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Re: Oliver, et al. v. Boston University, et al.
C.A. No. 16570-NC
Submitted: January 20, 2005

Dear Counsel:

Before the Court is Defendant Boston University's ("BU") motion to amend its answer to assert an affirmative defense under Massachusetts law which, because of BU's charitable status, would limit BU's potential monetary liability to $20,000. For the reasons discussed below, I conclude that allowing BU to limit its potential liability to the shareholders of a publicly traded Delaware corporation under such a

law would directly contravene fundamental public policies of this State, and, therefore, BU's motion for leave to amend its answer is denied.

I. BACKGROUND

Nominal Defendant Seragen, Inc., before its merger with Ligand Pharmaceuticals, was a Delaware corporation in the business of developing, manufacturing, and marketing various biotechnology products. BU, a Massachusetts not-for-profit corporation, owned or controlled more than 50% of the outstanding stock of Seragen. BU used this power to appoint its designees to the Seragen Board of Directors. The Plaintiffs allege that these designees, at the behest of BU, caused Seragen to participate in various transactions that benefited BU and various BU affiliates, while at the same time harming Seragen common stockholders. Specifically, the Plaintiffs allege that the issuance of the Series B and Series C preferred shares[1] and the negotiation of the Merger and Accord Agreements violated the directors' fiduciary duty of loyalty.[2]

Shortly before trial, BU now seeks to amend its answer in order to assert an affirmative defense under Massachusetts General Law ch. 231, § 85K (the

[1] BU received a portion of the Series B shares and the entirety of the Series C shares.
[2] For a more complete recitation of the Plaintiffs' allegations, see *Oliver v. Boston Univ.*, 2002 WL 385553 (Del. Ch.); *Oliver v. Boston Univ.*, 2000 WL 1038197 (Del. Ch.).

"Statute") which provides generally that damages arising from tort claims asserted against a charitable institution are capped at $20,000.[3] Plaintiffs have opposed the motion to amend.

II. STANDARD OF REVIEW

Court of Chancery Rule 15(a), which governs efforts to amend the pleadings, teaches that leave to amend should be "freely given when justice so requires."[4] This decision, however, is a matter for the discretion of the trial judge.[5] In exercising this discretion, the motion to amend must be denied if the defendant's amendment does not raise a cognizable defense and is therefore futile.[6] Whether a proposed amendment would be futile is measured under a standard akin to that employed in evaluating a motion to dismiss under Court of Chancery Rule 12(b)(6).[7]

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[3] For convenience, BU's assertion of a limited statutory immunity is treated as an affirmative defense. It would be more accurate to view it as "a matter constituting an avoidance." *See* Ct. Ch. R. 8(c).
[4] Ct. Ch. R. 15(a).
[5] *See Bokat v. Getty Oil Co.*, 262 A.2d 246, 251 (Del. 1970).
[6] *See FS Parallel Fund L.P. v. Ergen*, 2004 WL 3048751, at *2 (Del. Ch.); *Moore Bus. Forms, Inc., v. Cordant Holdings*, 1995 WL 707877, at *2 (Del. Ch.).
[7] *Nufarm GmbH & Co. v. RAM Research, Inc.*, 1998 WL 668648, at *3 (Del. Ch.). A motion to dismiss under Court of Chancery Rule 12(b)(6) may be granted "if it appears with reasonable certainty that the plaintiff could not prevail on any set of facts that can be inferred from the pleading. . . . All well-pleaded factual allegations and inferences that can be drawn therefrom are accepted as true." *Jacobson v. Ronsdorf*, 2005 WL 29881, at *4 (Del. Ch.).

III. CONTENTIONS

BU asserts that it should be permitted to amend its answer because it will result in no prejudice to the Plaintiffs, who do not question that BU is a charitable organization, and because consideration of this defense will not burden the trial. The Plaintiffs, on the other hand, oppose the motion on the grounds that the effort is both futile and untimely. They argue that the proposed amendment is futile because BU was not pursuing its charitable functions by investing in, and exercising control over, Seragen; because breaches of fiduciary duty are not torts; because Delaware law should apply to matters involving the governance of Delaware corporations; and because the Massachusetts damages cap, in this context, is against the public policy of Delaware.

IV. ANALYSIS

The Statute provides, in pertinent part, as follows:

> It shall not constitute a defense to any cause of action based on tort brought against a corporation . . . that said corporation . . . is or at the time the cause of action arose was a charity; provided, that if the tort was committed in the course of any activity carried on to accomplish directly the charitable purposes of such corporation . . . , liability in such cause of action shall not exceed the sum of twenty thousand dollars, exclusive of interest and costs. Notwithstanding any other provision of this section, the liability of charitable corporations . . . shall not be subject to the limitations set forth in this section if the tort

> was committed in the course of activities primarily commercial in character even though carried on to obtain revenue to be used for charitable purposes.

According to BU, the effect of the Statute would be to limit BU's potential liability to Seragen's shareholders to a maximum of $20,000.

A. *Timeliness*

BU filed its motion to amend on January 12, 2005, less than four weeks before the first day of trial, which is scheduled for February 7, 2005. Motions to amend filed on the proverbial eve of trial are not favored, and tardiness in the filing of such a motion may justify its denial.[8] BU does not claim that its application resulted from the discovery of previously unknown facts or law. Indeed, BU has

[8] *See In re Nantucket Island Assocs., L.P. Stockholders Litig.*, 2002 WL 31926614 (Del. Ch.). Because Court of Chancery Rule 8(c) anticipates that defenses in the nature of avoidance will be asserted in a timely fashion (*i.e.*, with a defendant's response to the complaint), it is also proper to measure BU's dilatory conduct in terms of waiver. *See, e.g., Connelongo v. Fidelity Am. Small Bus. Invest. Co.*, 540 A.2d 435, 440 (Del. 1988).

> The reason for Rule 8(c) is to put the plaintiff on notice, well before trial, that the defendant intends to pursue a defense in the nature of an avoidance. . . . If the defendant raises the issue at a pragmatically sufficient time and the plaintiff is not prejudiced in her ability to respond, there is no waiver. . . . Whether a defendant has waived an affirmative defense by failing to assert it timely is a matter left to the discretion of this Court.

Fletcher v. Ratcliffe, 1996 WL 527207 (Del. Super.) (citations omitted); *see also Ratcliffe v. Fletcher*, 690 A.2d 466 (Del. 1996) (TABLE), 1996 WL 773003 (Del. 1996). Accordingly, in light of the limited impact that allowing the amendment would have on the Plaintiffs or the trial and in the spirit that cases should be resolved on their merits, a finding of waiver would be unwarranted in the circumstances.

asserted the Statute as a defense in other proceedings.[9] BU, however, is correct in its contention that allowing the amendment would cause no prejudice to the Plaintiffs and that the impact on trial would be negligible. Because the standard governing motions to amend is a liberal one, the Court, in the exercise of its discretion, cannot fairly conclude that this motion comes too late.

B. *Applicability of the Statute to Fiduciary Duty Claims*

The Plaintiffs point out that the Statute only limits liability for torts. They argue that breaches of fiduciary duty are not torts. BU contends, first, that Plaintiffs claims are not based in contract or statute—thus, they must sound in tort, and, second, that a tort is a breach of a duty and a fiduciary duty is yet simply another type of duty.

Chancery exercises jurisdiction over fiduciary duties involved in corporate governance because "equity, not law, is the source of the right asserted."[10] "A fiduciary relationship is a situation where one person reposes special trust in and

[9] *See Linkage Corp. v. Trustees of Boston Univ.*, 679 N.E. 2d 191 (Mass. 1997).
[10] *McMahon v. New Castle Assocs.*, 532 A.2d 601, 604 (Del. Ch. 1987). Although not always separated by a bright line, equity's "inherent jurisdiction" is distinct from its jurisdiction over claims, legal in nature, for which the remedy at law is not adequate. *See* 1 DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 2-3[b] at 2-19-20 (2004).

reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another."[11]

The question, however, is whether a breach of fiduciary duty falls within the scope of a "tort" as that word is used in the Statute. In *In re Boston Regional Medical Center, Inc.*,[12] the United States District Court for the District of Massachusetts applied the Statute to restrict the liability of a charity for breaches of fiduciary duty (and the aiding and abetting of such breaches) to the statutory limit. As the Court there noted:

> The charitable immunity cap may arguably be a poor policy when viewed solely in the context of a particular case. The [plaintiff] alleges that [the charity] essentially operated a loose affiliation of corporations and placed the future of one at great and unreasonable risk in order to protect and benefit the others. Arguably, such conduct, if proven, should be fully remediable in judicial proceedings. However, the Legislature has in § 85K waived the competing considerations and chosen to limit strictly the remedy for any such misconduct. That is a judgment concerning policy properly made by elected and democratically accountable officials which the courts must respect and enforce.[13]

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[11] *Cheese Shop Int'l, Inc. v. Steele*, 303 A.2d 689, 690 (Del. Ch. 1973), *rev'd on other grounds*, 311 A.2d 870 (Del. 1973).
[12] 328 F. Supp. 2d 130 (D. Mass. 2004).
[13] *Id.* at 155. Whether the Statute encompasses breaches of fiduciary duty, a necessity if the Statute were to be applicable, was not deemed worthy of any extended consideration.

Accordingly, this Court cannot conclude that assertion of a cap by BU would be futile based on the argument that fiduciary duty breaches do not constitute torts within the meaning of the Statute.

C. *BU's Involvement with Seragen for Charitable Purposes*

In order to qualify for protection under the Statute, the charitable defendant must demonstrate that the wrongful conduct "was committed in the course of [an] activity carried on to accomplish directly [its] charitable purposes." The Plaintiffs argue that investing in, and controlling, Seragen was not part of BU's educational or charitable mission. Seragen, however, was seeking to implement biotechnology advances achieved, in part, through research conducted at BU. Research may, of course, be reasonably perceived as part of a major university's educational mission.[14] The Plaintiffs contend that BU may not seek refuge under the Statute because its involvement in Seragen was "primarily commercial in character."

In *Conners v. Northeast Hospital Corporation*,[15] the Supreme Judicial Court of Massachusetts set forth the analytical methodology for determining whether a

[14] The Plaintiffs point out that none of BU's affiliates on Seragen's board ever caused Seragen to inform its public shareholders that BU was carrying out its charitable/educational functions through Seragen.
[15] 789 N.E. 2d 129 (Mass. 2003).

charity's activity, which gave rise to liability, was within the scope of the Statute. Clearly, a charity's effort to acquire funds to support its charitable function is, by itself, insufficient to invoke the Statute. However, as taught by *Conners*, whether BU's goals with respect to Seragen were "primarily commercial" in nature cannot be separated from the inquiry into whether the activities "accomplished directly" its charitable purposes.

> To determine whether the statutory limitation on liability applies in a given case, Conners elevates the "primarily commercial" analysis of § 85K's second sentence to a separate test, independent of the "accomplished directly" analysis set forth in the first sentence. The two considerations then noted in the statute are not independent. . . .
>
> The second sentence of § 85K ("primarily commercial") clarifies the Legislature's intent in circumstances where the questioned activity of a charity is one that generates revenue: that sentence directs the fact finder to consider, among other things, whether the activity is a money-making enterprise merely designed to keep the charity afloat, in which case the limitation does not apply, or whether the revenue is generated by an activity accomplishing the purposes of the charity. . . . If the revenue-generating activity is indeed "primarily commercial," it cannot "accomplish directly" the charitable work of the organization. Conversely, a revenue-generating activity may, and in many circumstances does, "accomplish directly" the organization's purpose.[16]

[16] *Id*. at 478-79.

Whether BU's investment in Seragen and its role in corporate governance were carried out to "accomplish directly" its proper research functions is, under the standard of Court of Chancery Rule 12(b)(6), a question that cannot be resolved here if the Court must accept the facts presented by BU and give BU the benefit of all reasonable inferences. In short, whether the revenue-generating (as hoped) activities involving Seragen conformed with BU's charitable purposes is ultimately a question of fact, one that cannot be resolved adversely to BU in the context of the pending motion to amend.

D. *Delaware's Public Policy*

Delaware's courts will refuse to enforce or to apply foreign law if that law is repugnant to the public policy of Delaware.[17] Application of the Statute to the fiduciary duty claims asserted by the Plaintiffs in this action would be against this State's public policy. Delaware has a strong public policy of ensuring the accountability of corporate fiduciaries and those who control them for any actions they may take that harm shareholders.[18] To invoke the Statute in this case to limit

[17] *See J.S. Alberici Constr. Co., Inc. v. Mid-West Conveyor Co., Inc.*, 750 A.2d 518, 521 (Del. 2000).
[18] *See, e.g.*, *Andra v. Blount*, 772 A.2d 183, 193 (Del. Ch. 2000); *Quickturn Design Systems, Inc. v. Shapiro*, 721 A.2d 1281, 1292 (Del. Ch. 1998).

BU's potential liability would effectively shield BU from the consequences of its alleged manipulation of Seragen's internal corporate governance to benefit itself and its affiliates to the disadvantage of the public shareholders.[19] If applicable, the Statute would leave the public shareholders, the parties directly harmed by BU's alleged actions, without effective recourse against this potentially responsible party. Shareholders of a publicly traded company should not be subject to the vagaries of the laws of a defendant's domicile which may operate to preclude an award of an appropriate remedy for breaches of fiduciary duties owed to them by the defendant or the defendant's affiliates. As this Court has reflected, although in a somewhat different context but within the realm of corporate governance:

> The deference Delaware law pays to the special litigation committee process is a matter of our state's substantive, not procedural, law. It is among the many important policy choices that our state has made regarding the circumstances when it is appropriate to divest the board of directors of a Delaware corporation of a portion of its statutory authority to manage the corporation's affairs, *i.e.*, its right to control litigation brought on behalf of the corporation. And these choices are properly made by the state whose law governs the corporation, because that is the law that the corporation's stockholders have chosen to govern the firm and their relationship with it. Indeed, if the internal affairs of business corporations were not governed solely by the law of their chosen domicile, and where instead

[19] The substantive law of Delaware defines the duties owed to Seragen's shareholders. BU seeks to subject the remedies otherwise available to this Court to the limited immunity afforded by the Statute.

> subjected to a myriad of inconsistent and supplemental requirements by other states, the burden on the rights of stockholders to carry out joint economic activity through the corporate form would be markedly impaired, to their detriment, and likely to the nation's.[20]

The divergence present in this case is not merely the product of different policy choices by Massachusetts and Delaware; because the Statute cuts so deeply against the important policy of protecting public shareholders from self-dealing manipulation of corporate governance practices, it is, in this special context, clearly repugnant to this important public policy of Delaware. Therefore, the Statute may not be invoked for BU's intended purpose and the proposed amendment is futile. It follows that the motion to amend must be denied.

V. CONCLUSION

For the foregoing reasons, BU's motion for leave to amend its answer is denied.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[20] *In re Oracle Corp. Deriv. Litig.*, 808 A.2d 1206, 1212-13 (Del. Ch. 2002) (footnotes omitted).