identical economic terms. [16]

MFC caused Drummond to file a certificate of designation, signed by defendant Lee, for the newly issued shares in July 1996. That filing is claimed to have constituted a wrongful act within Delaware, and is an integral part of the chain of events that led to MFC's eventual seizure of absolute control over Drummond in the fall of 1996. That seizure would not

[16] MFC bought $6 million of Drummond voting preferred stock; Dnunmond bought $6 million of Logan voting preferred stock; and Logan bought $6 million of MFC preferred stock. Through these circular issuances of preferred stock, MFC obtained majority control over Logan, and eventually obtained majority control over Drummond as well.

have been legally possible without the certificate amendments and the filing of the certificate of designation.

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I am mindful that the "conspiracy theory" is not invoked lightly, and has only rarely been invoked successfully as a basis for attributed personal jurisdiction under § 3104(c)(1). The complaint in this case, however, alleges facts that are sufficient to implicate that theory of personal jurisdiction as to MFC. The defendants' motion to dismiss MFC for lack of personal jurisdiction will therefore be denied.

Having resolved the jurisdictional issue, I next address the defendants' several challenges to the legal sufficiency of the plaintiffs claims for relief.

B. The Disclosure Claims

Count VIII of the complaint alleges that the defendants violated their fiduciary duty of disclosure in various respects. Specifically, the complaint claims that the defendants, when seeking election to the Drummond board, had a duty to disclose their many conflicts of interest, which duty the defendants breached by electing to disclose only sorne of those conflicts and to conceal the rest from Drummond's stockholders. In addition, the plaintiff alleges five other disclosure violations, which arise out of: (1) the Logan purchase of the MFC preferred stock, (2) the sale of the Enviropur loan to

Logan, (3) the omission to report all self-dealing transactions involving fees, commissions and other items, (4) the omission to disclose a $14 million loan by Drummond to MFC, only $12 million of which was repaid, and (5) the omission to disclose the terms of the bond repurchase program.

For a duty of disclosure claim to survive a motion to dismiss, a plaintiff must allege that the fiduciary (i) disseminated (ii) materially false and misleading information (iii) resulting in (iv) injury to the stockholders.[17] The defendants argue that the complaint fails to meet this standard, because it does not sufficiently plead that Drmnmond stockholders would have considered any of the alleged self-dealing transactions to be material. In addition, the 'defendants contend, the complaint fails to plead that Drummond stockholders suffered any actual, quantifiable damage that resulted from any of the omitted disclosures.

The plaintiff responds that the complaint establishes that the nondisclosed facts were material because by concealing those facts the defendants were able to continue engaging in self-dealing transactions at the Company's expense. Moreover, Gibralt claims, had Drummond's stockholders been told of the transactions, they could have waged a proxy

[17] ***See Malone v. Brincat,*** Del. Supr., 722 A.2d 5, 9, 12 (1998); see ***also 0 'Reilly v. Transworld Healthcare, Inc.,*** Del. Ch., 745 A.2d 902, 920 (1999).

fight to wrest control of the Company or, alternatively, sued to enjoin the transactions rather than having to bring this action for damages after the fact. In addition, the plaintiff contends that it has adequately pled damage to Drummond and its stockholders, because the complaint alleges that as a result of these transactions, Drummond was rendered insolvent.

The complaint, in my view, adequately alleges breaches of the defendants' fiduciary duty of disclosure. That pleading makes it clear that the defendants disclosed some, but not all, of their self-interested transactions. An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.[18] The plaintiff must show 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.[19] Although the complaint does not state *in* haec *verba* that the undisclosed transactions were material, their materiality is inferable from the facts that are alleged, namely, that (a) the concealment of the undisclosed information enabled the defendants to continue engaging in self-dealing transactions at

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[18] ***TSC Industries*** v. *Northway,* ***Inc.,*** 426 U.S. 438 (1976) (cited with approval in ***Rosenblatt*** v. ***Getty Oil*** Co., Del. Supr., 493 A.2d 929, 944-45 (1985).

[19] ***See,*** *Loudon* ***v. Archer-Daniel+Midland Company,*** Del. Supr., 700 A.2d 135, 143 (1997).

the Company's expense, and (b) had the plaintiff and Drummortd's other public stockholders been aware of these transactions, that knowledge would likely have influenced how the plaintiff and Drummond's other public stockholders voted. Finally, the nondisclosures, by keeping Gibralt in the dark, prevented it from taking any corrective action such as filing an action for injunctive: relief or waging a proxy fight for control of the Company. For these reasons, I find that the plaintiff has adequately pled that the alleged undisclosed facts were material.

The complaint also fairly alleges resulting injury to the Company and its shareholders. The plaintiff describes a series of transactions undertaken by the defendants that systematically looted Drummond and drove it into insolvency. Taking these allegations as tru-as I must on this motion—they show that the plaintiff was significantly damaged by the loss in value of its investment that was caused by the defendants' wrongdoing.

For the preceding reasons, Count VIII of the complaint states cognizable disclosure claims and will not be dismissed.

C. Whether a Receiver Should Be Appointed

Count IX of the complaint asserts a claim for the appointment of a liquidating receiver for an insolvent corporation under 8 *Del. C.* § 291. A corporation is insolvent for purposes of § 291 if(i) it is unable to pay its

current expenses as they mature in the usual course of business; or (ii) it suffers a deficiency of assets below liabilities (i.e., a negative net worth) with no reasonable prospect that the business can be continued in the face thereof.[20]

The defendants contend that Gibralt's claim for the appointment of a receiver must be dismissed, for two reasons. First, they argue that the complaint makes no allegation of insolvency, in the sense that the Company is unable to meet its expenses as they come due. Second, defendants argue that the complaint pleads no threatened imminent loss that can be remedied only by a receivership.

The plaintiff responds that the complaint does allege that the Company is insolvent, and that two of the defendants have so admitted.[21] Gibralt further argues that a receiver is necessary because the defendants continue to control the company and it is they who drove Drumrnond into insolvency.

In my view, the claim to appoint a receiver is legally sufficient. The complaint alleges that Drummond is insolvent: it states that "[i]f Drummond

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[20] ***See, Banks v. Christina Copper Mines, Inc.,*** Del. Ch., 99 A.2d 504 (1953), see ***also*** *Siple* ***v. S&K Plumbing & Heating, Inc.,*** Del. Ch., C.A. No. 6731, Brown, V.C. (April 13, 1982).

[21] Complaint at ¶¶ 64 and 88.

pays the note to MFC, there will be nothing left of Drummond,"[22] and that "Mr. Zanatta flatly told Gibralt that Drummond intended to eventually redeem all of the bonds from MFC at par, which he acknowledges will leave essentially no value in the company."[23] The plaintiff has also sufficiently pled that the activities of the defendants, detailed elsewhere in this Opinion, are what placed Drummond in its current financial crisis. Lastly, a receivership is the only remedy that will oust the defendants from their controlling positions in Drummond. For those reasons, the claim for appointment of a liquidating receiver survives this dismissal motion.

D. Whether the Bond Exchange Usurped A Corporate Opportunity of Drummond

In Count VI, the plaintiffs claim that in March 1998 MFC exchanged approximately $18 million of its own bonds for Drummond bonds worth $26 million. The Drummond bonds MFC acquired were later exchanged for a promissory note secured by all of Drummond's assets. Drummond paid all the costs of, yet it received no benefit from, that exchange. Ratlher, Gibralt alleges, because the defendants had previously stripped the Company of its cash, Drummond was rendered unable to take advantage of the opportunity

[22] Complaint, at ¶ 88.

[23] Complaint, at ¶ 64.

to buy back its own bonds at the then-low market price. Instead, the defendants captured that opportunity for themselves and forced Drummond to pay their expenses, which conferred no benefit on the Company. As a consequence of this wrongdoing, the plaintiff claims, Drummortd is entitled to an order canceling the promissory note and reimbursing it for all the transaction costs the Company was forced to incur.

The defendants respond that the complaint states no cognizable claim, because it alleges no facts that Drummond was financially able to repurchase its own bonds in early 1998.[24] Moreover, the defendants urge, the allegation that Drummond lacked sufficient funds because of the defendants' wrongdoing is both legally irrelevant and an admission that is fatal to the corporate opportunity claim.

I concur that the plaintiff has not stated a cognizable claim for usurpation of a corporate opportunity. To plead such a claim, the plaintiff must plead (*inter alia*) facts that demonstrate that the company had the financial means to take advantage of the alleged opportunity.[25] The pled facts clearly show that Drummond did not have enough cash to repurchase

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[24] ***See Benerofe*** v. ***Cha,*** Del. Ch., C.A. No. 14614, Chandler, C., Mem. Op. at 10 (Feb. 20, 1998) (to state a claim for usurpation of corporate opportunity, plaintiff must allege that corporation had ability to exploit allegedly misappropriated opportunity).

[25] ***See id.***

all or even some of the bonds at the time MFC purchased them. For that reason, insofar as it alleges usurpation of a corporate opportunity, Count VI cannot survive this motion.

Although Count VI does not state a cognizable claim for usurpation of a corporate opportunity, it does not follow that that Count must be dismissed. Conduct that does not run afoul of the corporate opportunity doctrine may nonetheless constitute a violation of the broader, and more fundamental, fiduciary duty of loyalty.[26] The conduct alleged in Count VI appears to be of that character. At this stage the Court cannot conclude as a matter of law that the pled facts would not justify a grant of relief under any circumstances. Accordingly, insofar as Count VI alleges a breach of the defendants' fiduciary duty of loyalty, that claim will stand.

E. The 1997' Bond Repurchase

In Count V, the plaintiff alleges that in May 1997, Drummond was caused to repurchase $14.4 million of its bonds for approximately $13.4 million-an amount that was significantly higher than the prevailing market price.[27] The lbonds were repurchased from MFC and its affiliates, which

[26] See, e.g., Johnston *v.* Greene, Del. Supr., 121 A.2d 919 (1956).

[27] Drummond is alleged to have paid $82 per hundred, significantly above the market price, which ranged from $54.50 to $72.50 per hundred for the quarter ending June 30, 1997. Complaint, at ¶ 52.

previously had purchased those bonds at prices significantly below $13.4 million. Gibralt alleges that the purpose of this self-dealing repurchase transaction was to funnel money to MFC and its affiliates at the expense of Drummond. In the alternative, the plaintiff claims that the bond repurchase constituted waste.

The defendants respond that Gibralt has not stated a cognizable claim for self-dealing, because its allegations neither directly state, nor permit an inference, that the defendants and their affiliates were the sellers of the bonds.[28] Because the Court cannot infer that the defendants were the sellers, the defendants argue, the only claim that is alleged is waste. That claim, defendants insist, cannot survive because the complaint does not allege that the price Drummond paid for these bonds was above market, or otherwise was so excessive as to satisfy the demanding test for corporate waste.

I find, contrary to the defendants' position, that the complaint's allegations raise the inference that MFC was the seller of the bonds. The complaint specifically pleads that MFC was the seller of some of the bonds.[29] It further alleges that MFC's financial statements disclose the sale

[28] *McMillan v. Intercargo Corp.*, Del. Ch., C.A. No. 16963, Strine, V.C., Mem. Op. at 15 (April 20, 2000) ("neither inferences nor conclusions of fact unsupported by allegations of specific facts... are accepted as true") (quoting ***In re Lukens Inc. Shareholder Litig.***, Del. Ch., Cons. C.A. No. 16102, Lamb, V.C., Mem. Op. at 10-11 (Dec. 1, 1999)).

[29] Complaint, at ¶ 55.

of a large block of Drummond bonds,[30] and that the plaintiff communicated with every otlher large Drummond bondholder, each of which denied that it had sold the bonds to Drummond at a premium. Indeed, those bondholders told the plaintiff that the Company had never approached them about a possible bond repurchase.[31] Because the other large bondholders were not the sellers, it is logically inferable, by process of elimination, that the seller was MFC-the only other large bondholder. That being the defendants' only argument, the claim survives the motion to dismiss.[32]

F. The Preferred Stock Issuance

1. The Three-Steu-Acquisition of Control of Drummond

Count I claims that the defendants breached their fiduciary duty in connection with MFC's acquisition of control of Drummond. More specifically, Count I alleges that the issuance of voting preferred stock to MFC violated the defendants' fiduciary duties to the Drummond minority, because the transaction had no economic substance and was designed solely to enable MFC to capture absolute control of Drummond without paying a control premium. The plaintiff alleges that Smith (who controlled and was a

[30] ***Id.***

[31] ***Id.*** at ¶ 54.

[32] Because the Count survives as a claim for breach of fiduciary duty, the Court need not address whether Count V also states a legally sufficient claim for waste.

director of both MFC and Drummond), Zanatta (who was an employee of MFC), and Lee (who had substantial ties to Smith) all had material conflicts of interest when they voted to approve the transactions. Therefore, Gibralt urges, the defendants breached their fiduciary duties of loyalty by approving this self-dealing transaction that conferred no benefit on Drummond.

The defendants respond, first, that the claim is barred by the doctrine of laches and the three-year statute of limitations in 10 ***Del. C.*** § 8106, because (i) the transaction was fully and completely disclosed to Drummond stockholders in Drummond's June 27, 1996 Form 8-K, yet (ii) the original complaint was not filed until September 17, 1999, over three years later. Gibralt responds that this claim is not barred by the statute of limitations or laches, because the claim was equitably tolled until such time as the stockholders learned or should have discovered the breach of duty.[33]

At this stage I am unable to conclude as a matter of law that this claim is time-barred, because the complaint alleges facts that implicate the doctrine of equitable tolling. It is correct that more than three years elapsed between the first of the series of transactions complained of, and the filing of the original complaint. The issuance of the preferred stock was only the first step in a series of transactions, accomplished by defendants, whereby MFC

[33] Plaintiff relies on ***Kahn v. Seaboard Corp.***, Del. Ch., 625 A.2d 269 (1993).

obtained absolute control over Drummond. But, there also were other steps: the defendants caused Drummond to purchase $6 million of Logan preferred stock, and then caused Logan to purchase $6 million of MFC stock. By means of these three transactions, MFC gained absolute control over both Drummond and Logan. The first two of these transactions were publicly disclosed. The problem for defendants is that material facts about the third were not.

Specifically, the defendants did not disclose the Logan purchase of MFC stock. Had defendants done that, then the true nature of the transaction would have been apparent-the seizure of control, in which event the shareholders would have been on inquiry notice of a potential claim of wrongdoing. But, the defendants' nondisclosure of Logan's participation enabled the other two components of the three-part transaction---which were disclosed-to be portrayed (misleadingly) as simply an investment by MFC in Drummond that enabled Drummond to invest the proceeds in Logan securities.

The disclosure of one component of this transaction cannot operate to put the stockholders on notice of a claim that the entire transaction

constituted a -breach of duty.[34] Here, the entire three-step transaction is what is said to constitute the alleged breach of duty. Because the third step was not disclosed, the statute of limitations was equitably tolled as to the entire claim until such time as the stockholders were properly put on notice that a potentially actionable wrong had been committed.[35] What is uncertain on the present record is the precise time when the stockholders of Drummond were put on inquiry notice. Because that is a factual matter which cannot presently be determined from the complaint, Count I will not be: dismissed on the basis that it is time-barred.

2. Modification of the Indenture

The second claim alleged in Count I is that the defendants breached their fiduciary duty by modifying Drummond's bond indenture to delete its anti-takeover provision. The defendants argue that Drummond's shareholders lack standing to assert this claim, because the eliminated provision protected bondholders, not stockholders. In addition, defendants urge, the complaint alleges that MFC, which owned 35% of Drummond's voting stock, already had effective voting control at the time of the indenture

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[34] ***In re Maxxam, Inc./Federated Development Stockholder Litigation,*** Del. Ch, Consol. C.A. No. 12111, Jacobs, V.C., Mem. Op. at 17, n.5 (June 21, 1995).

[35] Because the plaintiffs delay in bringing this action is attributable to the defendants' nondisclosure of facts that would have alerted the plaintiff to the existence of a claim, the delay was not "unreasonable," and therefore the defense of laches would not apply.

revision, and that after the modification, MFC owned 49%. Thus, the defendants argue that because the 14% increase in MFC's voting power had no practical effect on its already formidable ability to influence Drummond's actions, the bond indenture modification caused no harm to the stockholders. Indeed, defendants say, the complaint does not allege that the amendment was either unfair to Drummond or that it benefited MFC at the expense of Drummond's other stockholders.

Gibralr: responds that it has standing to challenge the modification of the indenture, whose sole purpose was to enlarge Smith's and MFC's voting control over Drummond, because Drummond's shareholders were intended beneficiaries of the anti-takeover provision in two respects. First, the provision made an unwanted acquisition of Drummond more difficult; second, the Company benefited from the value that a potential control premium added to the market price of its stock. In all events, the plaintiff argues, whether or not the indenture amendment harmed Drummond or its stockholders presents a factual issue that cannot be decided at this stage. The plaintiff also argues that MFC's increase in ownership from 35% to 49% was significant and did harm Drummond's stockholders, because as a practical matter it eliminated the risk that Gibralt and the other public stockholders could join forces to oust MFC from board control.

I conclude that the elimination of the voting power restriction provision of the indenture, *per* se, does not state a cognizable claim. Here, it is claimed that the modification of the indenture resulted in the (deletion of a provision that was designed to prevent the ouster of Drummond's management, by making it more difficult for any bidder to take control of Drummond. That provision was intended to protect Drummond's bondholders. And although Drummond's shareholders may have received some incidental benefit from the indenture provision, the complaint does not allege that the stockholders were its intended third party beneficiaries. Having no standing to enforce the provision, the stockholders would not have an enforceable claim for breach of fiduciary duty arising from the deletion of that provision. If that conduct amounted to a wrong,, any resulting claim belonged to the bondholders. Accordingly, this claim, insofar as it sleeks relief *solely* by reason of the indenture modification, will be dismissed.[36]

[36] The dismissal may turn out to be a pyrrhic victory for the defendants, because that claim is dismissed only to the extent it exists as a free-standing claim for relief in isolation, ***i.e.,*** without regard to the role the indenture modification played in the defendants' larger scheme to gain control of Drummond and to strip its assets. Even though the modification of the indenture, by itself without more, will not warrant relief, that conduct, in combination with the other conduct that is alleged as part of a larger scheme of wrongdoing, would support the plaintiffs broader claim for relief.

G. Claims Concerning Ichor

Count II of the complaint alleges that the defendants engaged in four specific transactions, all involving Ichor, that resulted in harm to Drummond which, at the time of these transactions, held 60% of Ichor's stock. Each of these transactions is separately discussed.

1. The Line of Credit to Ichor

The plaintiff first claims that the defendants breached their fiduciary duties to Drummond by causing Drummond to loan Ichor $800,000, at a time when Ichor was in dire financial straits. According to the complaint, that was done to enable Ichor to pay off a $400,000 debt to MFC. The effect of this transaction, Gibralt claims, was to transfer the risk of default from MFC to Drummond.

The defendants urge that this claim must be dismissed, because the complaint does not allege that the terms of the loan amounted to self-dealing or were unfair to Drummond.

I conclude that the complaint sufficiently alleges that the transaction amounted to self-dealing by the defendants and was unfair to Drummond. This claim alleges that Drummond was caused to make the loan to Ichor in order to allow MFC to eliminate its loan to "a company going downhill."[37]

[37] Complaint, at ¶ 32.

From this it may be inferred that the defendants stand accused of causing Drummond to assume the significant financial risk of default by Ichor in a transaction that benefited MFC but provided no benefit to Drummond.

2. The Issuance of "Death Spiral" Preferred Stock

The complaint next alleges that after Ichor became a majority-owned subsidiary of Drummond in 1996, the defendants wrested control of Ichor from Drummond by (among other things) causing Ichor to issue "death spiral" preferred stock to the defendants and their affiliates.[38] The plaintiff alleges that Drummond was harmed by the issuance of the Ichor death spiral preferred stock, because the effect was to dilute Drummond's stock interest in Ichor solely to benefit MFC.

The defendants argue that this claim must be dismissed for lack of standing. Specifically, defendants contend that a shareholder of one corporation (Drummond) has no right to bring a derivative action on behalf of a "sister" affiliate of that corporation (i.e. Ichor). In addition!, the defendants urge that the claim is on its face impermissibly speculative, because there is no allegation that any dilution ever in fact occur-red.

[38] "Death spiral" is a term used in the market to describe convertible preferred stock which, unlike normal preferred stock, has no fixed conversion price. Rather, the lower the common price stock drops, the more common shares into which they are convertible. Complaint, at ¶ 36.

In my view, the lack-of-standing argument is without merit, because the claim is asserted on behalf of Drummond, which directly owned 60% of Ichor's stock. Using its control of Drummond, MFC placed two of its representatives, Smith and Zanatta, on the Ichor board. Smith and Zanatta then caused Ichor to issue the "death spiral" stock., which diluted *Drummond's* Ichor holdings. Because it is not alleged that MFC was involved in the issuance, Drummond would have no direct claim against MFC for stock dilution damage. But, Drummond would have a direct claim against Ichor and its board (who were also directors of Drummond) for wrongful dilution of Drummond's Ichor stock as a result of this transaction.[39] Indeed, that claim is being asserted by Gibralt derivatively on behalf of Drummond. Because Gibralt has standing to sue in that derivative capacity,[40] this claim will stand.

3. The Cancelled Guarantee

Third, the plaintiff claims that the defendants caused Drummond to allow Ichor to cancel a $750,000 guarantee Ichor previously made in favor

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[39] ***See, In re Tri-Star Pictures Inc., Litigation,*** Del. Supr., 634 A.2d 319, 330 (1993).

[40] The argument that the claim must be dismissed because there is no allegation that any dilution has yet occurred, is also defective. First, it is not a "standing" argument, but, rather, goes to the substance of the transaction that forms the basis for the claim. Second, the fact that the outstanding death spiral stock could be converted in the future indicates that the stock, when converted, will cause Drummond harm at some future time, and therefore would be a proper subject of equitable relief that could prevent the harm.

of Drummond. Sutton Park, an MFC affiliate, received 175,000 preferred shares of Ichor in exchange for $1 million in cash, plus the release of the $750,000 guarantee. The wrongdoing, plaintiff alleges, consisted of the defendants causing Drummond to release the guarantee for no consideration, to enable the defendants' affiliate, Sutton Park, to receive the Ichor shares. Gibralt claims that because it was Drummond that gave value in the form of the release of guarantee, the Ichor preferred shares rightfully belong to Drummond. Moreover, the plaintiff alleges, because the defendants cannot prove the entire fairness of this transaction, the complaint states a cognizable derivative claim against the defendants on Drummond's behalf.

The defendants respond that because the complaint alleges no facts to support the ccnclusory allegation that the guarantee was in favor of Drummond, **tlhe** claim fails for lack of an essential premise.

The defendants are wrong. The complaint alleges, in a nonconclusory way, that the guarantee operated in favor of Drummond,[41] and that the defendants caused Drummond to surrender the guarantee for no consideration.[42] If these facts are true-and their truth must be assumed at this stage-then the plaintiff has adequately pled a breach of fiduciary duty

[41] Complaint, ¶ 38.

[42] Complaint, ¶ 38.

that the defendants disloyally exercised their voting control for the benefit of Ichor and Sutton Park and to the detriment of Drummond. Accordingly, this claim survives the motion to dismiss.

4. The Sale of Ichor Shares Below Market Price

Lastly, Gibralt alleges that in June 1998, the defendants caused Drummond to sell 400,000 of its Ichor shares for $1.257 per share, a price that represented a 17% discount from the lowest price at which the stock had ever traded in the market ($1 .50 per share). Gibralt claims that the stock was sold to the defendants and their affiliates, and it bases that conclusion on the fact that no party other than the defendants was in a position to negotiate such a large discount from the market price. In addition, the plaintiff urges, that conduct fits the defendants' historical pattern of self-dealing. Accordingly, Gibralt concludes, causing Drummond to sell a large block of its Ichor shares, at a price far below the market value, to the defendants, states a claim for unlawful self-dealing.

The defendants contend that this claim must fail for two reasons. First, the defendants argue that the complaint does not allege that the discounted price for such a large block of shares was below market value. Second, the complaint does not state a cognizable claim of self-dealing,

because the defendants are not charged with having received anything of value to the exclusion and detriment of Drummond's other shareholders.

Although the sale of a large block of stock at a below market price does raise suspicion, I conclude that this claim cannot survive this motion. The reason is that the allegations critical to that claim are conclusory. The complaint alleges that "[b]ased upon the large discount to market—Ichor shares never sold below $1.50 at this time-plaintiff believes, and therefore alleges, that the shares were sold to the defendants or their affiliates."[43] Although the plaintiff is entitled to the benefit of any reasonable inference that can be drawn from the well-pled allegations of the complaint, the Court must disregard conclusory allegations unaccompanied by specific averments of supporting fact.[44] Here, the plaintiff alleges no specific averments of fact that would support a favorable inference that this transaction involved unlawful self-dealing.

Nor could this claim survive the dismissal motion even if it were viewed as a claim for waste. To withstand a motion to dismiss, the pled facts must demonstrate the sale of Ichor stock was "so completely bereft of

[43] Complaint, at ¶ 39.

[44] ***See,*** *McMillan*, note 26, ***supra*** at 15.

consideration that '[s]uch transfer is in effect a gift. '"[45] Here, the 17% alleged discount, without more, cannot be said to satisfy that strict standard.

IV. CONCLUSION

Counsel shall confer and submit an appropriate form of order implementing the ruling made in this Opinion.

[45] ***In re 3Com Corp. Shareholders Litig.,*** Del. Ch., C.A. No. 16721, Steele, V.C., Mem. Op. at 11 (Oct. 25, 1999) (citing ***Lewis v. Vogelstein,*** Del. Ch., 699 A.2d 327, 336 (1997)).