

**COURT OF CHANCERY
OF THE
STATE OF DELAWARE**

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Re: *Cornerstone Brands, Inc. v. John O'Steen*
Civil Action No. 1501-N

Dear Counsel:

For the reasons set forth below, after carefully examining the arguments presented by counsel, I deny defendant's motion to dismiss for lack of subject matter jurisdiction and to dismiss Count IV and Count V of the amended complaint for failure to state a claim upon which relief can be granted.

I. BACKGROUND

This case involves negotiations and an alleged separation agreement between plaintiff Cornerstone Brands, Inc. ("Cornerstone") and its long-time director and employee, defendant John O'Steen. Specifically, Cornerstone seeks to preclude O'Steen from collecting payment for certain Cornerstone stock options O'Steen accumulated pursuant to the 1998 Stock Incentive Plan (the "Option Plan"). In 2004, O'Steen's career with Cornerstone entered its sunset phase, and a Separation Agreement was executed that allowed, in relevant part, for O'Steen to

continue to serve on the Cornerstone board and to maintain rights to his unvested options under the Option Plan.

In the months following execution of the Separation Agreement, Cornerstone began negotiating a merger with IAC/InterActive Corp. (“IAC”). Before the merger’s signing, Cornerstone advised O’Steen that it had the right to terminate his remaining employment, and that under the Option Plan his remaining unvested options would be forfeited. Reaching a compromise, Cornerstone and O’Steen allegedly agreed that his 2005 options would vest (resulting in a payment of approximately \$1 million), but that his 2006 and 2007 options would be forfeited. Broadly, the crux of the dispute is whether or not such an agreement was reached.

Earlier, I decided that as a third-party beneficiary to the Merger Agreement between IAC and Cornerstone, O’Steen consented to jurisdiction in Delaware under the Merger Agreement’s forum selection clause (the “Forum Selection Clause”).¹ Presently before me is defendant’s motion to dismiss the entire amended complaint for lack of subject matter jurisdiction and to dismiss Counts IV and V of the amended complaint for failure to state a claim upon which relief can be granted.

II. CONTENTIONS

In its amended complaint, Cornerstone seeks relief on five counts. First, Cornerstone requests specific performance of the alleged agreement by which O’Steen forfeited rights to the 2006 and 2007 options in exchange for vested rights in the 2005 options. Second, Cornerstone seeks a declaration pursuant to 10 *Del. C.* § 6501 stating that O’Steen is not entitled to payment for the vesting and exercise of the 2006 and 2007 options. Third, in the alternative, plaintiff seeks a declaration stating that even if O’Steen is entitled to the stock options, he is not entitled to accelerated payment. Fourth, in the event that the court holds that it may not grant specific performance, Cornerstone requests damages or disgorgement of the 2005 options. Last, Cornerstone seeks damages for O’Steen’s violation of the Merger Agreement’s forum selection clause to which he was bound as a third-party beneficiary.

¹ *Cornerstone Brands, Inc. v. John O’Steen*, C.A. No. 1501-N (Del. Ch. Jan. 23, 2006) (oral ruling denying motion to dismiss).

O'Steen moves to dismiss the entire case for lack of subject matter jurisdiction on three grounds. First, O'Steen contends that there are no equitable claims, but instead equitable phrases that simply mask a breach of contract claim. Second, no equitable remedies provide jurisdiction because specific performance would not require any action. Instead, O'Steen asserts that Cornerstone actually only seeks a declaratory judgment, which is an adequate remedy at law and does not serve as a basis for jurisdiction. Last, O'Steen avers that plaintiff's reliance on 8 *Del. C.* § 111 (2006) is misplaced. O'Steen posits that any statutory grant of jurisdiction must be strictly construed.² As such, jurisdiction pursuant to § 111 extends only to a determination of the validity of "existing" agreements or instruments by which the corporation "creates or sells" options.³ Thus, § 111 does not apply to this "alleged" agreement that "relinquishes" options.

In any case, O'Steen moves to dismiss Counts IV and V for failure to state a claim upon which relief can be granted. O'Steen contends that the promissory estoppel and equitable estoppel claims are unenforceable for two reasons. First, both theories require enforcement of the promise as the primary remedial measure. In this case, enforcement of the promise would be unnecessary because it requires no action. O'Steen would simply retain the money he received for the 2005 option. Second, the alternative, disgorgement, is unavailable, because the Court cannot possibly place the parties in the position they were in before the agreement. Count V, O'Steen argues, fails because no Delaware written decision supports an award of legal fees for a breach of a forum selection clause where there is no other damage and where the action is before the appropriate forum. Thus, both Counts IV and V should be dismissed.

III. SUBJECT MATTER JURISDICTION

As Delaware's constitutional court of equity, this Court can acquire subject matter jurisdiction over a cause in only three ways: (1) if one or more of the

² See *Bowen v. Massachusetts*, 487 U.S. 879, 908 (1988); see also *In re RJR Nabisco Inc. S'holders Litig.*, 576 A.2d 654, 658 (Del. Ch. 1990) (analogizing federal courts to Court of Chancery as court of limited jurisdiction).

³ 8 *Del. C.* § 111(a)(2) (2006) specifically states that the Court of Chancery has jurisdiction: to interpret, apply, enforce or determine the validity of the provisions of: [a]ny instrument, document or agreement by which a corporation creates or sells, or offers to create or sell, any of its stock, or any rights or options respecting its stock.

plaintiff's claims for relief is equitable in character;⁴ (2) if the plaintiff requests relief that is equitable in nature;⁵ or (3) if subject matter jurisdiction is conferred by statute.⁶

This Court clearly has subject matter jurisdiction over this action pursuant to a statutory grant. Section 111 of the DGCL specifically states that an action may be brought in the Court of Chancery

to interpret, apply, enforce or determine the validity of the provisions of: [a]ny instrument, document or agreement by which a corporation creates or sells, or offers to create or sell, any of its stock, or any rights or options respecting its stock.⁷

In order to “interpret, apply, enforce or determine the validity” of any “instrument, document or agreement,” it is necessary first to determine the existence of that instrument, document or agreement. That determination may be less or more difficult depending on the facts of each case. When drafting § 111, however, the Delaware General Assembly did not intend that a plaintiff seeking redress petition one court to determine the existence of an agreement and then petition yet another court to interpret, apply, enforce or determine the validity of the same agreement. Stated differently, the General Assembly does not entrust the Court of Chancery with the jurisdiction to “interpret, apply, enforce or determine the validity” of any “instrument, document or agreement” by which a corporation creates options but then deprive it of the jurisdiction to determine the existence of the same. O’Steen’s reading of the statute is counter-intuitive in the context of Delaware corporate law where the General Assembly and the judicial branch seek to efficiently and expeditiously resolve corporate conflicts. Defendant cannot divest this Court of jurisdiction by simply restating the ultimate issue in this case.

Furthermore, § 111 specifically applies to this alleged agreement because the agreement created an interest in vested options and, as consideration, required the forfeiture of potential rights to other options. Prior to this agreement, O’Steen did

⁴ 10 *Del. C.* § 341 (“The Court of Chancery shall have jurisdiction to hear and determine all matters and causes in equity.”); *Monroe Park v. Metro. Life Ins. Co.*, 457 A.2d 734 (Del. 1983).

⁵ 10 *Del. C.* § 342 (“The Court of Chancery shall not have jurisdiction to determine any matter wherein sufficient remedy may be had by common law, or statute, before any other court or jurisdiction of this State.”); *Heathergreen Commons Condo. Ass'n v. Paul*, 503 A.2d 636 (Del. Ch. 1985).

⁶ *Candlewood Timber Group, LLC v. Pan Am. Energy, LLC*, 859 A.2d 989, 997 (Del. 2004).

⁷ *Id.*

not possess a right to vested options. The Separation Agreement allowed O’Steen to retain his rights under the Option Plan. The Option Plan provided for the vesting of certain options on designated dates in 2005, 2006, and 2007, only if O’Steen remained employed by the Company or a subsidiary at the time of vesting. The Separation Agreement, however, did not limit Cornerstone’s ability to terminate O’Steen. Thus, if Cornerstone retained a right to terminate O’Steen and chose to do so before the vesting dates of the options (which Cornerstone contends it would have done had an agreement not been reached), O’Steen would not be eligible to receive the options pursuant to the Option Plan. Consequently, this new agreement created a right to vested stock options, and § 111 governs it. Therefore, the motion to dismiss for lack of subject matter jurisdiction is denied.⁸

IV. COUNT IV

The standard for review regarding a Rule 12(b)(6) motion to dismiss is well-settled in Delaware law. “At the motion to dismiss stage of the litigation, plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences.”⁹ This standard strictly limits the court’s consideration to only the facts in and reasonable inferences drawn from the well-pleaded complaint. “[W]ell-pleaded allegations include specific allegations of fact and conclusions supported by specific allegations of fact.”¹⁰ The court may grant a motion to dismiss pursuant to 12(b)(6) where it appears with reasonable certainty that the plaintiff’s complaint fails to provide any reasonable grounds for relief.¹¹

In Count IV of the amended complaint, Cornerstone argues that in the event specific performance of the agreement is not granted, promissory estoppel or equitable estoppel applies, and Cornerstone is entitled to damages or disgorgement of the \$1 million paid to O’Steen for his 2005 options. On this motion, O’Steen does not challenge whether Cornerstone sufficiently pleaded facts necessary to

⁸ Because § 111 specifically confers subject matter jurisdiction, the merits of defendant’s claim regarding the existence of equitable claims and remedies need not be addressed.

⁹ *White v. Panic*, 783 A.2d 543, 549 (Del. 2001).

¹⁰ *Id.*

¹¹ *Medi-Tec of Egypt Corp. v. Bausch & Lomb Surgical*, 2004 Del. Ch. LEXIS 21, at *5 (Nov. 21, 2003).

meet the elements of promissory estoppel or equitable estoppel.¹² Instead, he challenges the relief requested.

Under the theories of promissory and/or equitable estoppel, Cornerstone requests the Court to rescind the benefit conferred by the agreement and to return the parties to their respective positions before they entered into an agreement. As O’Steen points out, this remedy may prove to be a difficult task. At the time of the alleged agreement, Cornerstone was contemplating a merger with IAC. O’Steen was a director of Cornerstone, and his termination might have elicited an immediate lawsuit.¹³ To place the parties in their respective positions before the agreement requires providing O’Steen with the power to holdup or hamper a merger that has already taken place. Thus, rescission may be an impossible form of relief. This, however, does not provide a ground to dismiss the claim.

The Court of Chancery has broad discretion to fashion any remedy required by equity. This may include enforcement of the promise, injunctive relief, and a host of other equitable and monetary remedies, any of which may be appropriate here. In determining an appropriate remedy, the Court must “evaluate the impact of its order in the light of all the circumstances present.”¹⁴ This Court, however, need not make such a determination at this early stage. The pressing question now is whether plaintiff states a claim upon which relief can be granted. Cornerstone pleads facts sufficient to provide reasonable grounds for relief based on the

¹² In order to prevail on a promissory estoppel theory, plaintiff must show (1) that a promise was made, (2) that the promisor reasonably expected to induce action or forbearance on the part of the promisee, (3) that the promisee relied on the promise and took action to his detriment, and (4) that such promise is binding because injustice can be avoided only by enforcement of the promise. *Hunter v. Diocese of Wilmington*, 1987 WL 15555, at *6 (Del. Ch. Aug. 4, 1987) citing Restatement (Second) of Contracts § 90; *Chrysler v. Quimby*, 144 A.2d 123 (Del. 1958); *Metro. Convoy Corp. v. Chrysler Corp.*, 208 A.2d 519 (Del. 1965).

In order to prevail on an equitable estoppel theory, plaintiff must show (1) conduct by the party to be estopped that amounts to a false representation, concealment of material facts, or that is calculated to convey an impression different from, and inconsistent with, that which the party subsequently attempts to assert, (2) knowledge, actual or constructive, of the real facts and the other party's lack of knowledge and the means of discovering the truth, (3) the intention o[r] expectation that the conduct shall be acted upon by, or influence, the other party and good faith reliance by the other, and (4) action or forbearance by the other party amounting to a change of status to his detriment. *Scott-Douglas Corp. v. Greyhound Corp.*, 304 A.2d 309, 318 (Del. Sup. 1973).

¹³ O’Steen argues that any such termination would have been inequitable as it was timed solely to deprive O’Steen of his option on the eve of a change of control event. Fortunately, the merits of this claim need not be addressed now.

¹⁴ *Hunter*, 1987 WL 15555, at *22.

estoppel theories,¹⁵ and numerous forms of relief may be granted at the discretion of this Court. Thus, defendant's motion to dismiss for failure to state a claim is denied.

V. COUNT V

In Count V of the amended complaint, Cornerstone seeks damages based on a claim that by initiating a separate legal proceeding in Ohio, O'Steen violated the Forum Selection Clause. Delaware follows the "American Rule," whereby a court will not award attorney's fees unless a statute, contract or procedural rule makes the award explicit.¹⁶ Nonetheless, in *El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp.*, the Supreme Court of Delaware implied that damages may be obtained for a breach of a forum selection clause, and an award of such damages does not contravene the American Rule.¹⁷ Accordingly, Cornerstone is entitled to prove its claim for damages based on O'Steen's alleged breach of the forum selection clause.

In sum, this Court has subject matter jurisdiction over Cornerstone's claims under 8 *Del. C.* § 111. In addition, O'Steen's motion to dismiss Count IV and Count V is denied.

¹⁵ Defendant does not challenge whether plaintiff pleaded sufficient facts regarding the elements of promissory and/or equitable estoppel; however, a cursory reading of the complaint shows that plaintiff meets the standard to survive a challenge under 12(b)(6). Plaintiff alleges that a promise was made and that O'Steen knew that the promise would induce reliance since it warned O'Steen that he might otherwise be terminated and lose his rights. Further, Cornerstone relied on the promise and allowed the 2005 options to vest; however, O'Steen has not complied, leaving Cornerstone with no remedy outside this Court.

¹⁶ See *Montgomery Cellular Holding Co. v. Dobler*, 880 A.2d 206, 227 (Del. 2005); *In the Matter of the State of Delaware*, 708 A.2d 983, 989 (Del. 1998).

¹⁷ *El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp.*, 669 A.2d 36, 40 (Del. 1995) (confirming Court of Chancery determination that party could raise forum selection clause defense in Texas litigation and recover the costs of Texas litigation); *Indosuez Int'l Fin., B.V. v. Nat'l Reserve Bank*, 758 N.Y.S.2d 308, 311 (N.Y. App. Div. 2003) ("[D]amages may be obtained for a breach of a forum selection clause [sic] and an award of such damages does not contravene the American Rule that deems attorneys' fees a mere incident of litigation."); *Lab. Corp. of Am., Inc. v. Upstate Testing Lab., Inc.*, 967 F. Supp. 295, 299 (N.D. Ill. 1997) (stating that a party "has a right to enforce [a forum selection clause] and recover damages for its breach"); *Masiongale Elec.-Mech., Inc. v. Constr. One, Inc.*, 806 N.E.2d 148, 150 (Ohio 2004) (affirming award of damages for breach of forum selection clause).

IT IS SO ORDERED.

Very truly yours,

William B. Chandler III

William B. Chandler III

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