IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

HAROLD O. KNIGHT, JR.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	C.A. No. 1750-N
	)	
CAREMARK RX, INC.,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

Date Submitted: October 30, 2006
Date Decided: January 12, 2007

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STRINE, Vice Chancellor.

The former Chief Financial Officer of Caremark Rx, Inc. ("Caremark"), Harold O. Knight, Jr., filed this action to compel Caremark to allow him to exercise options to buy Caremark stock. If permitted to do so, Knight would reap a profit of nearly $35 million because the exercise price of the options is now well below the market price of Caremark's stock.

Caremark has moved for summary judgment, arguing that Knight released any rights he had under his "Options Contracts" in a settlement he reached in April 2000 to resolve claims brought against him by Caremark (the "Settlement Agreement"). Caremark argues that the Settlement Agreement contained both a broad general release (the "General Release") and a more specific litigation release (the "Litigation Release") (collectively, the "Releases"), and that the plain terms of both Releases make clear that in the Settlement Agreement Knight released any rights he had under any of his Options Contracts with Caremark.

After consideration of the record, I conclude that, under Alabama law, which governs the interpretation of the Settlement Agreement, the General Release and the Litigation Release both foreclose Knight's attempt to exercise his options. By the clear terms of each Release, Knight abandoned any right to demand that Caremark allow him to exercise his options. Facing substantial claims against him, Knight accepted a Settlement Agreement that involved each party walking away, without any right to make future demands on the other. In particular, the undisputed record makes it clear that the Settlement Agreement compromised a lawsuit in which Knight, in his answer and counterclaims, raised the issue of his right to exercise options granted to him and in

which Caremark hotly contested that claim. In his counterclaim in that lawsuit, Knight plainly sought a declaration that all of his options were vested and that he had the full contractual term to exercise them. By the clear terms of the General Release and the Litigation Release, Knight just as plainly abandoned any right to press such a claim in the future.

Because the Releases are unambiguous, I reject Knight's attempt to create an ambiguity by introducing parol evidence that supposedly demonstrates that Caremark had a subjective understanding contrary to their plain language. That evidence is makeweight, anyhow. The mere fact that Caremark dallied in canceling Knight's options on its corporate books does not raise any triable issue of fact regarding the meaning of the Releases. There is an uncontradicted record that Caremark refused to acknowledge the legitimacy of the Options Contracts granted to Knight or any of his managerial colleagues who departed in the same time frame. As soon as Knight's options became an accounting issue — when they went in the money — they were removed from the company's books and records. The mere fact that Caremark then referenced a reason other than the Releases in taking that action does not mean that the Releases did not have the plain and intended effect of extinguishing Knight's rights under his Options Contracts.

In fact, the reason referenced — that Knight's options expired 90 days after he left Caremark's employment — is in fact consistent with Caremark's reading of the Releases. In the litigation that was the subject of the Settlement Agreement, Caremark argued that Knight and other executives had, through a so-called "House Trigger" in each of their

Options Contracts, improperly tied certain benefits — including vesting of their options — to the termination of the company's then-CEO, Larry House. Absent the House Trigger in his Options Contracts, Knight's options expired 90 days after he left Caremark, which was in 1998, long before the Settlement Agreement was signed. Only if the House Trigger was valid, which Caremark hotly contested in the litigation, could Knight claim that his options had not expired within 90 days of his termination. Caremark's erasure of them from its books on the basis that they had expired before the Settlement Agreement was even entered is therefore consistent with the position (which is demonstrated by Caremark's litigation behavior against other House-era executives) that the Releases were intended to extinguish any right Knight had to claim that the House Trigger had the effect of vesting all of his options and allowing him the entire contract period (rather than only 90 days after termination) to exercise them.

I. Factual Background

This case arises out of a corporate meltdown. Knight came on board at Caremark — then known as MedPartners, Inc. — in March 1993 and was promoted to CFO in November 1994. The Chairman and CEO of Caremark at the time was Larry R. House. For reasons that are in dispute, the company's performance faltered badly. This eventually led to the exodus of House and his key managerial subordinates in 1998. Rather than simply kiss the House team goodbye, however, the Caremark board caused the company to sue each of them, in part because certain of the departing executives demanded severance benefits, including certain option rights, from Caremark. Knight was among those who made such demands. In its complaint against Knight, which began

the "Alabama Litigation," Caremark alleged that Knight was part of a management team that mismanaged Caremark, concealed its poor performance, and larded itself with undisclosed compensation arrangements (including stock options) that were not properly disclosed to and approved by the compensation committee of Caremark's board. Caremark sought to have the House team pay damages to the company to make it whole for the harm their mismanagement allegedly caused. Specifically, and of critical importance to this case, Caremark alleged that the members of the House team, including Knight, had entered into employment agreements in 1996 that granted lavish severance benefits in the event Caremark decided to terminate House as CEO. This so-called House Trigger was a prominent feature of the complaints filed by Caremark.

The operative portion of the complaint filed against Knight stated as follows:

> The purported employment agreements of Johnston and Knight differ most significantly from House's employment agreement in that their purported agreements provide for severance payments (including, but not limited to, three years' salary, three years' total "achievable" bonus, numerous welfare and other benefits, and an immediate right to vest in 100 percent of all options to purchase common stock of the company) in the event that any one of them opts to resign from MedPartners within one year of the date on which House ceased to act as MedPartners' Chairman and chief executive Officer. This extraordinary "House trigger" imposes no limitation as to any reason for House's resignation or removal from that role, or as to the amount of time any Defendant must have worked at MedPartners before claiming a right to such severance. Neither the Compensation Committee nor the full Board of Directors ever agreed that a single officer's separation from the company on a voluntary or involuntary basis could constitute a "change in control"

> triggering severance compensation for other officers, including defendants Knight and Johnston.[1]

As can be seen, the complaint clearly seeks a determination that the provision of Knight's "Employment Agreement" — which had been entered on July 24, 1996 — that provided for automatic vesting of his options upon House's termination was invalid. Further, because the House Trigger was also inserted into the Options Contracts of Knight and other top House subordinates, in many cases retroactively, in mid-1996 at the time of the merger between MedPartners and Caremark that led to them becoming one business, the complaint clearly implicated the validity of the Options Contracts as well. As the parties agree, the House Trigger was first inserted into the specific Options Contracts by which Knight (and others) received options during the same general time period; indeed, in some cases, on the very same day as the Employment Agreement was executed.[2]

In response to Caremark's complaint, Knight filed an answer and counterclaims. His counterclaims sought specific performance of his Employment Agreement.[3] Most importantly, his pleadings made plain that he was seeking a judicial ruling that all of his options had vested because of the House Trigger and that he should have the entire period set forth in the Options Contracts to exercise them. That was made obvious by his counterclaim's express incorporation of Knight's demand letter to Caremark, which specifically demanded that Caremark grant him:

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[1] Defendant's Opening Br. ("DOB") Ex. 4 at 14.

[2] *See* Letter from Gregory P. Williams, Esq. to the court (Oct. 30, 2006) ("Williams Letter") at Exs. 1-8.

[3] DOB Ex. 2 at 31.

> A right to immediately vest in 100% of all options to purchase Common Stock of MedPartners that have been granted to [Knight] by MedPartners and the life of the option in which to exercise such.[4]

This clear demand by Knight's counsel illustrates the relationship between his demand, his Employment Agreement, and his right to the options. By its own terms, the Employment Agreement granted Knight no options. But, it did contain a broad severance provision tied to a House Trigger that indicated that upon House's termination, a "change of control" would be deemed to have occurred. Upon such a change of control, all of Knight's options would vest and he would have "a period of at least 90 days following termination . . . to exercise all such options in accordance with the terms thereof."[5] The provisions of the Options Contracts are different in important respects from this provision in the Employment Agreement dealing with Knight's options. The Options Contracts state that if Knight left after a change of control, his options would immediately vest and he would have the right to exercise the options "at any time during the remaining term" of the relevant Options Contracts.[6]

To be concrete, the House Trigger changed the rights Knight had after a termination without cause in two important ways. First, it vested all of the options that were contemplated to be issued to Knight during the term of the Options Contracts immediately upon a change of control. Absent this effect, upon a termination without cause, Knight would only have had the right to exercise the options that were already

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[4] DOB Ex. 2 at 21 (incorporating the demand letter as Ex. D) & Ex. D at 5 (the demand letter).
[5] DOB Ex. 2 at Ex. A § 10(d)(v).
[6] Complaint ("Compl.") Exs. A-E at § 3(b) & Ex. F at § 2(b).

exercisable and not options that he was eligible to receive in the future if he remained employed with Caremark. Second, the House Trigger extended the time Knight had to exercise his options in the event of a termination without cause. Once a change of control occurred by virtue of the House Trigger, the text of the Options Contracts allowed Knight to exercise his options at any time during their remaining terms, but, absent such a triggering event, Knight had only 90 days to exercise any vested options before they would expire entirely.[7]

In April 2000, Caremark and Knight settled the Alabama Litigation. Essentially, each walked away from the other without making any payments or agreeing to any admissions of liability. Knight gave Caremark a broad General Release that stated:

> Knight, for himself and his successors, assigns, trustees, executors, and administrators, hereby fully and finally releases, acquits and discharges Caremark and all of its representatives, agents, officers, directors, attorneys, successors, and assigns (hereinafter referred to as "the Caremark Releases") for any and all rights, titles, claims, liabilities and causes of action, whether known or unknown and whether accrued or not yet accrued, which in any way relate to or arise from, in whole or in part, directly or indirectly, any actions or omissions of the Caremark Releases as of the date of this Agreement, including but not limited to any claim for penalties, damages, costs, attorneys' fees, and litigation expenses in, or arising from or relating in any way to, the Action or claims asserted therein, or for or from any claims that were raised or asserted or could have been raised or asserted in the Action.[8]

[7] *Compare, e.g.*, Compl. Ex. A at § 3(b) (exercise period with House Trigger) *with* Compl. Ex. A at § 5(b) (exercise period without House Trigger).
[8] Compl. Ex. G at § 2.

Knight also expressly agreed, in the Litigation Release, that "he will not share in the proceeds or participate in any manner" if any of the other former officers of Caremark who were in litigation with it, including House and J. Brooke Johnston, Jr., were to obtain a judgment against or settlement with Caremark.[9]

A half-decade after agreeing to the Settlement Agreement, in November 2005, Knight sent Caremark a letter purporting to exercise 150,000 options granted to him on July 24, 1996.[10] At that time, the strike price of Knight's options was $16.625 per share, while the trading price of a Caremark share was over $52.

Knight brought this suit the same day, seeking a declaration that he continued to have the right to exercise 985,000 Caremark options based on the rights granted to him in the Options Contracts. In particular, Knight alleged that because of the House Trigger, "all of Knight's stock options vested [when House resigned in January 1998] giving [Knight] the remainder of the ten year period from the grant date to exercise his options."[11] In his complaint, Knight indicated that Caremark denied that he had any right to exercise any options and sought damages of nearly $35 million, calculated as the sum of the difference between the exercise price of each of his options and Caremark's October 31, 2005 closing price of $52.35 per share.[12]

Caremark responded to Knight's suit with the rather obvious defense that Knight's claim was barred by the Releases he signed in connection with the Settlement Agreement.

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[9] *Id.*
[10] Compl. ¶ 20.
[11] Compl. ¶ 5.
[12] *See* Compl. ¶¶ 5, 19 (stating Caremark's position); ¶¶ 21-22, 27 (setting forth Knight's damages claim).

Because this defense required Caremark (for understandable reasons) to submit documents (such as the pleadings in the Alabama Litigation) that Knight refrained from mentioning in his complaint, the court required Caremark to present the defense by way of a summary judgment, rather than a dismissal, motion. Knight was given the right to conduct discovery in order to oppose Caremark's argument that Knight had forsaken any right to exercise his options when he entered into the Settlement Agreement with Caremark in April 2000.

II. Caremark's Argument

Caremark's argument is simple. It contends that Knight entered into a broad General Release that required him to give up all rights he had against Caremark. Caremark asserts that by agreeing to this Release, Knight clearly abandoned any contractual right to exercise his Caremark options. As important, Caremark notes that Knight gave Caremark a specific Litigation Release that disclaimed any rights arising from or relating in any way to claims Knight raised or could have raised in the Alabama Litigation. Because Knight specifically sought a declaration in the Alabama Litigation that he had the full term of the Options Contracts to exercise his options, Caremark contends that Knight's current action is plainly barred by the Settlement Agreement.

III. The Procedural Standard And Governing Law

Caremark's motion implicates the familiar procedural standard of Rule 56. Under that standard, Caremark may only obtain summary judgment if, after reading the record

in a manner favorable to Knight, there is no triable dispute of fact and it is clear that Caremark is entitled to judgment as a matter of law.[13]

Caremark and Knight agree that the law of the State of Alabama governs this dispute.[14] Therefore, it is that State's law of contracts that I focus upon. Like Delaware, Alabama enforces unambiguous contracts as written and refuses to admit parol evidence to vary the terms of contracts that are clear on their face.[15] That general proposition also applies to the particular type of contract at issue here, which involved an exchange of releases between parties settling litigation.[16] Under Alabama law, "a release supported by valuable consideration, unambiguous in meaning, will be given effect according to the intention of the parties from what appears within the four corners of the instrument itself, and parol evidence may not be introduced . . . ."[17]

[13] Court of Chancery Court Rule 56(c) allows this court to grant summary judgment in favor of a movant if "there is no genuine issue as to any material fact" and the moving party "is entitled to judgment as a matter of law." *E.g.*, *Haas v. Indian River Volunteer Fire Co.*, 2000 WL 1336730, at *3 (Del. Ch. 2000), *aff'd*, 768 A.2d 469 (Del. 2001).

[14] The Settlement Agreement states that "[a]ll matters pertaining to the validity, construction, interpretation and effect of this Agreement shall be governed by the laws of the State of Alabama." Compl. Ex. G at § 9. Delaware courts honor such choice of law provisions so long as the chosen jurisdiction "bears some material relationship to the transaction." *J.S. Alberici Construction Co. v. Mid-West Conveyor Co.*, 750 A.2d 518, 520 (Del. 2000). Alabama clearly satisfies this test because the claims and counterclaims that the Settlement Agreement resolved were pending in its state courts.

[15] *E.g.*, *Southland Quality Homes, Inc. v. Williams*, 781 So.2d 949, 953 (Ala. 2000) ("If a contract is unambiguous on its face, there is no room for construction and it must be enforced as written.").

[16] *E.g.*, *Shadrick v. Johnston*, 571 So.2d 1008, 1012 (Ala. 1990) (quoting Ala. Code §12-21-109 (1975)) ("As with other contracts, where the language of a release is clear and unambiguous, its effect can be determined as a matter of law and extrinsic evidence is inadmissible to vary its terms.").

[17] *Cleghorn v. Scribner*, 597 So. 2d 693, 696 (Ala. 1992).

Caremark premises its motion on the plain language of the Settlement Agreement and the pleadings filed in the Alabama Litigation.[18]

IV. The General Release In The Settlement Agreement Bars Knight's Current Claims

By Knight's own admission, he gave Caremark a type of "general release" in the Settlement Agreement that "extinguish[ed] all causes of action."[19] But Knight now seeks to read that General Release as a very narrow one. His reading is at odds, however, with the broad language of the General Release and the traditional approach to construing language of this kind.

The purpose of a general release is to wipe out a broad swath of claims. Thus, under Alabama law and American law in general, general releases are deemed to encompass all claims except those that are explicitly carved out.[20] For a general release

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[18] Knight argues that a clause in the various Options Contracts precludes the Releases in the Settlement Agreement from barring his claims. That clause simply states that the Options Contracts "may be changed only by an Agreement in writing signed by the party against whom enforcement of any waiver, change, modification, extension or discharge is sought." *E.g.*, Compl. Ex. A at § 13. Knight's argument has no merit. For one thing, the clause simply reflects the idea that the parties to the Options Contracts cannot modify it orally but must do so through another writing. As important, the Settlement Agreement is a later writing signed by Knight and Caremark and one that specifically provides that it "supersedes any and all prior . . . agreements between the parties relating to the subject matter hereof." Compl. Ex. G at § 7. Thus, to the extent that the Releases encompass — as they do — Knight's claims in this case, the Settlement Agreement supersedes his prior agreements with Caremark relating to those claims.

[19] Plaintiff's Answering Br. ("PAB") at 25.

[20] *See Regional Health Svcs., Inc. v. Hale County Hosp. Bd.*, 565 So.2d 109, 114 (Ala. 1990) ("With a general release, the parties obviously intend to release all claims — contract claims as well as tort claims. . . . If the parties had wanted to limit the release, they could have expressly reserved and excepted certain claims . . . from the release."); 76 C.J.S. *Release* § 64 (2005) ("A general release, not restricted by its terms to particular claims or demands, ordinarily covers all claims and demands which have matured at the time of its execution and which were within the contemplation of the parties, and . . . any existing liabilities intended to be excepted from such a release should be expressly set forth therein.").

to bar a claim or right, it is therefore irrelevant whether the general release specifically mentions that claim or right. The key issue is simply whether the claim or right at issue — here the Options Contracts — falls within the reach of the language of the General Release the parties negotiated.

Knight, himself, recognizes the expansive nature of the General Release he signed. Knight admits that the General Release bars any claim or rights he had based on the Employment Agreement even though the Employment Agreement is not mentioned explicitly in the General Release. Because he can point to no principled distinction between the Employment Agreement and the Options Contracts, Knight's admission that the General Release bars claims under his Employment Agreement illustrates why that same Release extinguishes his rights under the Options Contracts. Put simply, neither has any grounding in the text of the General Release. Consequently, Knight's distinction does not aid him in advocating a narrow scope of the Release, but instead demonstrates its proper breadth.

In plain and unambiguous terms, Knight "release[d], acquit[ted], and discharge[d] Caremark . . . for any and all rights, titles, claims, liabilities and causes of action, whether known or unknown and whether accrued or not yet accrued, which in any way relate to or arise from, in whole or in part, directly or indirectly, any actions or omissions of Caremark . . . as of the date of this Agreement. . . ."[21] This capacious language easily applies to his present claims.

[21] Compl. Ex. G at § 2.

Knight has filed a "claim" seeking a declaration that he has the "right" to exercise options that were granted to him by "action" of Caremark before the Settlement Agreement was entered. His argument that contract rights were somehow not governed by the General Release finds no support in the text of the Release.[22] Indeed, in his own demand in the Alabama Litigation for an order requiring Caremark to allow him to exercise his options for the full term of the relevant Options Contracts, Knight claimed that he had the "right" to such an exercise period.[23] His use of the term "right" in connection with the Options Contracts draws resonance from the terms of those Contracts themselves, which are replete with references to Caremark granting (an action) Knight the "right" to purchase common stock of the corporation.[24] To wit, the key language of the Options Contracts that Knight bases his claim upon addresses the "right" of Knight, upon a change of control, to exercise all of his options during the remaining term of the Options Contracts.[25] This usage should not be unexpected as stock options are typically defined as a contract providing the holder with the right, but not the duty, to buy certain shares on contractually specified terms during the period the contract determines.[26]

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[22] As mentioned elsewhere, Knight makes the argument that he could not have litigated over the exercise term of his options before the Alabama Litigation was settled because those options were out-of-the-money. That argument is factually erroneous for the simple reason that Knight, in fact, sought specific performance and declaratory relief regarding the related issues of whether all his options were vested and the period of time he had to exercise them. More critical for immediate purposes, the General Release applies to "not yet accrued" rights and claims.
[23] DOB Ex. 2 at Ex. D.
[24] *E.g.*, Compl. Exs. A-E at §§ 1, 3(a), 5(c), 8, 16; *see also* Compl. Ex. F (describing the option grant as a "right to acquire a proprietary interest in the Company in the form of shares of the Company's Common Stock").
[25] Compl. Exs. A-E at § 3(b), Ex. F at § 2(b).
[26] *See Dunn v. Commodity Futures Trading Comm'n*, 519 U.S. 465, 469 (1997) ("An option, as the term is understood in the trade, is a transaction in which the buyer purchases from the seller

In sum, the clear language of the General Release bars Knight's claims.[27] Under Alabama law, that conclusion suffices to warrant a grant of summary judgment for Caremark as a matter of law.

V. The Specific Release In The Settlement Agreement Also Bars Knight's Claims

As Caremark asserts, Knight's claims are also barred by more specific language in the Litigation Release. By the language of the Litigation Release, Knight released Caremark "for or from any claims that were raised or asserted or could have been raised or asserted in the [Alabama Litigation]."[28]

Knight's only response is factually incorrect on two levels. He says that he never raised his current claims in the Alabama Litigation and that he never could have raised those claims. Neither contention is accurate.

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for consideration the right, but not the obligation, to buy or sell an agreed amount of a commodity at a set rate at any time prior to the option's expiration."); *see also* BLACK'S LAW DICTIONARY 1127 (8th ed. 2004) (defining an option as "the right (but not the obligation) to buy or sell a given quantity of securities, commodities, or other assets at a fixed price within a specified time");

[27] Knight also makes the bizarre argument that the Releases he gave to Caremark must be read in light of the much narrower release he was granted by Caremark in exchange. In other words, Knight argues that the "walk away" Settlement Agreement left each side with whatever claims and rights they had before the Settlement — apparently allowing them only to walk away and take a short breather before rejoining the fight! This ridiculous argument implies that Caremark obtained nothing at all in the Settlement Agreement, and that Knight remained free to assert all the same "claims" and "rights" he raised in the Alabama Litigation in the future and to assert any other rights he claimed against Caremark in the future. Thus, according to Knight, neither the General Release nor the Litigation Release, as discussed in greater detail elsewhere, actually released anything at all, not even claims under the Employment Agreement. That proposition is contradicted by the clear language of the Releases and all commercial (and common) sense, and I do not embrace it.

[28] Compl. Ex. G at § 2.

In the Alabama Litigation, Caremark clearly challenged Knight's right to claim that his options had vested because of the House Trigger. In this case, Knight has made a meal of the fact that House Triggers were contained in each of the Options Contracts and that the only subject of the Alabama Litigation was the House Trigger in the Employment Agreement. The problems with that are several and obvious.

I mention only two. The first is that it is commercially absurd to believe that Caremark was seeking only to deny Knight vesting under the House Trigger in the Employment Agreement, while allowing identical vesting under the House Trigger in the underlying Options Contracts.

The second and more important is that Knight himself — through his own counterclaims in the Alabama Litigation — made clear that he knew that no absurd technical argument of the kind he now attributes to Caremark was being made against him. Through counsel, Knight clearly sought adjudication that his options had vested and that he had the full period of time in the Options Contracts to exercise them.[29] In fact, Knight clearly sought an order of specific performance against Caremark, a request that clearly included a demand that Caremark treat all of his options as vested and exercisable during the full length of the relevant Options Contracts.[30] The latter issue was critical to

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[29] DOB Ex. 2 at ¶ 44 (demanding payment according to demand letter attached as Ex. D) & Ex. D (seeking "a right to immediately vest in 100% of all options" and "the life of the option in which to exercise such").

[30] Knight argues that his request for specific performance only involved a demand that Caremark arbitrate the issues in the Alabama Litigation. That argument fails the straight-face test as Knight's pleading in the Alabama Litigation contains separate prayers — indeed, consecutive ones — to compel arbitration and for specific performance. DOB Ex. 2 at 31. The contention that Knight could not have litigated over the term of his right to exercise his options in the

Knight because, as he admits, his options were out-of-the-money as of thirty days after his termination in May 1998. The only way for Knight to obtain value, therefore, was to ensure that he had the right to exercise the options during the full period of time set forth in the Options Contracts, thereby enabling him to reap profit if Caremark's performance turned around. Knight's argument in favor of his right to exercise during the full term of the Options Contracts is grounded, not in the Employment Agreement — which mentions a term of 90 days after Knight's termination — but in the language of the Options Contracts themselves, into which House Triggers were first inserted in the same period as the Employment Agreement was executed.

Therefore, absent an ability to exercise for the much longer term of the Options Contracts — an ability dependent on the validity of the House Trigger in his Options Contracts — Knight would have had to exercise his options in 1998 when they were deeply out-of-the-money. The cost of exercise for Knight then would have been millions of dollars, with no certainty that he would ever make up the loss. A decision to make that investment would have been, shall we say, untraditional. Indeed, at oral argument, Knight's counsel indicated that it was unthinkable that Knight would have exercised his options in that circumstance.[31]

Putting a point on that are the circumstances that gave rise to this case. When Knight was sued by Caremark in 1998, he was not alone as a defendant. Caremark also

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Alabama Litigation is frivolous. He clearly could have and, in fact, did litigate over that matter. Either suffices to implicate the release he signed.

[31] Transcript of Oral Argument on Defendant's Motion for Summary Judgment ("O/A Tr.") at 48, *Knight v. Caremark Rx, Inc.*, C.A. No. 1750-N (Del. Ch. Oct. 23, 2006) (calling the exercise of underwater options "unrealistic").

sued other former officers, including J. Brooke Johnston. Caremark and Johnston clashed over the same option exercise issues that it settled with Knight. In the end, Johnston prevailed and received a jury award granting him the right to exercise his Caremark options at any time during the ten years from the dates of the initial grants of those options.[32]

By this time, Caremark's fortunes had improved considerably and its stock price was trading above the exercise prices of Knight's options. Knight apparently took note of Johnston's victory and brought this suit. Although he denies Johnston's victory inspired him and claims that he believed his options were exercisable throughout the entire period since he departed Caremark, Knight cannot explain why he let 50,000 options expire in February 2005 — before Johnston's triumph in June 2005[33] — when if he had exercised them he would have reaped nearly 1.4 million in profit.[34]

Caremark's explanation is simple: Knight's options expired before Johnston won his suit and at a time when Knight believed his options were all cancelled. After Johnston won his suit and obtained a judgment allowing him ten years after the grant to exercise his options, Knight decided to take a shot at achieving the same thing. In fact, Knight's complaint describes Johnston's victory in supporting his argument that his own

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[32] DOB Exs. 7-10; *see also* Compl. at ¶ 18(c).

[33] Although Johnston was initially awarded a jury verdict in February 2002, the issue of whether his option rights would be exercisable for their entire term was not decided until June 3, 2005. *See* DOB Exs. 7-10.

[34] During oral argument, the most favorable light Knight's counsel could shed on his client's decision to leave $1.4 million on the table was to call it "an administrative mistake." O/A Tr. at 35-36.

options were exercisable for the full period of the Options Contracts.[35] At the time summary judgment briefing began, a declaration that his options remained exercisable would allow him to make a profit of around $35 million.

In fact, the reality that the options Knight now seeks to exercise were out-of-the money at the time of the Alabama Litigation also illustrates why he sought a declaration that he could exercise them during the entire period of the relevant Options Contracts. Absent such a declaration, they would have expired without exercise. Only by obtaining a declaration that he had years to exercise them could Knight secure the potential to profit from the options if Caremark's stock rebounded.

His counterclaim in the Alabama Litigation therefore expressly incorporated his demand to have Caremark honor his asserted "right" to have the full period of the relevant Options Contracts to decide whether to exercise the options. Thus, Knight actually "raised" and "asserted" in the Alabama Litigation the claims he now raises and asserts in this case.

Notably, his demand in the Alabama Litigation to have the full period of the relevant Options Contracts to exercise is, as discussed before, rooted in the text of the Options Contracts, not the Employment Agreement. The Employment Agreement mentioned a period of "at least 90 days" after his termination.[36] The Options Contracts have text granting a much longer period in the event of a "change of control," a definition

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[35] Compl. at ¶ 18.
[36] DOB Ex. 2 at Ex. A § 10(d)(v).

that was amended to include the departure of House during mid-1996.[37] It was House's departure in January 1998 that Knight obviously seized upon when he left Caremark as the "change of control" giving rise under the Options Contracts to the lengthy exercise period he sought. It was also Caremark's belief that the House Trigger was illegally adopted that inspired Caremark's refusal to grant Knight and others the right to immediate vesting of all their options and the right to exercise those options during the full length of the relevant Options Contracts. Therefore, the current claims Knight makes were central to the prior Alabama Litigation.

Finally, it is equally obvious that even if Knight had not expressly raised and asserted that claim, he could have. There was plainly a concrete dispute between Caremark and him about the validity of his options, whether they were vested, and when they could be exercised. Moreover, because the economic value of an option is influenced importantly by the length of time over which it can be exercised,[38] Knight had a legitimate interest in obtaining, as he plainly sought, a judicial declaration that he had the full contractual terms to exercise his options and an order requiring Caremark to honor Knight's exercise during those periods. Knight's argument that he could not have raised or asserted a claim regarding the appropriate exercise period because he had not yet decided whether to exercise his options is not only belied by the fact that he did raise and assert such a claim in the Alabama Litigation, but it is also meritless in light of long-

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[37] *See* Williams Letter at 1 (explaining that the options "did not contain the House Trigger when originally issued" and that "the House Trigger was added to the options at the time of the Caremark merger in mid-1996).

[38] *E.g.*, RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 583 (7th ed. 2003).

understood principles of jurisprudence, which allow parties to seek declaratory relief when there is a concrete disagreement that affects important interests.[39]

VI. Knight's Reliance Upon Parol Evidence To Create An Ambiguity Is Unavailing Under Alabama Law

Having no good arguments about the language of the Releases, Knight has tried to manufacture an ambiguity by resorting to extrinsic evidence. One such piece of evidence is his self-serving affidavit to the effect that he only intended through the Releases to relinquish any claims he had under the Employment Agreement, and not any claims he had to exercise his options, based on the House Trigger, under his Options Contracts. Evidence of this kind does not create a triable issue of fact.[40] Absent ambiguity in the

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[39] *See DRC, Inc. v. Great American Ins. Companies*, 901 So.2d 710, 713 (Ala. 2004) ("Under [Alabama's] Declaratory Judgment Act, parties are not compelled to wait until the events giving rise to liability have occurred before having a determination of their rights and obligations."); *see also* 10B CHARLES A. WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE & PROCEDURE § 2751 (3d ed. 2006) (explaining that declaratory relief "gives a means by which rights and obligations may be adjudicated in cases involving an actual controversy that has not reached the stage at which either party may seek a coercive remedy"); *id.* at § 2752 (discussing the history of the federal Declaratory Judgment Act).

[40] Notably, Knight does not provide evidence that he communicated this subjective understanding to Caremark. Left unexplained also is why Knight, a sophisticated financial professional who was CFO of a public company, failed to exercise options worth $1.4 million in February 2005. The most rational explanation — he thought he had forsaken any right to exercise his options years before and only began to assert otherwise after Johnston prevailed on the very claim that Knight had abandoned — is one that Knight never addresses in his sworn affidavit. *See* Affidavit of Harold O. Knight (May 30, 2006). Further, his assertion that Caremark never informed him it was treating his options as cancelled before he attempted to exercise them in November 2005 is belied by his own complaint in this matter which was filed the same day as his attempt to exercise his options and which expressly states that Caremark had already cancelled his options and denied that he had any right to exercise them. Compl. at ¶¶ 5, 19.

Releases — of which there is none — parol evidence regarding the subjective intent of the parties has no force under Alabama law.[41]

Knight's other argument must be given some credit for creativity. In discovery, Knight found a personnel record indicating that "AS OF 8/16/00" — some months after the Settlement Agreement was entered — he had 1.165 million vested options.[42] Because of this, Knight argues that Caremark, as a corporation, must not have believed that the Settlement Agreement released his rights under the Options Contracts. When Knight's options were actually cancelled from Caremark's books and records — an event which happened sometime between August 16, 2000 and January 15, 2001[43] — the notation indicated that the options at issue in this case were cancelled on September 14, 1998, exactly 90 days after Knight's termination.[44] The reason for cancellation listed was "Termination-Voluntary."[45] From this, Knight reasons that a latent ambiguity exists regarding the otherwise plain language of the Releases in the Settlement Agreement and that a trial must be had to determine the actual subjective intent of the parties.

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[41] *E.g.*, *Hartford Acc. & Indem. Co. v. Cochran Plastering Co., Inc.*, 935 So.2d 462, 469 (Ala. Civ. App. 2006) ("It is well settled that '[i]n the absence of fraud or ambiguity, a release supported by valuable consideration will be given effect according to the intention of the parties, which is to be judged by the court from what appears within the four corners of the instrument itself, and ordinarily parol evidence is not admissible to impeach or vary its terms.'" (quoting *Johnson v. Asphalt Hot Mix*, 565 So.2d 219, 220 (Ala. 1990))).

[42] PAB Ex. A.

[43] *See* PAB Ex. B at 6.

[44] PAB Ex. C.

[45] *Id.*

I do not adopt that reasoning. Under Alabama law, parol evidence is admissible to show that a latent ambiguity exists only in unusual circumstances.[46] When the contract contains an essential word that has one meaning for one party but a different one for the other, a latent ambiguity arises and extrinsic evidence is admissible to clarify the bargain. For example, in the classic case of *Raffles v. Wichelhaus*,[47] a latent ambiguity arose when two parties contracted for a shipment of cotton from Bombay aboard a ship named the 'Peerless,' but, as it turned out, two ships sailing from Bombay at different times each had the name 'Peerless.' As a result, even though the plain language requiring the shipment aboard a specified vessel was unambiguous on its face, a latent ambiguity regarding the specific ship desired was found to exist. But, where there is no uncertainty in meaning created by collateral matters and the language of the contract is facially unambiguous, the parol evidence rule prohibits consideration of extrinsic evidence.[48]

Knight's claim that a latent ambiguity arose as to the meaning of the "rights, titles, claims, liabilities, and causes of action" given up in the Releases contained in the

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[46] *See Meyer v. Meyer*, --- So.2d ----, 2006 WL 1302609, at *6 (Ala. Civ. App. 2006) ("[A] latent ambiguity is one that appears only as the result of extrinsic or collateral evidence showing that a word, thought to have but one meaning, actually has two or more meanings.") (quotations omitted); *see also* 11 WILLISTON ON CONTRACTS § 33:40 at 816 (4th ed. 2003) ("The usual instance of a latent ambiguity is one in which a writing refers to a particular person or a thing and is thus apparently clear on its face, but upon application to external objects is found to fit two or more of them equally.") (quotations omitted).

[47] 159 Eng. Rep. 375 (1864); *see also Greene v. Hanover Ins. Co.*, 700 So.2d 1354, 1356 (Ala. 1997) (allowing parol evidence to show that the naming of "James Scott Vance" in an insurance policy was a transposition of the person's first and middle names and was intended to refer to "Scott James Vance"); *Lamar v. Minter*, 13 Ala. 31, 35 (1848) (finding extrinsic evidence admissible to clarify the latent ambiguity arising from the incorrect listing of Sheppard Spencer Johnson's name in a deed as "Spencer S. Johnson").

[48] *E.g.*, *Martin v. First Nat. Bank of Mobile*, 412 So.2d 250, 253-54 (Ala. 1982) (finding "no room for construction" where the language of a will was not subject to any other reasonable alternate meaning).

Settlement Agreement is the sort of end run around unambiguous contracts that the parol evidence rule was created to avoid. Knight does not suggest that these were code words or that there is some other well understood meaning that should be imparted to these terms. Rather, his only textual arguments are that the Options Contracts cannot be included with this language and that the Options Contracts' merger clauses require a writing to alter those Contracts — arguments I have already assessed and rejected, and which do not implicate the unwritten understanding at the heart of the latent ambiguity doctrine.

Even if I were to accept Knight's latent ambiguity position, the records he points to do not create a triable dispute of fact in any event for several reasons. For one, the fact that certain employees, charged with record-keeping, made entries at particular times does not mean those entries bear at all on the intent of those who actually negotiated the Settlement Agreement for Caremark. That Caremark's staff only got around to canceling Knight's options on the books and records of the company sometime between August 16, 2000 and January 15, 2001 is also not very telling, at least not to anyone experienced with the operation of large organizations. That is particularly so when it is realized that none of Knight's options was in-the-money until *after* Caremark had marked them as cancelled on its books and records.

The fact that Knight's personnel records recorded his options as vested during the period in the Alabama Litigation when Caremark's position was clear that it considered those options not to be vested is equally significant. That is, Caremark did not change its

books and records during a period when Knight clearly knew Caremark was refusing to treat his options as vested and exercisable for their full contractual terms.

Furthermore, the fact that Caremark recorded voluntary termination as a reason that the options were cancelled does not mean that there were not other reasons. In that regard, it must be remembered that absent the placement of the House Trigger in the Options Contracts themselves, Knight had no textual basis for claiming that he could exercise any of his options beyond the 90 days following his termination. His only basis for asserting such a right was rooted in the mid-1996 insertion of the House Trigger in the definition of change of control in the Options Contracts, an insertion that, if valid, gave Knight the full term of the Options Contracts to exercise. That is the key right at issue in this case. The Caremark record indicating that the options were cancelled 90 days after his termination is therefore consistent with its assertion that any longer exercise period Knight could claim as a result of the House Trigger in the Options Contracts was of no force and effect. And, so long as Knight's exercise period was limited to 90 days after his termination, whether all his options were vested was immaterial as a practical matter. Because those options were deeply out-of-the-money during that period, a limitation to that 90-day period resulted in their extinguishment as an economic factor for Caremark.

Finally, there is no dispute in the record that Caremark has never recognized the legitimacy of the House Trigger in its dealings with Knight or Knight's inspiration, Johnston. It consistently argued that the House Trigger was invalid and could not accelerate vesting of, or lengthen the exercise period for, otherwise vested options.

In conclusion, this parol evidence is not admissible at all to vary the clear language of the Releases and, even if considered, does not raise a triable issue of fact regarding the intended meaning of the Release.

V. Conclusion

For the foregoing reasons, Caremark's motion for summary judgment is hereby GRANTED and Knight's claims are dismissed with prejudice. I need not and do not reach Caremark's res judicata argument. IT IS SO ORDERED.