

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

LIONS GATE ENTERTAINMENT)
CORP., a British Columbia corporation,)
)
Plaintiff,)
) Civil Action No. 2011-N
v.)
)
IMAGE ENTERTAINMENT INC., a)
Delaware corporation,)
)
Defendant.)

MEMORANDUM OPINION

Date Submitted: May 23, 2006

Date Decided: June 5, 2006

J. Travis Laster and Matthew F. Davis, of ABRAMS & LASTER LLP, Wilmington, Delaware; OF COUNSEL: John P. Stigi III and R. Anthony Young, of SHEPPARD, MULLIN, RICHTER & HAMPTON LLP, Los Angeles, California, Attorneys for Plaintiff.

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CHANDLER, Chancellor

This case raises novel issues regarding the construction of corporate instruments providing for a classified board of directors, and the reformation of bylaws of a publicly traded company. Lions Gate Entertainment Corp., a British Columbia corporation (“Lions Gate”), commenced this action against Image Entertainment, Inc., a Delaware corporation (“Image”), seeking: first, a declaration that Image’s board of directors will not become classified until Image’s 2006 annual stockholders meeting and that all of Image’s board seats are up for election at the 2006 annual meeting; second, a declaration that the board does not have the authority to amend Image’s bylaws; and third, a declaration that the board does not have the authority to amend Image’s certificate of incorporation without a vote of Image’s shareholders.

Image answered the complaint, raised affirmative defenses, and asserted a counterclaim seeking reformation of its charter and bylaws. Lions Gate has since moved for summary judgment on the three declarations it seeks, and has moved to strike Image’s affirmative defenses and its counterclaim. To the extent that the affirmative defenses and counterclaim survive Lions Gate’s motion to strike, Lions Gate seeks summary judgment on Image’s affirmative defenses and counterclaim.

I. FACTUAL BACKGROUND

Lions Gate is a diversified independent producer and distributor of motion pictures, television programming, and home entertainment. Lions Gate beneficially owns 4,033,996 shares of Image's common stock, representing 18.94% of Image's outstanding shares and making Lions Gate currently Image's second largest shareholder. Lions Gate has a market capitalization of approximately \$900 million and its shares trade on the New York Stock Exchange.

Image is the surviving corporation of a reincorporation merger in which Image's then-parent Image Entertainment, Inc., a California corporation ("Image-California") merged into Image. Image is a home entertainment company engaged in the domestic acquisition and wholesale distribution of content for release on DVD. Image is a direct competitor of Lions Gate. Image has a market capitalization of approximately \$80 million, and its shares trade on Nasdaq.

This action concerns three provisions of Image's Charter and bylaws: (i) a bylaw provision establishing a classified board (the "Classified Board Provision"); (ii) a bylaw provision purporting to give the Image board the power to amend the bylaws (the "Bylaw Amendment Provision"); and (iii) a charter provision purporting to give the Image board the power to unilaterally

amend the charter (the “Charter Amendment Provision”). It is undisputed that these provisions appeared in Image’s original charter as filed with the Delaware Secretary of State on August 1, 2005, and Image’s original bylaws adopted by the board on August 1, 2005. Nonetheless, a more complete history of the adoption of the charter and bylaws is appropriate.

With the 2005 annual meeting of Image-California’s shareholders approaching, Image-California’s board received a draft proxy statement describing a proposed merger that would result in Image-California becoming a Delaware corporation. On July 12, 2005, the board approved the draft proxy statement. Appended to the draft proxy statement was a draft merger agreement that included the charter and bylaws that would govern the Delaware company surviving the reincorporation (Image). Those operative documents contain the provisions that are the subject of this litigation. The Classified Board Provision, the most contentious of the provisions, provides as follows:

The directors shall be divided into three classes, designated Class I, Class II, and Class III, as nearly equal in number as the then total number of directors permits. At the 2006 annual meeting of stockholders, Class I directors shall be elected for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. At each succeeding meeting of stockholders beginning in 2007, successors to the class of

directors whose terms expire at that annual meeting shall be elected for a three-year term¹

Pursuant to a written consent dated July 12, 2005, the Image-California board approved both the reincorporation and the merger agreement.

On July 27, 2005, Image filed its definitive proxy statement with the SEC. The proxy statement discussed Image-California's proposal to reincorporate in Delaware through the merger of Image-California with its Delaware subsidiary Image. The proxy statement summarized the terms of the charter and bylaws to govern the reincorporated Image and attached the actual merger agreement, the charter and the bylaws. The proxy statement summarized the effect of the second proposal as follows:

If Proposal 2 is accepted, Messrs. Greenwald and Epstein (Class I) will serve for a term of one year, Messrs. Huxley and McCloskey (Class II) will serve for an initial term of two years, and Messrs. Coriat and Haber (Class III) will serve for an initial term of three years. As each director's term expires, successor directors will serve for three year terms.²

The proxy statement also summarized the effect of the reincorporation proposal as follows:

Shareholder approval of the reincorporation proposal will constitute approval of: [...] (ii) the articles of incorporation and the bylaws of Image-Delaware. [...]

¹ Plaintiff's Opening Brief in Support of its Motion for Summary Judgment, Motion to Strike, and Motion to Dismiss ("POB") Ex D. at IE0994-95.

² POB Ex. J at K000342.

The following discussion summarizes all of the material terms of the charter documents, bylaws, and law of California and Delaware as they pertain to stockholder rights. *The summary is not intended to be complete and is qualified in its entirety by reference to the attached Merger Agreement, including the certificate of incorporation and bylaws of Image-Delaware attached as Exhibits B and C thereto.*³

Significantly, Image-California disclosed clearly and prominently that the summary descriptions of the charter and bylaws in the body of the proxy statement were subject to and “qualified in their entirety” by the documents themselves.

On August 1, 2005, Dennis H. Cho, Image-California’s General Counsel and Secretary, formed Image by filing the charter with the Delaware Secretary of State. The Charter contained the Charter Amendment Provision. As of August 1, 2005, the Image board acted by unanimous written consent to adopt the bylaws, which included the provisions at issue in this lawsuit. As of the same date, the Image-California board acted by unanimous written consent to approve the reincorporation merger.

On September 9, 2005, Image-California held its 2005 annual meeting. Martin Greenwald, Image-California’s President, CEO and Chairman of the Board, conducted the 2005 annual meeting according to a script. There is no mention in the script of the board becoming classified at the 2005 annual

³ *Id.* at K000343 (emphasis added).

meeting. When nominating the candidates for election to the board, Greenwald stated that he was nominating individuals to serve until the next annual shareholders meeting. Likewise, at the close of the meeting and following the announcement of the voting results, Greenwald declared the names of the six directors who had been elected as directors of the company to serve until the next annual shareholders meeting and until their respective successors are elected and qualified.

Also on September 9, 2005, Image filed a current report on Form 8-K disclosing that the stockholders had approved the election of the six nominees to the board, and approved the reincorporation from California to Delaware. Image further disclosed that the instruments defining the rights of Image common stockholders were now governed by the Image charter and bylaws. Finally, on that same day, Cho executed a “Secretary’s Certificate of Adoption of Bylaws” certifying that the bylaws were those adopted by the Image board on August 1, 2005; the bylaws contained the two bylaw provisions at issue in this case.

On September 13, 2005, Lions Gate filed a Schedule 13D with the SEC disclosing its purchases of stock and an offer to acquire Image at a substantial premium to Image’s pre- and post-offer trading price. From September through November 2005, Lions Gate engaged in discussions with Image

regarding a negotiated acquisition. The Image board ultimately rejected Lions Gate's proposal and terminated discussions.

On December 12, 2005, Charles Schilling, an associate with Lions Gate's financial advisor, identified the disputed language in the bylaws, which provides that the Image board will not become classified until the 2006 annual meeting. Schilling consulted with Lions Gate's California and Delaware counsel regarding the provision. After focusing on such language for the first time, Lions Gate considered its strategic alternatives regarding Image over a period of three months. On March 16, 2006, Lions Gate filed an amendment to its Schedule 13D with the SEC. Lions Gate disclosed it had lost confidence in the ability or desire of Image's current board of directors to maximize shareholder value. Lions Gate further disclosed that it was contemplating nominating a slate of six directors for Image's 2006 annual meeting. On the same day it filed the amendment to its Schedule 13D, Lions Gate filed this action.

On May 12, 2006, Image conceded that the Charter Amendment Provision was invalid. It then withdrew the allegations in its counterclaim that the Charter Amendment Provision was the result of drafting error and waived its related request for reformation.

II. STANDARD OF REVIEW

Summary judgment is appropriate “if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law.”⁴ In ruling on the motion, this Court must view the facts in the light most favorable to the non-moving party, and make all reasonable inferences in favor of the non-moving party.⁵ In the event that the moving party demonstrates that no genuine issue of material fact exists, the non-moving party must then produce evidence that creates a triable issue of material fact, lest summary judgment be entered against the non-moving party.⁶

Image resists the application of a summary judgment standard, and mistakenly claims that on March 24, 2006, this Court agreed to hear only Lions Gate’s motion for judgment on the pleadings. During the March 24 hearing, however, the Court expressly invited the parties to file case dispositive motions to be heard simultaneously, including a motion for summary judgment by Lions Gate.⁷ Although Image declined to file a motion

⁴ CT. CH. R. 56(c).

⁵ *Judah v. Del. Trust Co.*, 378 A.2d 624, 632 (Del. 1977).

⁶ *McGowan v. Ferro*, 859 A.2d 1012, 1027 (Del. Ch. 2004), *aff’d*, 873 A.2d 1099 (Del. 2005).

⁷ Plaintiff’s Rely Brief in Support of its Motion for Summary Judgment, Motion to Strike, and Motion to Dismiss (“PRB”) Ex. Y at 27 (The Court: “I would assume Mr. Laster

to dismiss, Lions Gate was nonetheless entitled to file its motion for summary judgment. Rule 56 provides that “[a] party seeking to recover upon a claim ... may, at any time after the expiration of 20 days from the commencement of the action ... move with or without supporting affidavits for summary judgment in the party’s favor upon all or any part thereof.”⁸ The motion for summary judgment was filed twenty-two days after the complaint was filed, and forty-six days before the May 23 oral argument. Lions Gate’s summary judgment motion was properly filed, and complied with Rule 56.⁹

III. ANALYSIS

A. *Count I: Determination of the Plain Meaning of the Classified Board Provision*

Count I of Lions Gate’s complaint seeks a determination as to the plain meaning of the Classified Board Provision. “It is a fundamental principle that the rules used to interpret statutes, contracts, and other written instruments are

would be moving for summary judgment, or something akin to that, and you [Image] could move for judgment on the pleadings [or] move to dismiss ... and have that briefed simultaneously....”); see also *id.* at 41 (Mr. Laster: “I also understood, I take it, that this will be parallel briefing. If Image moves to dismiss, there will be parallel briefing between our motion for summary judgment and their motion to dismiss?” The Court: “That’s what I was trying to accommodate [Ms. Reese] on, Mr. Laster....”).

⁸ CT. CH. R. 56(a).

⁹ Even were I to conclude that service, rather than filing, marks “commencement of the action” for purposes of Rule 56, the Court may truncate the 20-day period when doing so aids judicial efficiency without prejudicing the defendant. *Loppert v. WindsorTech, Inc.*, 865 A.2d 1282, 1290 (Del. Ch. 2004). Here, I invited the parties during the March 24 conference to file case-dispositive motions, including a potential motion for summary judgment in light of the upcoming proxy contest. Due to Image’s decision to hold its 2006 annual meeting in September rather than the earlier date originally indicated, the parties were afforded adequate time for discovery and to prepare the case-dispositive motions.

applicable when construing corporate charters and bylaws.”¹⁰ Absent ambiguity, their meaning is determined solely by reference to their language.¹¹ To demonstrate ambiguity, a party must show that the instruments in question can be reasonably read to have two or more meanings.¹² The language of the instrument, if simple and unambiguous, is given the force and effect required.¹³ The proper construction of any contract is purely a question of law,¹⁴ and numerous decisions of this Court have interpreted provisions found in certificates of incorporation or bylaws on motions for summary judgment.¹⁵

The sole issue with respect to Count I is whether the Classified Board Provision establishes a classified board that will become staggered at the 2006 annual meeting, or whether the classified board became effective at the 2005 annual meeting. Section 141(d) of the Delaware General Corporation Law (the “DGCL”) provides the authority for a Delaware corporation to

¹⁰ *Gentile v. SinglePoint Fin., Inc.*, 788 A.2d 111, 113 (Del. 2001).

¹¹ *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342-43 (Del. 1983).

¹² *Rhone-Poulenc Basic Chem. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

¹³ *Gentile*, 788 A.2d at 113 (citations omitted).

¹⁴ *O’Brien v. Progressive N. Ins. Co.*, 2000 WL 3313833, at *4 (Del. Super. Dec. 18, 2000).

¹⁵ *See, e.g., Matthews v. Groove Networks, Inc.*, 2005 WL 3498423, at *1-3 (Del. Ch. Dec. 8, 2005) (granting defendant’s motion for summary judgment after interpreting certificate of incorporation).

implement a classified board.¹⁶ The statute does not require that the classification take place immediately, and this Court has upheld a classified board provision that would create a classified board at a future date.¹⁷ Further, a provision establishing a classified board does not necessarily create a board in which directors serve staggered three-year terms. Section 141(d) contemplates at least two other types of classified boards, one in which a particular director or class of directors may be elected by the holders of a particular class or series of stock, potentially with different voting rights and a different term, and a second in which a particular director or class of directors may have “voting powers greater than or less than those of other directors,” regardless of whether or not that class of directors is elected by the holders of a particular class or series of stock.¹⁸

In this case, no ambiguity infects the Classified Board Provision. The first sentence states that the directors shall be divided into three classes, while the second and third sentences address the issue of when the classification shall become effective and how the classes will differ:

The directors shall be divided into three classes, designated Class I, Class II, and Class III, as nearly equal in number as the then total number of directors permits. At the 2006 annual meeting of

¹⁶ 8 *Del. C.* § 141(d) (“The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of stockholders, be divided into 1, 2 or 3 classes....”)

¹⁷ See *Comac Partners, L.P. v. Ghasnavi*, 793 A.2d 372 (Del. Ch. 2001).

¹⁸ *Id.*

stockholders, Class I directors shall be elected for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. At each succeeding meeting of stockholders beginning in 2007, successors to the class of directors whose terms expire at that annual meeting shall be elected for a three-year term....¹⁹

The first, second and third sentence of the Classified Board Provision work together to establish a board that becomes classified “at the 2006 annual meeting of stockholders,” with the three classes differing as to their terms. It is only at the 2006 annual meeting that the scheme is implemented through the election of Class I directors for a one-year term, Class II directors for a two-year term and Class III directors for a three-year term. Consistent with this plain meaning, the first paragraph of Section 3.1 of the bylaws provides that “[e]lected directors shall hold office until the next annual meeting and until their successors shall be duly elected and qualified.”²⁰ Such language is inconsistent with an immediately-effective classified board, in which elected directors initially hold office for staggered terms and subsequently serve three-year terms.

Image insists that the language of the Classified Board Provision is ambiguous. It is not. “Ambiguity does not exist where the court can determine the meaning of a contract without any other guide than

¹⁹ POB Ex D. at IE0994-95.

²⁰ *Id.* at IE0995.

acknowledgement of the simple facts on which, from the nature of language in general, its meaning depends.”²¹ Notwithstanding the crystal clarity of the Classified Board Provision, Image contends that the use of numerical years in the bylaws, without specifying whether fiscal or calendar years, is ambiguous. Anticipating that the bylaws alone cannot be reasonably read to have these two divergent meanings, Image points to its proxy materials in support of such purported ambiguity. This tact is unavailing, however.

Image incorrectly relies on a single case to justify relying upon extrinsic evidence to demonstrate ambiguity. In *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, the Delaware Supreme Court considered accompanying proxy materials instructive in determining whether any ambiguity existed in a certificate of incorporation.²² In that case, however, the proxy materials simply confirmed the plain reading of the purpose of the amended charter and the provision in question.²³ Further, after *Centaur Partners* was decided, the Delaware Supreme Court sharply limited the extent to which courts may consider extrinsic evidence in determining the plain meaning of a contract.²⁴ In particular, the Court held that extrinsic evidence could not be used to

²¹ *Rhone-Poulenc Basic Chem. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

²² 582 A.2d 923, 928 (Del. 1990).

²³ *Id.* at 929 (“Centaur’s argument for a 50% threshold is contrary to the clear purpose reflected in the language of the amended certificate of incorporation.”).

²⁴ *Eagle Indus. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232-33 & n.7 (Del. 1997).

“create an ambiguity.”²⁵ Therefore, disregarding Image’s presentation of copious extrinsic evidence purporting to create an ambiguity,²⁶ I find the Classified Board Provision to be clear and unambiguous.

Even were I to agree with Image that the Classified Board Provision is ambiguous, Lions Gate would still be entitled to summary judgment on Count I. Under Delaware canons of interpretation, “[w]hen a corporate charter is alleged to contain a restriction on fundamental electoral rights of stockholders under default provisions of law ... the restriction must be ‘clear and unambiguous’ to be enforceable.”²⁷ Importantly, these interpretive canons apply before the consideration of parol evidence.²⁸

²⁵ *Id.* at 1232; *Harrah's Entm't, Inc. v. JCC Holding Co.*, 802 A.2d 294, 313 & n.45 (Del. Ch. 2002).

²⁶ I say purporting to create ambiguity, because even were I to consider it, the extrinsic evidence shows only the possibility of error, not ambiguity. In its feeble attempt to create ambiguity, Image presents isolated portions of the proxy statement (mistakenly) informing shareholders that the bylaws provide for an immediately effective classified board. Unfortunately, this does not create an ambiguity of interpretation, *i.e.*, it does nothing to specifically support Image’s contention that the term “2006 annual meeting” could actually be referring to the “fiscal 2006 annual meeting.” Support for that contention would be further obfuscation of fiscal and calendar year terminology, or proof that simple numerical years “XXXX” were regularly used in Image parlance to mean “fiscal year XXXX.” Certain statements in the proxy materials that plainly contradict the bylaws only suggest that certain portions of the proxy statement are mistaken, or that the bylaws were wrongly scribed. Neither conclusion warrants a different construction of the bylaws. Finally, Image cannot rely on its disclosures to such an extent because all of the disclosures in the body of the proxy statement were “qualified in their entirety” by the language of the charter and bylaws.

²⁷ *Harrah's Entm't v. JCC Holding Co.*, 802 A.2d 294, 309 (Del. Ch. 2002).

²⁸ *Id.* at 311.

The presumption of annual director elections is a fundamental electoral right that exists under the default provisions of Delaware law.²⁹ The implementation of a classified board is a fundamental governance change.³⁰ The loss of a final opportunity to elect the whole board has an obvious disenfranchising effect, and any ambiguity in the Classified Board Provision must therefore be construed against the drafter, Image.

B. Counts II and III: Determination of the Validity of the Bylaw Amendment Provision and the Charter Amendment Provision

Lions Gate seeks determinations that the Bylaw Amendment Provision and the Charter Amendment Provision are *ultra vires*, invalid and void. Facial challenges to the legality of provisions in corporate instruments are regularly resolved by this Court.

Regarding the Bylaw Amendment Provision, § 109 of the DGCL is instructive: after a corporation has received any payment for any of its stock, a board of directors has the power to amend the corporation's bylaws only if the certificate of incorporation "confer[s] the power to adopt, amend or repeal bylaws upon the directors."³¹ In the absence of a provision in the certificate of incorporation conferring power upon the directors to adopt, amend or

²⁹ *Preston v. Allison*, 650 A.2d 646, 649 (Del. 1994).

³⁰ *Chesapeake Corp. v. Shore*, 771 A.2d 293, 346 (Del. Ch. 2000).

³¹ 8 *Del. C.* § 109.

repeal bylaws, a bylaw cannot confer this power on the board of directors.³²

Image's proxy statement evidences this common knowledge.³³

On August 1, 2005, the Image board issued 100 shares to Image-California in return for consideration of \$10.³⁴ From that point on, the board could only amend the bylaws if the Image charter granted that power to the board.³⁵ Image "admits that the certificate of incorporation does not include express authorization for the board to amend the bylaws."³⁶ The Bylaw Amendment Provision, however, purports to give the Image board precisely this authority. Because the charter does not confer the power to amend the bylaws upon the board, the Bylaw Amendment Provision is invalid, *ultra vires*, and void. Additionally, Image has admitted that if its counterclaim for reformation of the Charter is rejected, the Bylaw Amendment Provision is invalid.³⁷ Finally, implicitly acknowledging the merits of this claim, Image has failed even to address Lions Gate's arguments in its brief or in oral argument. The Bylaw Amendment Provision is therefore invalid.

³² *Id.*

³³ POB Ex. J at 15 ("Under Delaware law, directors may amend the bylaws of a corporation only if such right is expressly conferred upon the directors in its certificate of incorporation.")

³⁴ *See* POB Ex. N at IE1027.

³⁵ 8 *Del. C.* § 109.

³⁶ POB Ex. F, Answer ¶ 25.

³⁷ POB Ex. W.

The Charter Amendment Provision purports to provide that the charter can be amended by the board *or* the shareholders. Under § 242 of the DGCL, after a corporation has received payment for its capital stock, an amendment to a certificate of incorporation requires both (i) a resolution adopted by the board of directors setting forth the proposed amendment and declaring its advisability *and* (ii) the approval of a majority of the outstanding stock entitled to vote on the amendment.³⁸ Because the Charter Amendment Provision purports to give the Image board the power to amend the charter unilaterally without a shareholder vote, it contravenes Delaware law and is invalid; Image has so conceded in its May 12, 2006 admission.

C. Summary Judgment on Image's Affirmative Defense and Counterclaim for Reformation

Image asks that the charter and bylaws be reformed to (i) classify the Board effective as of the 2005 annual meeting, (ii) add a provision to the Charter authorizing the Bylaw Amendment Provision, and (iii) revise the Charter Amendment Provision to say “and” instead of “or.” Image requests reformation on two grounds. First, Image contends that as between Image and its sole incorporator before the reincorporation, the charter and bylaws as filed were the result of a mutual mistake. Second, Image argues that as between Image and its stockholders following the reincorporation, the charter

³⁸ 8 *Del. C.* § 242.

and bylaws were either (a) the result of mutual mistake, or (b) the result of unilateral mistake on the part of Image, coupled with knowing silence on the part of Image's stockholders.

For purposes of this motion for summary judgment, I will assume that (i) Image and its incorporator intended the charter and bylaws to read as Image now claims and (ii) the Image-California board and the Image board likewise intended the charter and bylaws to read as Image now claims. Assuming these facts to be true, Lions Gate is nonetheless entitled to judgment as a matter of law.

“The purpose of reformation is to make an erroneous instrument express correctly the intent of, or the real agreement between, the parties.”³⁹

“The Court of Chancery has jurisdiction to reform a document to make it conform to the original intent of the parties ... [including] a certificate of incorporation.”⁴⁰

In *Waggoner*, the Delaware Supreme Court describes the principles governing the doctrine's application:

Generally, reformation is appropriate, when an agreement has been made, or a transaction has been entered into or determined upon, as intended by all parties interested, but in reducing such agreement or transaction to writing, either through the mistake common to both parties, or through the mistake of the plaintiff

³⁹ *In re Estate of Justison*, 2005 WL 217035, at *10 (Del. Ch. Jan. 24, 2005).

⁴⁰ *Waggoner v. Laster*, 581 A.2d 1127, 1135 (Del. 1990).

accompanied by the fraudulent knowledge and procurement of the defendant, the written instrument fails to express the real agreement or transaction. In such a case the instrument may be corrected so that it shall truly represent the agreement or transaction actually made or determined upon according to the real purpose and intention of the parties.⁴¹

When reformation is applied to a certificate of incorporation and by strong analogy to a corporation's bylaws, *Waggoner* suggests two additional requirements: “(i) it must be clear that all present and past shareholders intended [the] provisions to be included within the certificate or bylaws, and (ii) there must not be any intervening third party interest.”⁴²

A party seeking reformation must establish the need for the remedy by clear and convincing evidence,⁴³ and may introduce parol evidence to meet this burden.⁴⁴ The existence of a scrivener's error, without more, is not sufficient to meet the “clear and convincing” test.⁴⁵ The standard requires proof higher than mere preponderance, but lower than proof beyond a

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Interactive Corp. (a/k/a USA Interactive) v. Vivendi Universal, S.A.*, 2004 WL 1572932, at *15 (Del. Ch. July 6, 2004).

⁴⁴ *James River-Pennington Inc. v. CRSS Capital, Inc.*, 1995 WL 106554 (Del. Ch. Mar. 6, 1995).

⁴⁵ *Amstel Assocs., LLC v. Brinsfield-Cavall Assocs.*, 2002 WL 1009457, at *5 (Del. Ch. May 9, 2002).

reasonable doubt.⁴⁶ It requires evidence that would cause the trier of fact to believe that the truth of the factual contention is highly probable.⁴⁷

1. Image Cannot Establish the Intent of All Its Present and Past Stockholders

Reformation is unavailable in this case as a matter of law under the *Waggoner* test for the simple reason that Image cannot establish the intent of “all parties interested,” including all of Image’s present and past stockholders.⁴⁸ According to publicly available information,⁴⁹ Image has 13.15 million shares outstanding and an average daily volume over the past three months of over 70,000 shares. At this rate, Image had literally thousands of record and beneficial holders as of the record date for the 2005 annual meeting and it has literally thousands of record and beneficial stockholders today. It is simply impossible for Image to show that all present and past shareholders intended the provisions to read as Image now claims.⁵⁰

⁴⁶ *Cerebrus Int’l, Ltd. v. Apollo Mgmt. L.P.*, 794 A.2d 1141, 1151 (Del. 2002).

⁴⁷ *Id.*

⁴⁸ 581 A.2d at 1135. The requirement that all present and past stockholders agree on the intent arises out of the basic principle that for reformation to be appropriate, “all parties to the written instrument” must agree on its meaning. 27 Williston on Contracts § 70:13 (4th ed. 2006); *see also id.* § 70:19 (“The purpose of reforming a contract on the basis of mutual mistake is to make a defective writing conform to the agreement of the parties upon which there was mutual assent.”).

⁴⁹ *See, e.g.*, www.finance.yahoo.com.

⁵⁰ *Waggoner*, 581 A.2d at 1136.

Image’s Rule 30(b)(6) witness effectively conceded the futility of such quixotic endeavor: “You can’t really roll-call 20 million shares of stock.”⁵¹

Image argues that the *Wagonner* standard requiring the establishment of the intent of *all* shareholders, both past and present, to reform a certificate of incorporation or bylaws is either inapplicable to the present set of facts or is simply too draconian a policy. Image is incorrect in both respects.

a. The *Wagonner* Standard Requiring
Unanimity Applies to the Facts at Hand

Attempting to distinguish *Wagonner* from the facts in this case, Image points to the different procedural postures of each case. Procedurally, the Court of Chancery’s decision in *Wagonner* was entered after discovery and a full trial.⁵² In our case, Image argues, the parties have conducted discovery limited by the expedited nature of the claims and, therefore, unanimity should not be required at this stage. The summary judgment standard requires that I view the facts in the light most favorable to the non-moving party and make all reasonable inferences in favor of the non-moving party; it does not require the suspension or dilution of a clearly applicable requirement for reformation. Therefore, construing the record in the light most favorable to Image, and making all reasonable inferences in its favor, there is no possibility that Image

⁵¹ PRB, Ex GG. at 183.

⁵² *Id.* at 1130.

can show by clear and convincing evidence that *all* past and present shareholders intended management's purported understanding of the Classified Board Provision.

Further attempting to distinguish *Wagonner* from the instant facts, Image points to the different rights implicated in each case. *Wagonner* involved the requested imposition of preferred voting rights and Image argues that the requirement for unanimity should be narrowly limited to such cases. I see no reason, in the circumstances here, to accept Image's distinction. As discussed earlier, the presumption of annual director elections is a fundamental electoral right that exists under the default provisions of Delaware law.⁵³ A rule applying to a party seeking reformation of a charter or bylaws that would affect preferred voting rights should, in the circumstances of this case, likewise apply to a party seeking to deprive shareholders of their ordinary voting rights at an annual election of directors.

b. The Application of the *Wagonner* Standard
is Supported by Policy Considerations

Image argues that the *Wagonner* standard for unanimity is draconian and incorrect, and that Image need only establish the intent of shares

⁵³ *Preston*, 650 A.2d at 649.

sufficient to effect the corporate action in question.⁵⁴ This is not what *Waggoner* held. There is a fundamental difference between seeking stockholder approval on a matter when voting standards requiring less than unanimity clearly and regularly apply, and seeking to reform a matter that stockholders already have voted upon. In the latter situation, the corporation is asking the Court to depart from the result of the stockholder vote and divine what stockholders really wanted. To protect against error in such a difficult enterprise, the *Waggoner* requirement of unanimity logically applies. Additionally, such strict measures encourage clarity in drafting and dissuade managers and controlling shareholders from casually littering their operative instruments with mistakes that they might reform—or might not—depending on the contingencies that arise.

Finally, I find support for the strict application of *Waggoner*'s unanimity requirement in the similarly strict standards required for the retroactive application of a certificate of correction. Under 8 *Del. C.* § 103(f), a corporation may correct any inaccurate or defectively executed instrument authorized under the Delaware General Corporation Law to be filed with the

⁵⁴ Even assuming Image's laxer standard, it is unclear to me that unanimity should give way to a simple majority requirement (mimicking the requirement to give effect to the corporate action in question), instead of an 80% requirement (as required by the bylaws themselves when modifying the Classified Board Provision). See POB Ex. J, at K000396.

Delaware Secretary of State.⁵⁵ That section also provides that the correction will operate retroactively to the date of the original certificate, except as to persons who would be “substantially and adversely” affected by the correction.⁵⁶ This rule has an effect similar to *Wagonner’s* unanimity requirement. In a case such as this, involving an alleged “clerical error,” § 103(f) would prevent the retroactive classification of a board because of the substantial and adverse effects such classification would have on shareholders who expected to vote upon an entire slate of directors at the upcoming shareholders meeting. Section 103(f) demonstrates how a statutory analog to reformation gingerly treats the retroactive application of a correction to constitutive documents, especially when the “correction” will materially affect the interests of public shareholders.⁵⁷

2. Image Has Failed to Establish a Specific Prior Understanding as Required for Reformation

Following briefing and oral arguments, Image can no longer point to the “specific prior understanding that differed materially from the written

⁵⁵ *Turner v. Bernstein*, 1999 WL 66532, at *9 (Del. Ch. 1999).

⁵⁶ *Id.*

⁵⁷ One might imagine unusual circumstances, however, where reformation would not have a substantial and adverse effect upon *any* shareholder. In that circumstance, a court of equity might relax the unanimity standard. This is not such a case. Here, the retroactive classification of a board indisputably affects present shareholders both substantially and adversely. *Waggoner’s* unanimity standard is thus properly invoked.

agreement.”⁵⁸ Image has undermined its ability to establish a specific prior understanding by failing to identify what it believes the Classified Board Provision was intended to say and instead arguing two different versions.

Rather than asserting that there was a specific prior understanding about what the Classified Board Provision was meant to provide, Image now contends that the use of “2006” in the Classified Board Provision *might* have been in lieu of “2005” or that it *might* have been in lieu of “fiscal 2006.” These are two quite different understandings. The first would refer to a calendar year starting on January 1, 2005 and ending on December 31, 2005, and could not be shifted. The second would refer to a fiscal year starting on April 1, 2005 and ending on March 31, 2006, and might be shifted in accordance with relevant accounting rules. To plead and prove a claim for reformation, Image must point to the “specific prior understanding” that the Classified Board Provision was supposed to implement. By trying to claim both calendar 2005 and fiscal 2006, Image has failed to plead and cannot prove a specific prior understanding as to the correct text of the Classified Board Provision. For these reasons, judgment on the reformation claim must be entered in favor of Lions Gate.

⁵⁸ *Cerberus*, 794 A.2d at 1151-52.

D. Summary Judgment on Image's Other Affirmative Defenses

In addition to seeking reformation, Image also has invoked the affirmative defenses of acquiescence and waiver, laches, and unclean hands. Each of these equitable defenses, however, cannot be used in this case to alter the terms of a corporation's constitutive documents, such as Image's charter and bylaws. Section 141(d) permits the classification of a board, though only in a corporation's charter or bylaws. Image requests that this Court alter the clear terms of Image's bylaws due to the alleged inequitable conduct of a single shareholder. The Delaware Supreme Court has limited the application of such equitable powers in similar circumstances involving void corporate actions.

In *Waggoner*, stockholders of STAAR Surgical Corporation ("STAAR") who believed they held convertible preferred stock with supermajority voting rights sued to enforce a written consent they purportedly executed removing the STAAR board of directors. STAAR defended on the grounds that the preferred stock was void because the blank check authority on which the board had relied to issue the stock did not empower the board to give the preferred stock voting rights. As with Image, the blank check provision was inserted in STAAR's charter as part of the corporation's reincorporation to Delaware. The Court of Chancery held that the super-

voting rights were unauthorized and void. On appeal, the stockholders “maintain[ed] in equity that estoppel should prevent the appellees from denying the validity of the preferred stock.”⁵⁹ The Delaware Supreme Court rejected the attempt by the stockholders to invoke equitable principles: “Estoppel, however, has no application in cases where the corporation lacks the inherent power to issue certain stock or where the corporate contract or action approved by the directors is illegal or void.”⁶⁰ The Supreme Court held that equitable estoppel was inapplicable “as a matter of law.”⁶¹ This holding was revisited and approved by the Supreme Court in a second decision involving the same convertible preferred stock.⁶²

Because the Classified Board Provision clearly and unambiguously provides that the board will become classified and staggered at the 2006 annual meeting, and because Image’s claims for reformation fail as a matter of law, Image does not presently have a classified board and all six of its board members must stand for election at the 2006 annual meeting. To rely on this Court’s equitable powers to declare that Image’s board was classified as of the 2005 meeting would circumvent the explicit statutory requirements of § 141(d). Image cites no authority to support the proposition that equity

⁵⁹ 581 A.2d at 1133.

⁶⁰ *Id.* at 1137.

⁶¹ *Id.*

⁶² See *Staar Surgical v. Waggoner*, 588 A.2d 1130 (Del. 1991).

may properly be invoked to rescue a corporate act that violates a statutory command.⁶³ Furthermore, the Supreme Court has made it clear that equitable principles cannot be employed to change the terms of authoritatively binding corporate documents. “The law properly requires certainty in such matters.”⁶⁴

For all the foregoing reasons, summary judgment is entered in favor of Lions Gate on all claims, affirmative defenses, and counterclaims. An Order has been entered in accordance with this decision.

⁶³ *McKesson Corp. v. Derdiger*, 793 A.2d 385, 394 (Del. Ch. 2002).

⁶⁴ *Staar*, 588 A.2d at 1136.