IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JOHN BARING, DANIEL SHEEHAN, JAMES THOMAS WARD, AUDREY WOLF and WATERGATE EAST, INC.,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 516-N
WILLIAM K. CONDRELL, JAMES W. LEWIS, ELIZABETH B. WOOD, JUDITH S. EATON and LESTER SCHLITZ,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: September 28, 2004
Decided: October 18, 2004

James P. Hughes, Jr., Christian D. Wright and Karen E. Keller, of YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware, Attorneys for Plaintiffs.

William E. Manning, of KLETT ROONEY LIEBER & SCHORLING, of Wilmington, Delaware; OF COUNSEL: Gerald E. Burns and Elizabeth L. Long, of KLETT ROONEY LIEBER & SCHORLING, Philadelphia, Pennsylvania, Attorneys for Defendants.

CHANDLER, Chancellor

Plaintiffs, certain board members of Watergate East Inc. ("WEI"), have petitioned for declaratory judgment concerning the April 12, 2004 vote of the WEI Membership. The petition was brought pursuant to Section 225 of the General Corporation Law, 8 *Del. C.* § 225(b). Defendants, the remaining WEI board members, have answered and counterclaimed, seeking similar relief. Both parties have moved for summary judgment on their respective claims.

There is little dispute in this case as to the relevant facts and no dispute as to the facts this Court finds material. Because the resolution of the issues now before the Court touch upon an earlier matter, I refer to the record in that matter where appropriate to develop the facts of this case.[1] As framed by the parties, this case presents two issues: What effect should this Court give the April 12, 2004 membership vote; and what effect, if any, did the election of certain new members to the WEI board have on this Court's February 25, 2004 Order? I address these issues in turn.

I. BACKGROUND

The Watergate East Inc., ("WEI") nominal plaintiff, is a not-for-profit corporation organized under the laws of the State of Delaware. WEI owns and operates the Watergate East, a 240-unit, cooperative apartment building.

[1] That case is styled as *Baring et al. v. Watergate East, Inc., et al.*, Del. Ch., C.A. No. 192-N, Chandler, C. (Feb. 25, 2004).

In turn, WEI is part of the larger Watergate Complex, which is comprised of five other buildings including the famous Watergate Hotel ("Hotel").[2] This six-building complex was developed as part of a planned urban development program located in Washington D.C.[3]

Each named party to this suit occupies an apartment in the Watergate East pursuant to a proprietary lease agreement with WEI. Watergate East residents are then issued WEI shares and carry voting rights appurtenant to those shares. Both the individual plaintiffs, and the individual defendants, serve on WEI's board of directors.[4]

Some time in 2003, the Blackstone Group, the previous owners of the Watergate Hotel, decided to sell the Hotel.[5] Monument Residential LLC ("Monument") emerged as a likely suitor and intended to convert the Hotel to a cooperative condominium complex with over 100 units.[6] In addition to the Hotel purchase, Monument expressed an interest in a 75-lot subterranean parking garage and other Hotel facilities, including some former restaurant

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[2] In total, the Watergate Complex is comprised of the Watergate East, the Watergate South and the Watergate West (two separate and individually owned cooperative apartments), the Watergate Hotel, and two separately owned office buildings.

[3] Defs.' Opening Br. in Supp. of their Req. for Decl. Relief ("Defs.' Sept. Opening Br.") C.A. No. 516-N (Sept. 20, 2004) at 5.

[4] WEI's board seats 11 directors. For purposes of this litigation, the parties have characterized the board in two factions—for the plaintiffs, a six-director, pro-sale majority and for the defendants, a five-director, anti-sale minority.

[5] Pls.' Opening Br. in Supp. of their Req. Pursuant to 8 *Del. C.* § 225(b) for Decl. Relief, ("Pls.' Feb. Opening Br.") C.A. No. 192-N (Feb. 20, 2004) at 6.

[6] *Id*.

space and a ballroom facility (the "Property"). This Property is currently owned by WEI and leased to the Hotel under a 99-year lease agreement. Monument has offered $4.25 million dollars to purchase the Property.[7]

The Monument offer proved to be a divisive issue to the Watergate East residents. For months, the WEI board debated the issue. Various residents formed both pro-sale and anti-sale platforms. The issue came to a head in December of 2003 when the WEI board voted in favor of a special meeting of the Membership to vote on the Monument Proposal.[8] That vote, which sparked the litigation now before this Court, was held on January 22, 2004.

Despite winning the ballot 54 to 46 percent,[9] the pro-sale faction was denied victory because the WEI board imposed a super majority-voting requirement. On January 29, 2004, the plaintiffs, who then represented a pro-sale minority of the WEI board, filed an action for declaratory judgment seeking to invalidate the super majority-voting requirement and declaring the January 22 vote binding on the WEI board.

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[7] *Id.* at 7.

[8] *Id.* Ex. 12 ("December 2, 2003 Draft Minutes of Watergate East Board Special Meeting").

[9] The Final vote cast on January 22, 2004 was 33,428 votes for the sale and 28,535 votes against the sale. *See id.* at 18.

On February 25, 2004, this Court entered an Order nullifying the super majority-voting requirement.[10] In reaching this decision, this Court was then, and remains now, doubtful that a board with such entrenched views could decide this divisive issue while remaining faithful to the fiduciary duties owed the membership. As a result, WEI was ordered to hold another membership meeting where a fully and properly informed membership would cast their vote and decide whether WEI would sell the Property to Monument.

That holding was communicated to the membership by letter and a second vote was scheduled for WEI's annual meeting held on April 12, 2004.[11] As April approached, both sides geared up once again to cast their ballots on the Monument offer. Bruce Drury, an independent auditor who WEI had engaged to tally the January 22 results, was again hired for the April meeting.[12]

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[10] This Court found that as a matter of Delaware law the sale of the Property did not constitute a sale of all or substantially all of WEI's assets and that neither WEI's charter nor its bylaws required a membership vote on the issue of the sale. Nevertheless since the WEI board had continuously promised the membership a vote they were now estopped from denying it. Once a vote was ordered, WEI's 29th bylaw provides that a simple majority vote of those present at the membership meeting would decide the issue. *See* Letter Opinion and Order Determining Validity of Watergate East Members Vote Regarding Sale of Property to Monument Residential ("Feb. 25 Order") C.A. No. 516-N (Feb. 25, 2004) at 2.

[11] Defs.' Sept. Opening Br. at 10.

[12] Bruce Drury was a certified public account and a partner in a Washington based accounting Firm. WEI engaged Mr. Drury in the past in connection with various yearly accounting audits. *See* Transcript of Deposition of Daniel Sheehan ("Sheehan Dep.") at

On April 12, the vote commenced as planned and two issues were before the membership. The first issue was the proposed Monument offer. The second was the election of three directors needed to fill vacancies recently created by expired terms. As votes came in, Mr. Drury and an assistant used a laptop computer to facilitate the counting.[13] At no time during the voting were signatures check for authenticity, or conflicts concerning duplicative proxies resolved.[14] Once the tally was completed, Mr. Drury reported that three pro-sale directors had been elected and that the proposed sale was approved by a margin of only 492 votes.[15]

The following morning and in the ensuing two days, Mr. Drury received queries regarding the ballots.[16] At least one resident contacted Mr. Drury to determine whether certain votes had been cast.[17] Confronted with increasing calls from the membership, Mr. Drury contacted Kiomars Aghazadeh, WEI's general manager, to confirm voter information and seek

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101; *see also* Transcript of Deposition of Bruce Drury ("Drury Dep.") at 7, 11, 27. Nothing alleged by either party impugns Mr. Drury's credibility or independence.

[13] *See* Transcript of Deposition of Kiomars Aghazadeh ("Aghazadeh Dep.") at 30-32. Mr. Aghazadeh, WEI's general manager, provided this computer. Thus, by the close of the vote, at least one electronic copy of the tally and the physical ballots existed and could have verified the results of this election.

[14] *See* Drury Dep. at 180-181, 196.

[15] *See* Defs.' Sept. Opening Br. Ex. 23 ("April 26, 2004 Letter from Drury to Sheehan").

[16] *See* Drury Dep. at 116-119.

[17] *Id*. at 117.

instruction.[18] As these protests mounted, Mr. Aghazadeh became increasingly frustrated with questions concerning the vote and decided to delete from his laptop the electronic copy of the April 12 vote.[19] Two days after the deletion of the database, Mr. Drury testified that he was instructed to destroy the ballots and Proxies. Thus by April 15, all records of the April 12, 2004 vote had been destroyed.[20]

Certain members became incensed upon learning of the ballot's destruction. More than 50 members submitted petitions to the WEI board demanding a special meeting for purposes of "re-voting" on the Monument offer.[21] In the meantime, Daniel Sheehan, WEI's newly elected president and a continuing director, directed Mr. Aghazadeh, despite the destruction of all records, to get an official vote certification from Mr. Drury.[22] Next Mr. Sheehan wrote a letter to Mr. Drury instructing him that no other WEI board member other than himself, the treasurer, or chair of the Audit committee were permitted to contact him.[23] By a second letter sent the same day, Mr. Sheenhan informed Mr. Drury that he would not invite him to attend a

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[18] *Id*. at 117-120.
[19] *See* Aghazadeh Dep. at 90-95.
[20] *Id*. at 126-128.
[21] WEI bylaws provide that the president shall call a special meeting of the members if requested to do so in writing by fifty members so long as neither statute nor WEI's charter proscribes such a meeting.
[22] Defs.' Sept. Opening Br. Ex. 29 ("April 24, 2004 E-Mail from Sheehan to Aghazadeh").
[23] *Id.* Ex. 30 ("April 28, 2004 Letter from Sheehan to Drury").

special meeting called to explore the destruction of the ballots, despite a request of certain board members to the contrary.[24] Then on April 28, 2004, Mr. Sheehan sent a letter to the Zoning Commission stating that WEI's members had voted to approve the sale to Monument.[25] This letter made no mention of the members' call for a revote.[26]

The members were successful in calling a special meeting for the purposes of voting once again on the Monument offer. This vote, which occurred on June 9, 2004, was markedly different from the last. WEI engaged the League of Women's Voters ("LWV") to administer the vote and prior to the vote, the board adopted a resolution outlining a uniform procedure to ensure the integrity of the process.[27] The LWV collected all ballots cast and tabulated the results at the LWV offices the following day. Each side had a proctor present during the tabulations and challenges to specific votes were discussed and resolved by agreement or by the LWV.[28] On June 10, 2004, LWV declared that the membership had voted against the

[24] *Id.* Ex. 31 ("April 28, 2004 Letter from Sheehan to Drury").
[25] *Id.* Ex. 28 ("April 28, 2004 Letter from Sheehan to Zoning Commission").
[26] *Id*.
[27] *Id*. Ex. 44 ("LWV contract, certification and invoice"); Ex. 46 ("June 9, 2004 Voting Procedures").
[28] *Id*. at 22.

Monument offer by a margin of only 0.7 percent. LWV formally certified this result on June 23.[29]

One day after the June 9 vote, the WEI board held a special meeting to determine whether or not to proceed with the sale.[30] Pursuant to WEI bylaw, the defendants, the 5-member minority of the WEI board, were able to defer consideration of this matter for 14 days.[31] Defendants also filed an action in the Superior Court of the District of Columbia hoping to stay the sale.[32] In response, plaintiffs, the 6-member majority of the WEI board, filed this action.

On June 28, another special meeting of the board was held, at which point a majority of the board approved the sale to Monument (the very sale the membership had disapproved on June 9) and authorized Mr. Sheehan to sign an agreement of sale.[33] The parties have since agreed to stay the sale pending the outcome of this case.

II. ANALYSIS

This action is brought pursuant to 8 *Del. C.* § 225(b). In a proceeding under Section 225(b), the Court is permitted to "hear and determine the result of any vote of stockholders upon matters other than the election of

[29] *Id*. Ex. 44.
[30] *Id*. Ex. 49 ("Draft Minutes of June 10, 2004 Meeting").
[31] *Id*.
[32] *Id*. at 23.
[33] *Id*. Ex. 50 ("Minutes of June 28, 2004 Meeting").

directors." In order for a court to exercise declaratory judgment jurisdiction there must be an actual controversy:

> (1) it must be a controversy involving the rights or other legal relations of the party seeking declaratory relief; (2) it must be a controversy in which the claim of right or other legal interest is asserted against one who has an interest in contesting the claim; (3) the controversy must be between parties whose interests are real and adverse; and (4) the issue involved in the controversy must be ripe for judicial determination.[34]

There is no question that the requirements set forth in *Gannet* are met here.

Both parties have moved for summary judgment. Court of Chancery Rule 56(c) entitles a party to summary judgment "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[35] When the Court is faced with cross-motions for summary judgment the same standard must be applied to each of the parties' motions and the mere existence of cross-motions does not necessarily indicate that summary judgment is appropriate for one of the parties.[36] Thus when presented with cross-motions for summary judgment a movant will be granted relief only if the Court determines that the record does not require a more thorough

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[34] *Gannett Co. v. Bd. of Managers of the Del. Crim. Justice Info. Sys*., 840 A.2d 1232, 1237 (Del. 2003).
[35] Ch. Ct. R. 56(c).
[36] *Kronenberg v. Katz*, 2004 Del. Ch. LEXIS 77 *38 (Del. Ch.).

development to clarify the law or its application to the case.[37] Such is the case here.

A. The Validity of the April 12, 2004 Vote[38]

Beginning with this Court's February 25 Order, it was determined that as a matter of law the membership was not *required* to vote on the Monument sale.[39] Nevertheless, the Court of Chancery is a court of equity and where appropriate will exercise its broad equitable powers to fashion a remedy that the law cannot provide.[40] Thus, when equitable principles of estoppel worked in tandem with the fiduciary duties the WEI board owed the membership, I concluded a membership vote on this matter was *needed*.[41] So once it was determined that a vote belonged to the membership, that vote assumed its protective status under Delaware law.

The shareholder franchise occupies a special place in Delaware corporation law and our courts remain vigilant in policing conduct having

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[37] *Id.*

[38] Both parties suggest I refer to 8 *Del. C.* § 231 in resolving this issue. I decline to do so. The clear statutory language authorizes the use of § 231 in two circumstances, neither of which is present here. WEI is not listed on a national stock exchange. Nor has WEI voluntarily assumed the strictures of § 231. If this Court were to impose § 231 on a corporation that met neither of these alternatives, the Court would by implication usurp the options created by statute and would thus apply § 231 requirements to any voting dispute brought before the Court.

[39] Feb. 25 Order at 2.

[40] *See e.g., Gotham Partners, L.P. v. Hallwood Realty Partners*, *L.P.*, 817 A.2d 160, 176 (Del. 2002) ("[T]he Court of Chancery's 'powers are complete to fashion any form of equitable and monetary relief as may be appropriate.'"); *accord Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983) (same).

[41] Feb. 25 Order at 4 ("The members should be the ones who decide this issue.").

the effect of impeding or interfering with the effectiveness of a shareholder vote.[42] Watergate East residents have contemplated this issue for over a year. The record establishes that the January membership vote was split by less than one-percent.[43] Nothing changed between the time surrounding the January vote, the February 25 Order and the April vote. Nothing justified the belief that the April election would be decided by a wider margin. Thus, in light of the acrimony separating the two membership factions, the WEI board had a duty to establish a fair, open, fully informed, and verifiable vote. Once the ballots were destroyed,[44] prior to verification and during a period

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[42] *See In re MONY Group S'Holder Litig*., 853 A.2d 661, 673 (Del. Ch. 2004); *accord MM Cos. v. Liquid Audio,* Inc., 813 A.2d 1118, 1127 (Del. 2003) ("This Court and the Court of Chancery have remained assiduous in carefully reviewing any board actions designed to interfere with or impede the effective exercise of corporate democracy by shareholders…"). Although this Court is hesitant to attribute bad faith to the majority of the WEI board, when certain members of that board or its agents determined that the destruction of the ballots would resolve this matter, I conclude that such an interference with the franchise justifies upholding the June election. There has been some dispute as to whether Mr. Aghazadeh and Mr. Drury independently destroyed the ballots or whether the board instructed them to do so. I find the resolution of this issue immaterial. Because Mr. Aghazadeh, acting as WEI's General Manager, is an agent of the corporation, his conduct, while working within the scope of his employment, is fairly attributed to the corporation. Mr. Aghazadeh destroyed the database and clearly communicated the order to destroy the ballots to Mr. Drury. *See* Drury Dep. at 126-127.

[43] *See supra* note 9.

[44] Plaintiffs' reliance on *Gow v. Consolidated Coppermines Corp.,* 165 A. 136 (Del. Ch. 1933) is misplaced. In *Gow*, the court determined that it was not an error to disregard ballots that were removed by voting inspectors because those inspectors were replaced and another vote was conducted at the same meeting. Factoring in the rationale was the fact that the proxies underlying the ballots cast were counted at the beginning of the meeting and the claims before the master did not allege that the absence of the voting list or proxies caused injustice. Importantly, these proxies were independently verified three days before the meeting, were accurately counted and challenges to those proxies resolved well in advance of the meeting. *Id.* at 146.

of increasing inquisition, the April vote lost any indicia of reliability and fair process.[45] I therefore find that the procedure surrounding the April 12, 2004 vote was fatally flawed and that vote is given no effect in consummating the deal with Monument.[46]

B. The Validity of the June 9, 2004 Vote.

Shortly after the destruction of the ballots, the residents opposed to the sale circulated a petition pursuant to WEI's 25th bylaw requesting a "Special Meeting of the members to 'revote on the sale of WEI's properties to… Monument.'" [47] That revote was held on June 9, 2004.

Correctly anticipating the potential for another election debacle, the WEI board retained the League of Women's Voters to proctor the election.

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[45] Importantly, absent the ballots and the database there was no independent way to verify the April election results. The shareholder franchise has always been guaranteed at the very least a threshold of procedural fairness. *See generally In re MONY*, 853 A.2d at 673; *In re IXC Communs. Shareholders Litig. v. Cincinnati Bell, Inc.*, 1999 Del. Ch. LEXIS 210, (Del. Ch.) (upholding vote that was part of a democratic governance process in which shareholders were adequately informed and free to exercise their judgment); *Malone v. Brincat*, 722 A.2d 5 (Del. 1998) (requiring directors to disclose all material information to shareholders prior to vote); *Schnell v. Chris-Craft Industries, Inc*., 285 A.2d 437 (Del. 1971) (invalidating management attempts to obstruct the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management); *Standard Power & Light Corp. v. Investment Associates, Inc.,* 51 A.2d 572 (Del. 1947) (recognizing that the corporate enterprise should adhere to well-established democratic theories, which embody principles of fairness and reasonableness as opposed to principles which are unfair and unreasonable).

[46] Because neither party has contested the election of the three new WEI directors, I do not address that issue.

[47] Pls.' Compl. Pursuant to 8 *Del. C.* § 225(b) for Determination of Vote of Members and Ancillary Interim Relief C.A. No. 516-N, (June 18, 2004) at 6 ¶ 11.

The board also developed written procedures for the election.[48] Among the procedures were protocols for: the opening and closing of the polls; the verification of proxies and a method of resolving proxy disputes; the vote counting; the use of proctors; and importantly, the vote verification.[49] Neither party has contested the results of the June 9 election. Because of these procedural safeguards, and that no dispute exists as to the results, I find that the June 9, 2004 vote was within the spirit of my February 25 Order and thus the only legitimate vote cast on the Monument sale.[50]

C. The Effect of the Intervening Board

Plaintiffs argue that despite the June 9 vote, the infusion of different blood into the WEI board has somehow negated the mandate of my February 25 Order. In addressing that contention I begin with a quote from that Order:

> I am concerned about the ability of the directors to evaluate the sale in a manner that comports with their fiduciary duties to the members of Watergate East. The directors of a non-profit membership corporation have a duty to act in the best interest of the corporation's members, and must set aside their parochial interests. In this situation, I am not confident that this is possible.[51]

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[48] *Id.* Ex. 4 ("June 9, 2004 Voting Procedures Special Meeting").
[49] *Id.* Ex. 4.
[50] This finding is limited to the facts of this case and is not meant to suggest or imply that other factual circumstances would not dictate the use of different voting procedures.
[51] Feb. 25 Order at 3.

On April 12, 2004, the composition of the WEI board shifted from a 6 to 5 anti-sale majority to a 6 to 5 pro-sale majority. The record shows that this is still a deeply divisive issue. For over a year, the terms of this agreement have been set. For over a year, the board has debated the issue. For over a year, the membership has contemplated the merits of this transaction and indeed has expected their vote to be fair and meaningful. Thus at this stage of the litigation, it would be inequitable to ignore my February 25 Order and declare the membership vote a meaningless gesture.

Indeed it is the board of directors of a Delaware corporation who manage the business and affairs of the corporation.[52] Moreover, it may be the case that the election of a different majority to a board is sufficient to sterilize a deeply divisive conflict. Plaintiffs in fact make this contention.[53] Still, it is not uncommon for our courts to recognized some of the practical differences that exist between a widely held corporate enterprise and a

[52] *See* 8 *Del. C.* § 141(a).

[53] Plaintiffs' point to two strains of Delaware corporate jurisprudence and posit that the election of new board members negate my February 25 Order. *See* Pls.' June Opening Br. at 39-42. I disagree. First, this is not a derivative action and the strong Delaware policy implicated in the demand requirement is noticeably absent. Unlike the facts recited in *Harris v. Carter*, 582 A.2d 222 (Del. Ch. 1990), the election of the new WEI board members shifted the composition of that body from a 6 to 5 anti-sale majority to a 6 to 5 pro-sale majority. This situation hardly represents an election that removed the "disabling conflict" at issue in my February 25 Order. *See Id.* at 230-231. Second, this certainly is not a poison pill case, and the policy rationale for the dead hand pill cases has no application here. For the reasons discussed above, the governance of a housing cooperative presents quite a different situation than a corporation facing a hostile takeover.

cooperative housing corporation. The former, of course, offers the shareholder the unique advantages of centralized management and the utility that an investor gains through "passive (low cost) ownership and . . . investor diversification."[54] In this instance, it is of practical necessity that principals vest unfettered discretion in their agents for all but the most fundamental corporate decisions.

Individual owners of a housing cooperative are in a different position. They usually have a relatively large economic stake (*i.e.*, their homes) in the enterprise. Their means of communicating with fellow co-ops is comparatively simple. Thus a board of directors "is merely a group of unitholders elected from time to time to govern those aspects of life at the [Watergate East] that require common decision-making."[55]

The Court recognizes these practical differences and finds them compelling in reaching its decision today. Because membership in a cooperative corporation presents unique issues of corporate governance and the fact that the WEI membership has expected a meaningful vote in this transaction, I find, pursuant to 8 *Del. C.* § 225(b), that despite the election of three different members to WEI's board, the vote cast on June 9, 2004 was

[54] *Fisher v. Council of the Devon,* 1999 Del. Ch. LEXIS 239 at *8-9 (Del. Ch.).
[55] *Id*.

the definitive act of the WEI corporation and that the membership has declined to accept the Monument offer.

This Order shall be applied to the transaction as it stood on the day of the June 9, 2004 vote. That is the transaction the membership had contemplated and that is the transaction that was rejected by the membership. Because this is an equitable remedy applied to the specific facts of this case, this Order does not alter the general statutory scheme of 8 *Del. C.* § 141(a).[56]

IT IS SO ORDERED.

[56] The parties have briefed and argued the issue of how long this Order shall bind the WEI board of directors from performing duties traditionally delegated to a board under § 141(a). Nothing herein shall be interpreted as altering that statutory framework. Similarly, nothing herein shall be interpreted as preventing the membership from exercising their powers pursuant to 8 *Del. C.* § 109(b).