COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: In Re Sunstates Corporation Shareholder Litigation, C.A. No. 13284

Dear Counsel:

After oral argument on March 23, 2001, I reserved decision on several matters. I address them now.

The motion to dismiss

The defendants have moved to dismiss several claims :in Count I of the amended complaint, which is brought derivatively on behalf of Sunstates Corporation. The premise of their argument is that the claims at issue do not belong to Sunstates Corporation but to one or more of its foreign subsidiaries and may only be asserted in a double or multiple

derivative suit.' To support their argument, defendants point out that, while the transactions at issue were authorized by the parent company directors, they were actually implemented through various subsidiaries and not through the parent corporation itself. Thus, any actual injury suffered, they argue, was felt at the subsidiary -- not the parent company -- level. Because those subsidiaries are not parties to this action and cannot be joined, defendants contend, the claims must be dismissed.

I conclude that the motion to dismiss should be denied. The complaint alleges well pleaded facts which, if true, would support a finding that the individual defendants, all directors of Sunstates, breached their duty of care and duty of loyalty to Sunstates. It is irrelevant in this regard that the transactions those defendants authorized were later implemented through one or more subsidiaries. As Vice Chancellor Strine noted in ***Grace Brothers, Ltd. v. Uniholding Corp.,*** "There is no safe harbor in our corporate law for fiduciaries who purposely permit a wholly-owned subsidiary to effect a transaction that is unfair the parent company on whose board they serve."[2] Those subsidiaries may, conceptually, have separate claims against their directors. They, or someone acting on behalf of their creditors, may also have claims against the parent corporation and those who controlled it under some theory of recovery. The potential existence of those claims does not, however, mean that the parent company directors cannot be sued in that capacity for breach of fiduciary duty.

I also would not dismiss the claims at this stage of the proceedings, even if they were best characterized as double or multiple derivative

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[1] Plaintiffs have agreed to stay several claims in Count I of the Amended Complaint in light of an action filed by the Illinois Insurance Department. These are as follows: 1) the purchase of collectibles by Coronet Financial and Sunstates Equities (Am. Cmplt. ¶¶ 73-74); 2) the default on the LaSalle Bank loan (*Id.* ¶¶ 80d, 82-84); and 3) the purchase of allegedly worthless securities (*Id.* ¶¶ 49-53, 75-791). Defendants, in turn, argued that these claims should be dismissed. I will stay these claims rather than dismiss them, pending the outcome of the Illinois action.

[2] Del. Ch., C.A. No. 17612, mem. op. at 32, Strine, V.C. (July 12, 2000).

claims, unless I concluded, considering all pertinent facts and circumstances, that "in equity and good conscience, the action slhould [not] proceed among the parties before" the court.[3] In reaching this conclusion, I reject defendants' categorical argument that, in *Sternberg v.* 0 ***'Neil,*** the Delaware Supreme Court decided that in all double derivative suits, both parent and subsidiary are indispensable parties.[4]

I do not read *Sternberg* as creating or endorsing such a bright-line rule with respect to double or multiple derivative actions in which the parent is a Delaware corporation amenable to suit here and the subsidiary is not. In *Sternberg*, the issue was whether plaintiff could maintain a double derivative action against the directors of a Delaware subsidiary of an Ohio parent corporation that was not generally subject to suit in Delaware, the opposite of the situation confronted here. The Court of Chancery dismissed the action, holding, first, that it lacked personal jurisdiction over the parent corporation and, second, that the parent corporation was an indispensable party to the action.[5] The Supreme Court reversed because it concluded that Delaware could exercise personal jurisdiction over the Ohio parent corporation without offending the Due Process Clause of the federal constitution.

In reaching its decision, the Supreme Court had occasion to state that "[i]n a double derivative action, both the parent and the subsidiary corporations are indispensable parties."[6] The focus of its analysis, however, was on whether the parent corporation was an indispensable party such that the action could not proceed in its absence, The Supreme Court did not have occasion to consider whether, in the opposite situation presented here, the action could proceed in the absence of the subsidiary corporation. Moreover, the Supreme Court rested its conclusion that the

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[3] Ct. Ch. R. 19(b).

[4] Del. Supr., 550 A.2d 1105, 1124 (1988).

[5] *Sternberg v. O'Neil*, Del. Ch., 532 A.2d 993 (1987).

[6] Del. Supr., 550 A.2d at 1124.

parent corporation was indispensable in a double derivative claim on grounds that "any recovery for losses suffered by the subsidiary that were being sued upon would go to the parent. "[7] Obviously, the same rationale does not justify a conclusion that an absent foreign subsidiary is also an "indispensable" party to an action brought double derivatively on its behalf.[8]

Rather than apply a bright-line rule, I conclude that should the issue come up during the course of trial, or in post-trial proceedings, it should be analyzed in accordance with Court of Chancery Rule 19(b). For purposes of discussing the issue further, I assume, without deciding, both that the absent subsidiaries are "persons to be joined if feasible"' as described in either Rule 19(a)(l) or (a)(2), and that they cannot be made parties to this action.[9] Thus, under Rule 19(b), the issue would be "whether in equity and good conscience the action should proceed among the parties before [the court], or should be dismissed. " The factors to consider in reaching that decision are enumerated in the rule. Most important for these purposes, are whether the absence of the subsidiaries from the litigation is likely to prejudice them or any of the parties before the court; whether any such prejudice could be avoided by the shaping of relief or the insertion of other protective provisions in the judgment; and whether, if the action were dismissed, plaintiffs would have an adequate remedy.

These are all issues that can be addressed fully should it later appear that any of the claims presented in the litigation rightfully belong to one or

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[7] Id. The Court of Chancery made the same observation. Del. Ch., 532 A.2d at 999.

[8] Both the Court of Chancery and the Supreme Court cited and relied on *Levine v. Milton,* Del.Ch., 219 A.2d 145 (1966). That case involved a double derivative suit involving two Panamanian corporations, neither of which was amenable 1.0 suit in Delaware. Thus, it does not provide controlling authority on the issue presented here.

[9] Plaintiffs concede the unavailability of the subsidiaries in their reply.

more subsidiaries of Sunstates. I should note, however, that in the case of a solvent, wholly-owned subsidiary, it is not obvious why the interests of the subsidiary are not fully protected by the presence of its parent corporation in the litigation.

Class definition

The class claim in Count II alleges that Sunstates violated the preferences in its charter relating to its $3.75 Cumulative Preferred Stock when, in 1991-1993, it bought shares of common and preferred stock at a time when the preferred stock dividend was in arrears. The class period is alleged to run from February 1, 1991 through September 30, 1993. The proposed class is defined to include all persons who owned shares of the preferred stock during the class period, except the defendants and their affiliates and those persons who sold all of their shares of preferred stock back to the company in one of the challenged repurchase transactions. By way of relief, the complaint seeks the imposition of a constructive trust on the common and preferred shares purchased in alleged violation of the preferences and an award of damages sustained by the class.

I asked for further briefing on whether the class should be defined to include persons who acquired shares of the preferred stock after the end of the class period. My reason for doing so was the lack of clarity in our law as to whether the claim at issue is one that transfers to a purchaser when shares of stock are sold. The plaintiffs responded as follows:

> Both plaintiffs and defendants have assumed, up to this point, that these claims were not assigned when shares were sold, and that those who held the shares at the time of the alleged wrongdoing are the proper claimants. We believe that this assumption was correct.

Plaintiffs' response gives several "obvious" examples or situations in which claims are not viewed as being transferred along with the stock. They first point to claims by persons who allege that they were caused to

sell their shares at an unfair price as the result of a breach of fiduciary duty. Next they cite to the situation where a dividend is declared and shares are sold "ex dividend" after the record date. Finally, relying on ***Dieter v. Prime Computer, Inc.***,[10] plaintiffs argue that because a person who purchased shares after the alleged wrongdoing might be found to be an inadequate or atypical class representative, I should infer that such a person has no claim and cannot be a member of the class.

I am not satisfied that these arguments or authorities adequately address the point raised. One induced to sell shares as a consequence of a breach of fiduciary duty plainly has a claim separate from the ownership of the shares themselves. The same would ordinarily be true of a person induced to purchase shares by fraud. Similarly, the declaration of a lawful dividend has long been understood to give stockholders as of the record date standing as creditors to sue at law for the recovery of the amount due."[11] Finally, ***the Dieter*** case does not consider the merits of the proffered defense and, thus, does not stand for the proposition that the putative representatives in that case had no claim or were not members of the class.[12]

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[10] Del. Ch., 681 A.2d 1068 (1996)

[11] *Jefferis v. Wm. D. Mullen Co.*, 132 A. *687* (1926); *Selly v. Fleming Coal* Co., 180 A. 326 (1.935). The legal rights of the parties are well enough understood to be reflected in the way the markets deal with the trading of shares as to which a dividend has been declared. As of the record date for the dividend, shares customarily trade "ex dividend," meaning that the seller, who is the record holder as of the record date, retains the right to the dividend. The buyer knows this and pays a price that reflects that fact.

[12] *Dieter v. Prime Computer, Inc.*, Del. Ch., 681 A.2d 1068 (1996), was an action by common stockholders challenging the fairness of the terms of a merger. The court in that case refused to certify as class representatives persons who had purchased their shares of common stock after the terms of the challenged transaction were announced. The court reasoned that those putative representatives could be subject to a unique defense based on the timing of their purchase and, for that reason, were not "typical" of the class. Because there were other putative representatives who were not subject to the same objection, the court specifically did not address the merils of the

In this case, I can see little reason why the claim for breach of the preferred stock charter provisions would not ordinarily transfer with the shares. This is the general rule embodied in 6 ***Del. C.*** § 8-303(a), which provides that "upon delivery of a . . . security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer." The phrase "all rights in the security" can be understood as distinguishing between personal rights of the holder, on the one hand, and rights that inhere in the security itself, on the other. For example, the right to receive payment of a lawfully declared dividend is a separate property right of the record stockholders and, thus, is not a right "in the security." By contrast, it is not readily apparent that a claim by a class of stockholders about the corporation's dealings in other shares allegedly in violation of the corporation's charter gives rise to a separate right to damages belonging to the individual members of that class. The wrong is not to the stockholders individually but to a provision of the corporate charter designed to protect the dividend preference o-f the shares. Thus, a suit for violation of such a protective charter provision is one to enforce obedience to the charter in order to protect the contractual preference, and the remedy is more apt to take the form of a declaration of rights and an order restoring the status quo ***ante*** than an award of money damages. [13]

For now, I conclude that the class should be defined to include those persons who either have or at one time had a claim arising out of the conduct challenged in Count I and who have or had a right to recover some relief as a result. If plaintiffs are able to prove that Sunstates violated its certificate of incorporation, I will then consider the appropriate remedy to

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asserted defense, finding only that "the spectre of the defense does disqualify the Dieters as appropriate class representatives." *Id.* at 1072-73.

[13] *See, e.g. Elliott Assocs.. L. P. v. Avatex Corp.,* Del. Supr., 715 A.2d 843 (1998).

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issues without regard to these distinctions. Only if considerations relating to the shaping of relief required that differences in timing of share purchases by class members be taken into account would it be necessary to consider how best to address such differences.

Very truly yours,

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