1996 WL 549960
Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware, New Castle County.

Arnold PASTERNAK, Plaintiff,

v.

Malcolm I. GLAZER, Avram A. Glazer, Ronald C. Lassiter, Robert V. Leffler, W. George Loar, and Zapata Corporation, Defendants.

Civil Action No. 15026. | Submitted Sept. 12, 1996. | Decided Sept. 24, 1996.

Attorneys and Law Firms

Elizabeth M. McGeever, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington; Daniel F. Wake, of Krendl, Horowitz & Krendl, Denver, Colorado, for Plaintiff.

Allen M. Terrell, Jr., Robert J. Stearn, Jr. and Brigitte V. Fresco, of Richards, Layton & Finger, Wilmington; R. Paul Yetter, of Baker & Botts, L.L.P., Houston, Texas, for Defendants Ronald C. Lassiter, Robert V. Leffler, Jr., W. George Loar and Zapata Corporation.

Joseph C. Schoell, of Morris, James, Hitchens & Williams, Wilmington, for Defendants Malcolm I. Glazer and Avram A. Glazer.

Opinion

MEMORANDUM OPINION

JACOBS, Vice Chancellor.

*1 On May 31, 1996, the plaintiffs commenced this action challenging a proposed merger (the "Merger") between Zapata Corporation ("Zapata") and Houlihan's Restaurant Group, Inc. ("Houlihan's"). On July 11, 1996, the plaintiffs amended their complaint to allege that the proposed merger is invalid because the June 4, 1996 Agreement and Plan of Merger (the "Merger Agreement") requires approval by only a simple majority of Zapata's shareholders, whereas Article SEVENTH of Zapata's Restated Certificate of Incorporation (the "Supermajority Provision") requires approval by 80% of Zapata's shareholders.

The plaintiffs moved to enjoin the proposed Merger, and a final hearing on their injunction application was held on September 6, 1996. For the reasons next discussed, the application to enjoin the proposed Merger will be granted.

I. FACTS

A. *The Merger Agreement*

The defendant, Zapata, is a Delaware corporation. Defendant Malcolm Glazer ("Glazer") is the Chairman of Zapata's board of directors, and owns or beneficially controls approximately 35% of Zapata's stock. Glazer also owns or controls 73.3% of the outstanding shares of Houlihan's.

On June 4, 1996, Zapata, Houlihan's and Zapata Acquisition Corp., a wholly owned subsidiary of Zapata specially created to effect the Merger ("Zapata Sub"), entered into the Merger Agreement. Under that Agreement, Houlihan's will

merge with and into Zapata Sub, and Houlihan's stockholders will receive shares of Zapata in exchange for their Houlihan's stock.

The Merger Agreement provides that only the approval of a simple majority of Zapata's outstanding shares is required to approve the Merger:

> *Section 4.14.* Vote Required. The affirmative vote of the holders of a majority of the outstanding shares of [Zapata] Common Stock and Preference Stock, voting together as a class, on the issuance of the shares of [Zapata] Common Stock in the Merger, as required by the NYSE, is the only vote of the holders of any class or series of [Zapata's] capital stock necessary to approve the Merger and the transactions contemplated thereby.

Pl.Cert.Ex. B, at A-23.

The shareholders meeting to vote on the proposed merger was originally scheduled for August 22, 1996, but it has been postponed pending the outcome of this litigation.

B. *Article SEVENTH of Zapata's Restated Certificate*

The charter provision critical to this motion is Article SEVENTH, Subsection (A)(i) of Zapata's Restated Certificate of Incorporation. Article SEVENTH, which was adopted in 1971, states in relevant part as follows:

> ... the affirmative vote or consent of the holders of 80% of all stock of this corporation entitled to vote in elections of directors, considered for the purposes of this Articles SEVENTH as one class, shall be required:
>
> (i) *for a merger or consolidation with or into any other corporation,* or
>
> (ii) for any sale or lease of all or any substantial part of the assets of this corporation to any other corporation, person or other entity, or
>
> ***2** (iii) any sale or lease to this corporation or any subsidiary thereof of any assets ... in exchange for voting securities ... of this corporation or any subsidiary by any corporation, person or entity,
>
> if as of the record date for the determination of stockholders entitled to notice thereof and to vote thereon or consent thereto such other corporation, person or entity which is party to such a transaction is the beneficial owner, directly or indirectly, of 5% or more of the outstanding shares of stock of this corporation entitled to vote in elections of directors, considered for the purpose of this Article SEVENTH as one class. Such affirmative vote or consent shall be in addition to the vote or consent of the holders of the stock of this corporation otherwise required by law or any agreement between this corporation and any national securities exchange.

Pl.Cert.Ex. C, at 31-32 (emphasis added).

Subsection (D) of Article SEVENTH states that the 80% supermajority vote requirement does not apply in two circumstances: (a) if the merger was approved by Zapata's board of directors before the other constituent corporation became the beneficial owner of more than 5% of Zapata's stock, or (b) if the transaction is between Zapata and a majority-owned subsidiary. Neither exception is applicable here.

II. THE PARTIES' CONTENTIONS

The plaintiffs claim that Article SEVENTH unambiguously requires an 80% shareholder approval of the proposed Merger.[1] Specifically, plaintiffs contend that Subsection (A)(i), which governs "a merger or consolidation with or into any other corporation", applies not only to a merger with or into Zapata itself, but

also to a merger with or into a wholly owned Zapata subsidiary. That is because, plaintiffs argue, Subsection (A)(i) is broadly worded and contains no language that explicitly limits its application to mergers involving only Zapata itself. [2]

Defendants disagree. They contend that Article SEVENTH is unambiguously inapplicable to mergers with or into a Zapata subsidiary, because Subsection (A)(i) has no language that explicitly encompasses subsidiary merger transactions. Therefore, defendants conclude, Subsection (A)(i), by its own terms and when viewed in the larger context of Article SEVENTH, applies only to a merger where Zapata itself is a constituent corporation.

III. ANALYSIS

A. *Applicable Principles of Interpretation*

Because a certificate of incorporation is a contract between the corporation and its shareholders, it is interpreted according to the rules of contract construction. *Berlin v. Emerald Partners,* Del.Supr., 552 A.2d 482, 488 (1988). Accordingly, this Court must give effect to the intent of the contracting parties as evidenced by "the language of the certificate and the circumstances surrounding its creation and adoption." *Waggoner v. Laster,* Del.Supr., 581 A.2d 1122, 1134 (1990); *accord, Kaiser Aluminum Corp. v. Matheson,* Del.Supr., --- A.2d ----, No. 168, 1996, Veasey, C.J. (Aug. 29, 1996), at 8.

***3** Except in the case where a charter provision is found ambiguous, this Court must give effect to its clear language. *Kaiser,* at 9. " 'A contract is not rendered ambiguous simply because the parties do not agree upon its proper construction. Rather, ... [it] is ambiguous only when the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings.' " *Id.,* at 9 (quoting *Rhone-Poulenc Basic Chems. Co. v. American Motors Ins. Co.,* Del.Supr., 616 A.2d 1192, 1196 (1992)). In determining whether a charter provision is ambiguous, the intent of the stockholders in enacting the provision is instructive. *Centaur Partners, IV v. National Intergroup, Inc.,* Del.Supr., 582 A.2d 923, 928 (1990).

Having set forth the applicable principles of construction, I turn to the parties' respective arguments.

B. *The Structure and Plain Language of Article SEVENTH*

The defendants contend that this Court must read the Supermajority provision as applying solely to a merger "of this corporation," *i.e.,* a merger involving Zapata itself. Although the defendants concede that these words are not explicitly found in Subsection (A)(i), they argue that that meaning is implicit, because the phrase "this corporation" is found in the paragraph that immediately precedes the enumeration, in the subparts immediately following, of the three categories of transactions requiring supermajority approval. [3] In this Court's view, nothing in Article SEVENTH supports the position that Subsection (A)(i) is or was intended to be so limited.

Unlike the broad language of Subsection (A)(i) (which covers "a merger with or into another corporation"), the language of Subsections (A)(ii) and (A)(iii) explicitly and precisely limits the scope of those two latter Subsections. Thus, Subsection (A)(ii) covers a sale or lease of "all or any substantial part of the assets *of this corporation* to any other corporation, person or other entity ..." Pl.Cert.Ex. C, at 31 (emphasis added). Subsection (A)(iii) refers to a sale or lease "to *this corporation or any subsidiary thereof* ..." *Id.,* at 32 (emphasis added). No such language appears in Subsection A(i). If the defendants' argued-for limitation is added to the three Subsections by implication, the explicit limitations in Subsections (A)(ii) and (A)(iii) would become surplusage. An interpretation of a contract that renders one or more terms redundant is not preferred over a

construction that gives effect to each of the agreement's terms. *See Warner Commun. v. Chris-Craft Industries,* Del.Ch., 583 A.2d 962, 971 (1989), *aff'd* Del.Supr., 567 A.2d 419 (1989).

The use of the phrase "of this corporation" in Subsections (A)(ii) and (A)(iii) demonstrates that had the drafters of Article SEVENTH intended to limit the scope of Subsection A(i) to mergers involving only Zapata, they knew fully well how to accomplish that.[4] The total absence in Subsection A(i) of the limitation expressly contained in Subsections (A)(ii) and (A)(iii), shows that the drafters intended no such limitation. *See Sullivan Money Management, Inc. v. FLS Holdings, Inc.,* Del.Ch., C.A. No. 12731, Jacobs, V.C. (Nov. 20, 1992), Mem.Op. at 9-10.

***4** In contrast to the defendants' interpretation, the plaintiffs' construction of Subsection (A)(i) as encompassing subsidiary mergers requires no implication or importation of any language from other sections of Article SEVENTH. Nor does the plaintiffs' interpretation render any term of that Article redundant. Rather, the plaintiffs' interpretation flows directly from the clear, explicit language requiring a supermajority vote for "any merger with or into any other corporation."

C. *The Stockholders' Intent in Adopting Article SEVENTH*

The defendants' interpretation of Subsection (A)(i) is deficient for another reason: it would render that provision essentially ineffective, by the simple expedient of structuring a merger in two steps rather than one. In step one-the merger of the acquired corporation ("Houlihan's) with and into a Zapata subsidiary-Article SEVENTH would not apply, because the merger would not involve Zapata as a constituent corporation. In step two-the merger of the subsidiary with and into Zapata-Article SEVENTH would not apply because the transaction would be exempt under Subsection (D)(ii).[5]

It cannot be supposed that the drafters of Article SEVENTH, or the stockholders who adopted that provision, would have intended for the supermajority voting protection to be so easily sidestepped. The proxy statement accompanying the proposed amendment to Zapata's certificate of incorporation indicated that the purpose of the proposed amendment was to confer broad protection to shareholders against the risks posed by transactions involving Zapata and a large shareholder. The proxy statement represented that "[t]he intended effect of the proposed amendments would be to make more difficult the use by a corporation of its ownership in the Company to effect a transaction which might not be in the best interests of the Company and its other stockholders." Pl.Cert.Ex. G, at 7. Thus, Article SEVENTH was intended to protect shareholders against "conflict of interest" transactions involving Zapata and holders of significant blocks of Zapata stock, by making those transactions more difficult to effect.[6] The defendants' interpretation, which would *not* make such transactions any more difficult to effect, is in that respect inconsistent with the drafters' intent.[7] That weighs heavily against accepting the defendants' interpretation as reasonable or fair. *See Centaur Partners,* 582 A.2d at 928.

The plaintiffs' interpretation would not create such a glaring loophole. Their construction of Article SEVENTH to encompass mergers involving Zapata subsidiaries is entirely consistent with the intent to protect shareholders from exploitation in "conflict of interest" transactions.[8] The defendants' interpretation, on the other hand, would defeat that intent and strip Zapata's shareholders of that important procedural protection.

IV. *CONCLUSION*

For the reasons stated above, the defendants have failed to persuade this Court that their interpretation of Subsection (A)(i) of Article SEVENTH is reasonable or fair, or (as a consequence) that that provision is ambiguous. Clearly and on its face the Supermajority Provision of Article SEVENTH applies to mergers involving a wholly owned subsidiary of Zapata, as well as mergers involving Zapata itself.

*5 To the extent that the Merger Agreement requires only a simple majority stockholder approval of the proposed Merger, it contravenes Article SEVENTH of Zapata's Certificate of Incorporation. On that basis, an injunction prohibiting the consummation of the proposed Merger will issue. Counsel shall submit an implementing form of order.

Footnotes

1 The defendants have conceded that under the attribution provisions of Article SEVENTH subsections (B) and (C), the Supermajority Provision is applicable to a merger between Houlihan's and Zapata, given Glazer's stock interest in both corporations.

2 In addition to their contract interpretation argument, Plaintiffs claim that the defendants' decision to structure the transaction as a three-party merger (*i.e.,* into a Zapata-owned subsidiary) was specifically intended to circumvent the supermajority voting provision. That, according to plaintiffs, constitutes an inequitable manipulation of the corporate machinery which creates an independent basis to enjoin the Merger.

> Defendants respond that the current merger structure was contemplated before the supermajority vote issue was even considered. Therefore, defendants say, there is no evidence that the transaction was structured to avoid the Supermajority Provision, or that any inequitable manipulation occurred. Because the Court finds that supermajority approval of the proposed Merger is required by the plain meaning of the Article SEVENTH, Subsection (A)(i), it does not reach the inequitable manipulation claim.

3 Specifically, a merger [Subsection (A)(i)], a sale of all or substantially all of Zapata's assets [Subsection (A)(ii)], and a sale of assets of $2 million or more to Zapata or its subsidiary in exchange for voting securities of Zapata or its subsidiary [Subsection (A)(iii)].

4 *See also, Warner Commun. v. Chris-Craft Industries, supra,* at 970 (charter provision creates protections for preferred stock "... in case of any consolidation or merger *of the corporation* with or into another corporation") (emphasis added).

5 Whether intended or not, a similar circumvention would occur here by the use of Zapata Sub to acquire Houlihan's. The Houlihan's stockholders will receive *Zapata* (not Zapata Sub) stock in the Merger -the same consideration they would receive were Houlihan's being merged directly into Zapata.

6 This case involves precisely the same "conflict of interest"-related risk that would exist if the merger were into Zapata directly. Glazer, as the holder of 73.3% of Houlihan's stock and as the holder of approximately 35% of Zapata's stock, stands to gain more from a higher purchase price (paid by Zapata) for his Houlihan's stock, than do the other Zapata stockholders.

7 The defendants contend that Article SEVENTH was intended only as an anti-takeover provision, but offer no persuasive evidence to support that assertion. Article SEVENTH, by its very language, is not limited to transactions involving a potential takeover of Zapata. For example, Subsection (A)(iii) specifically requires a supermajority vote for a sale or lease of assets, having an aggregate fair market value of $2 million or more, to a subsidiary of Zapata in exchange for stock of a subsidiary of Zapata. Such a transaction would not necessarily involve a change of control or takeover.

8 That a broad application of the Supermajority Provision to mergers was intended is further evidenced in the declaration found in the Proxy Statement that "the Board of Directors is of the opinion that where a proposed *merger or other similar transaction* involves a corporation or other business entity having a direct or indirect substantial ownership or control of the voting power of [Zapata] ... a substantially higher voting requirement is preferable." Pl.Cert.Ex. G, at 7 (emphasis added).