



Lillis v. AT&T Corp., C.A. No. 717-VCL (Del. Ch. July 21, 2008) (V.C. Lamb)

This decision followed a remand by the Delaware Supreme Court of an earlier Court of Chancery decision. In the Court of Chancery's earlier opinion, which followed a trial, it held that certain options granted to former officers and directors of a telecommunications company were improperly adjusted in connection with a cash merger in 2004. The cash consideration that was received in the merger by the option holders, which they later challenged under the option plan, equaled the "intrinsic value" of the options (i.e., the cash merger price minus the applicable strike price) as opposed to the full "economic value" of the options (i.e., intrinsic value plus time value). Plaintiffs' challenge to receiving only intrinsic value in the 2004 merger was based upon a provision of the option plan requiring that an option holder's options be adjusted at the time of a merger and that the holder's "economic position" would not be any worse after the merger than immediately before it as a result of the adjustment. In its prior opinion, the Court of Chancery held the phrase "economic position" to be ambiguous and, relying on extrinsic evidence, interpreted the phrase to require the preservation of the "full economic value" of each holder's options in the merger. The extrinsic evidence that the Court relied upon in reaching this conclusion was (i) a course of conduct demonstrating that other adjustments in prior transactions had preserved the full economic value of the plaintiffs' options, (ii) the fact that stock options constituted an exceptionally large percentage of the plaintiffs' compensation, and (iii) several admissions by the defendant at the initial stages of the litigation that the provision of the option plan at issue preserved the the full economic value of the options at issue. The Court indicated clearly that it relied most heavily on the defendant's admissions in reaching its original conclusion.

On appeal, the Delaware Supreme Court agreed with the Court of Chancery's decision that the term "economic position" was ambiguous. The Supreme Court, however, disagreed with the Court of Chancery's reliance upon certain extrinsic evidence and failure to consider other extrinsic evidence and remanded the case for reconsideration pursuant to its instructions. Specifically, the Supreme Court instructed the Court of Chancery (i) not to give any evidentiary weight to defendant's admissions since those admissions did not relate to the interpretation of the option plan, and (ii) to address the significance of (a) the distinction between a stock merger and a cash merger, and (b) cash/stock election provisions in a transaction completed by the defendant prior to the 2004 merger.

On remand, the Court of Chancery reached a different result than its original opinion, concluding that the option plan at issue should be construed to permit the adjustment of the options in a cash merger into the right to receive only the amount of cash paid for the underlying stock (i.e., intrinsic value). The Court attributed the different result almost entirely to the fact that it could not, pursuant to the Supreme Court's instruction, consider the defendant's admissions regarding economic value, which the Court stated was "by far the most compelling support for the plaintiffs' position." As for the Supreme Court's instruction relating to consideration of extrinsic evidence of the parties' course of conduct, the Court first considered the significance of the distinction between stock mergers and cash mergers. In its consideration of this distinction, the Court commented that stock mergers by their nature preserve the "economic position" of option holders because the underlying stock is replaced, thus incorporating the expected time value of the new options. Since this preservation occurs automatically in stock transactions, the Court recognized that it could not rely upon prior stock transactions as evidence of a course of conduct of preserving "economic position" of options pursuant to the plan. With respect to the significance of a cash/stock election option in a prior transaction, the Court held that while it did provide some support for the plaintiffs' position that this transaction was structured to preserve the time value of their options, the Court concluded that such extrinsic evidence was insufficient to overcome the interpretation of the option plan in accordance with the prevailing rule of interpreting anti-destruction provisions which is "to tie the interests of option holders to the interests of the securities into which they are exercisable." In sum, the Court held that without the ability to rely on the defendant's prior admissions, the remaining extrinsic evidence was insufficient to support plaintiff's interpretation of the option plan as requiring preservation of the full economic value of the options.

The full opinion is available [here](#).



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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

CHARLES LILLIS, GARY AMES,)	
RICHARD POST, FRANK EICHLER,)	
ROBERT CRANDALL, LOU SIMPSON,)	
PIERSON GRIEVE, RICHARD)	
MCCORMICK, JANICE PETERS,)	
PEARRE WILLIAMS, ROGER)	
CHRISTENSEN, DOUG HOLMES,)	
STEVEN BOYD, PATTI KLINGE,)	C.A. No. 717-VCL
CONNIE CAMPBELL, SHARON)	
O'LEARY, JIM TAUCHER, BUD)	
WONSIEWICZ and DANIEL)	
YOHANNES,)	
)	Del. Supr., No. 490, 2007
Plaintiffs,)	Del. Supr., No. 459, 2007
)	
v.)	
)	
AT&T CORP.,)	
)	
Defendant.)	

***REPORT TO THE DELAWARE SUPREME COURT
UPON REMAND FOR RECONSIDERATION***

**Remanded: May 22, 2008
Report Submitted: July 21, 2008**

LAMB, Vice Chancellor.

On July 20, 2007, I issued an Opinion and Order (the “Trial Opinion”) holding that certain stock options granted to former officers and directors of a telecommunications company were improperly adjusted in connection with a 2004 cash merger. The cash consideration received by the option holders equaled the intrinsic value of the options (the cash merger price minus the strike price) as opposed to the full economic value (the intrinsic value plus the time value). After finding the controlling anti-destruction provision in the stock option plan to be ambiguous, and with the assistance of extrinsic evidence, I interpreted the provision as requiring the preservation of the full economic value of the options in the merger.

In reaching this decision, I relied heavily on a series of admissions made in the course of the litigation. I also considered evidence of several stock-for-stock transactions that adjusted the options to preserve their full economic value, as well as the fact that stock options constituted an exceptionally large component of the option holders’ compensation. Significantly, the Trial Opinion recognized that its conclusion was at variance with both the general rule interpreting anti-destruction provisions as tying the value of derivative instruments to the value of the underlying security, and the attendant principle that, in a cash merger, option holders receive only the difference between the merger consideration and the exercise price of the option (the options’ intrinsic value).

On May 22, 2008, the Delaware Supreme Court issued an Opinion and Order (the “Opinion”) affirming this court’s holding concerning the ambiguity of the anti-destruction provision, but remanding the case with instructions to reconsider the extrinsic evidence, taking into account a different and more limited set of factors. Most important, the Opinion instructed this court to exclude from its consideration evidence of the principal defendant’s prior inconsistent positions.

After reconsidering the extrinsic evidence in a manner consistent with the Supreme Court’s instructions, I now conclude that the stock option plan is properly construed to permit the adjustment of options in a cash merger into the right to receive only the amount of cash paid for the underlying stock.

I.¹

A. Section XVIII.A

Following the announcement of the 2004 Cingular/AT&T Wireless Services merger, the plaintiffs (who held AT&T Wireless options) brought suit seeking the full economic value of their in-the-money and out-of-the-money options under Section XVIII.A of the relevant stock option plan.² In its review of the Trial

¹ The facts discussed in this opinion pertain to the issues relevant on remand. See the Trial Opinion for a complete discussion of the parties and the factual background of this dispute. See *Lillis v. AT&T Corp.*, 2007 WL 2110587 (Del. Ch. July 20, 2007).

² The stock options underlying this dispute were issued under a 1994 MediaOne stock option plan (the “1994 Plan”). The relevant provision in that agreement is Section XVIII.A, which reads: “In the event there is any change in the Common Stock by reason of any consolidation, combination, liquidation, reorganization, recapitalization, stock dividend, stock split, split-up, split-off, spin-off, combination of shares, exchange of shares or other like change in capital

Opinion’s finding that Section XVIII.A is ambiguous, the Supreme Court considered the competing interpretations of the parties.³ The Supreme Court framed the relevant inquiry as follows: “what exactly was plaintiffs-appellees’ ‘economic position’ in the face of an impending cash out merger?”⁴

The Supreme Court reasoned, in considering the plaintiffs’ interpretation, that since “a stock option’s worth can increase substantially over time. It therefore is logical that the ‘economic position’ of the stock option *might* include time value.”⁵ Turning to the defendants’ interpretation, the Court stated:

On the other hand, at the point of time ‘immediately prior’ to a cash out merger, the ‘economic position’ of the stock options retains no time value because the options will be immediately exchanged for the right to receive a cash sum. In light of the impending cash out merger, there is no prospect that the option will ever be worth anything more than that exact cash sum. Thus, ‘economic position’ of the stock option might relate only to the cash sum for which the option will be exchanged.⁶

Finding both of these interpretations to be reasonable, the Supreme Court affirmed this court’s finding that the term “economic position” is ambiguous.

structure . . . the number or kind of shares or interests subject to an Award and the per share price or value thereof shall be appropriately adjusted by the Committee at the time of such event, provided that each Participant’s economic position with respect to the Award shall not, as a result of such adjustment, be worse than it had been immediately prior to such event.” Defs.’ Opening Br. Ex. A. at 14.

³ *AT&T Corp. v. Lillis*, No. 490, 459, 2007, Mem. Op. 23-24 (Del. May 22, 2008) (hereinafter “Mem. Op.”).

⁴ Mem. Op. 25.

⁵ *Id.* (emphasis in original).

⁶ *Id.* at 25-26.

B. The Supreme Court's Instructions

The Trial Opinion, after finding Section XVIII.A to be ambiguous, interpreted the term “economic position” to preserve the full economic value of the plaintiffs’ options. This conclusion was based primarily on the following extrinsic evidence: (1) other adjustments preserved the full economic value of the plaintiffs’ options, (2) stock options constituted an exceptionally large percentage of the plaintiffs’ compensation at MediaOne, and, most important, (3) AT&T made several admissions in the initial stages of the litigation that Section XVIII.A preserved the full economic value of the options issued under the 1994 Plan.⁷

The Supreme Court took exception with certain aspects of this analysis and remanded this matter with instructions. First, the Supreme Court found that this court “should not have given any evidentiary weight to AT&T’s supposed admissions because those supposed admissions did not relate to the interpretation of the 1994 plan.”⁸ Second, the Supreme Court directed that this court:

address fully the significance of (i) the distinction between a stock merger and a cash out merger; and, (ii) the \$85 cash election in the AT&T-MediaOne transaction, in deciding what the contracting parties intended by their use of the term ‘economic position.’⁹

The Supreme Court’s first instruction directs me to exclude the AT&T

⁷ This court also noted that the plaintiffs’ testimony and the testimony of MediaOne’s in-house counsel, but, as will be discussed, this was of minimal evidentiary weight.

⁸ *Id.* at 26.

⁹ *Id.* at 8.

admissions cited in the Trial Opinion in interpreting Section XVIII.A. The Supreme Court found that the AT&T admissions did not refer to the 1994 Plan, but to two separate agreements, namely the Employee Benefits Agreement and the Wireless Adjustment Plan, created in connection with AT&T's split-off of Wireless. As a result, this court is to "afford no weight to AT&T's supposed admissions when interpreting Section XVIII.A" ¹⁰

With respect to the second instruction, the Supreme Court noted that the Trial Opinion "spent no time discussing the fact that" each of the transaction cited were stock-for-stock transactions and not cash outs like the Cingular-Wireless merger.¹¹ The Supreme Court also questioned why this court did not consider the cash election in the AT&T-MediaOne merger in the analysis of extrinsic evidence. Finding the cash election in the AT&T-MediaOne merger to be "the only earlier transaction that included a cash component," the Supreme Court stated it "is the only transaction similar to" the Cingular-Wireless cash out merger.¹² Therefore, the Supreme Court directed me "to reconsider the evidentiary importance of the parties' course of conduct in the MediaOne-AT&T transaction."¹³

II.

¹⁰ *Id.* at 33.

¹¹ *Id.* at 27.

¹² *Id.* at 28

¹³ *Id.* at 29.

On remand, the parties submitted briefs, and I heard argument on June 26, 2008. The plaintiffs vigorously contest the Supreme Court’s ruling precluding AT&T’s admissions. According to the plaintiffs, this finding “overlooks dozens of admissions in AT&T’s original 2004 Answer, its 2005 brief, and its representations to this [c]ourt, on the record and in correspondence, reflecting that its admissions were based on the 1994 Plan” and not some other plan.¹⁴ On June 6, 2008, the plaintiffs filed a motion for reargument in the Supreme Court advancing the same argument, but on June 16 that the motion was “stricken pursuant to Supreme Court Rules 18 and 34.”¹⁵ Despite the Supreme Court’s clear mandate, the plaintiffs insist that they are “free to revisit the Supreme Court’s factual misconception of AT&T’s admissions and the remand provides an opportunity for this [c]ourt to address the issue.”¹⁶ Alternatively, the plaintiffs contend that the Supreme Court’s decision is not a final order, which permits reexamination of this issue.¹⁷

The plaintiffs also argue that the Supreme Courts’ instruction concerning the distinction between a cash merger and a stock-for-stock merger should not alter this court’s interpretation of Section XVIII.A. They contend that since Section

¹⁴ Pls.’ Opening Br. 2.

¹⁵ Pls.’ Reply Br. Ex. U (emphasis omitted).

¹⁶ Pls.’ Reply at 25.

¹⁷ According to the plaintiffs, “[t]he Clerk of the Court informed plaintiffs’ counsel that Rule 18 applies only to final orders and, because the Supreme court retained jurisdiction over the appeal, the [Supreme Court’s opinion] is subject to review and is not final.” *Id.*, *see id.* Ex. V.

XVIII.A is a unique contractual provision, this court’s analysis is controlled by its terms that preserve the full economic value of the plaintiffs’ options regardless of the structure of a transaction. Indeed, they urge, “[t]he adjustment mandated by [Section XVIII.A] applies regardless of whether a merger involves cash, stock or a combination of both.”¹⁸

With respect to the cash election in the AT&T-MediaOne merger, the plaintiffs further assert that it is not comparable to the Cingular-Wireless merger and, therefore, cannot support the defendants’ interpretation. According to the plaintiffs, in contrast to the Cingular-Wireless merger, the AT&T-MediaOne merger agreement established an alternative for option holders to preserve the full economic value of their options. Conversely, the Cingular-Wireless merger agreement required the conversion of all options into cash, limiting options to their intrinsic value. In addition, say the plaintiffs, the cash election is dissimilar from the Cingular-Wireless merger because it represented far more than any calculation of full economic value of the plaintiffs’ options. They seek to minimize the evidentiary weight of the cash election by arguing as follows:

Because the elections were made immediately prior to the merger, and because the values of the consideration available under the elections were fluctuating and subject to proration, the existence of the cash election does not, as the Supreme Court suggests, reflect an intent to

¹⁸ Pls.’ Opening Br. 9.

provide only intrinsic value to option holders in a cash merger.¹⁹

More forcefully, the plaintiffs dismiss the significance of the cash election as post hoc maneuvering on the part of the defendants. The plaintiffs assert that “MediaOne’s negotiations to insure that all employees retained” the right to the stock election is persuasive evidence of the parties’ intent to preserve the full economic value of the plaintiffs’ options.²⁰

Unsurprisingly, the defendants whole-heartedly agree with the Supreme Court’s ruling concerning the admissions. According to the defendants, this court is barred from reexamining this issue based on the doctrine of the law of the case because it was squarely addressed on appeal. The defendants argue that the distinction between cash mergers and stock-for-stock mergers is informative because of the general rule, noted in the Trial Opinion, that derivative instruments are tied to the underlying security. According to this general rule, the defendants argue that all options are converted into the cash out merger price because the underlying security is converted into cash.

Finally, the defendants contend that the cash election in the AT&T-MediaOne merger is highly probative because even though option holders were permitted to convert different options under different elections, “each of the

¹⁹ *Id.* at 5-6.

²⁰ *Id.* at 6.

elections had to comply with Section XVIII.A.”²¹ Thus, according to AT&T, the cash election in the MediaOne merger makes clear that the term “economic position” means intrinsic value. Otherwise, option holders selecting the cash election would have been granted additional consideration for the future value of their options.

III.

As the party seeking judicial enforcement of their interpretation of an ambiguous contract, the plaintiffs bear the burden of proof in this action.²² This court will evaluate the extrinsic evidence “with respect to the existence of a disputed contractual right under the preponderance of the evidence standard”²³

IV.

A. The AT&T Admissions

This court first turns to the Supreme Court’s instructions concerning the AT&T admissions relied on in the Trial Opinion. As the defendants note, “[t]he law is well established that when an appellate court remands a case for further proceedings, ‘the trial court must proceed in accordance with the mandate and the

²¹ Defs.’ Reply Br. 21.

²² See *Bell Atl. Meridian Sys. v. Octel Commc’ns Corp.*, 1995 WL 707916, at *6 (Del. Ch. Nov. 28, 1995).

²³ *Concord Steel, Inc. v. Wilmington Steel Processing Co., Inc.*, 2008 WL 902406, at *4 (Apr. 3, 2008).

law of the case as established on appeal.”²⁴ This doctrine requires this court to “implement both the letter and the spirit of the mandate, taking into account the appellate court’s opinion and the circumstances it embraces.”²⁵

This doctrine, however, has several exceptions that permit “reconsideration of a prior decision that is clearly wrong, produces an injustice or should be revisited because of changed circumstances.”²⁶ The plaintiffs rely on the first exception, asserting that further examination of AT&T’s admissions is warranted because the Supreme Court overlooked facts in the record and clearly erred.²⁷ The plaintiffs primarily challenge the Supreme Court’s review of AT&T’s December 8, 2004 answer and assert that the Court improperly limited its review to a single paragraph. According to the plaintiffs, other statements in the answer confirm that AT&T’s admissions referred to the 1994 Plan not the Employee Benefits Agreement or the Wireless Adjustment Plan.

While the Supreme Court did specifically reference only one paragraph in its discussion, it also generally found that AT&T’s answer never admitted “that Section XVIII.A preserved the time value of plaintiffs-appellees’ options.”²⁸ This broad language suggests that the Supreme Court reviewed all of AT&T’s answer in

²⁴ *Insurance Corp. Of America v. Barker*, 628 A.2d 38, 40 (Del. 1993) (quoting *Bankers Trust Co. v. Bethlehem Steel Corp.*, 761 F.2d 943, 949 (3d Cir. 1985)).

²⁵ *Barker*, 628 A.2d at 40 (quoting *Bankers Trust*, 761 F.2d at 949).

²⁶ *Hamilton v. State*, 831 A.2d 881, 887 (Del. 2003).

²⁷ Pls.’ Reply Br. 26 (quoting *Hamilton*, 831 A.2d at 887).

²⁸ Mem. Op. 31.

making its ruling. Therefore, in order to comply with the Supreme Court’s mandate, this court must ignore AT&T’s admissions in the analysis of the extrinsic evidence.²⁹ The implications of this conclusion to the plaintiffs’ case are severe. As the Supreme Court noted, “great weight” was placed on these admissions in the Trial Opinion. Indeed, this extrinsic evidence was by far the most compelling support for the plaintiffs’ position.

B. The Parties’ Course Of Conduct

_____As previously noted, in its second instruction, the Supreme Court directed this court to fully address “the significance of . . . the distinction between a stock merger and a cash out merger; and . . . the \$85 cash election in the AT&T-MediaOne transaction, in deciding what the contracting parties intended by their use of the term ‘economic position.’”³⁰

1. Cash Mergers vs. Stock-For-Stock Mergers

_____In the Trial Opinion, this court discerned “some understanding of the meaning of the phrase ‘economic position’” from other adjustments made under

²⁹ Alternatively, the plaintiffs assert that “because the Supreme Court remanded and the Opinion did not constitute a final order, this [c]ourt may determine that there is no ‘law of the case’ to which it must adhere.” Pls.’ Reply Br. 26. While the Supreme Court’s opinion was not a final ruling on the proper interpretation of Section XVIII.A, there is no equivocation in the Supreme Court’s instruction to not consider AT&T’s admissions. The plaintiffs will be free to raise these issues on appeal anew once this opinion is filed in the Supreme Court.

³⁰ Mem. Op. 8.

the 1994 Plan.³¹ The transactions cited were stock-for-stock transactions.³² Given the dissimilar characteristics of cash mergers, the Supreme Court concluded the stock-for-stock transactions “did not necessarily evidence what the parties intended to occur in a cash out merger,”³³ reasoning:

In the case of a stock for stock merger, option holders expect to have their old options replaced with new options because the old (underlying) stock is being replaced with new (underlying) stock. In such a transaction, by its very nature, the “economic position” of the options will invariably incorporate the expected time value of the new options.

But where the stock and the options are to be cashed out in a merger, the option holders can have no expectation of receiving replacement options in new stock. Instead, option holders will, and expect to, receive only cash representing intrinsic value for their options.³⁴

As evidenced from the “some understanding” language prefacing the analysis of the stock-for-stock transactions, this court did not afford considerable evidentiary weight to these transactions. The Supreme Court’s discussion illustrates the inherent problem in relying on these transactions in the context of a cash merger.

While these transactions “preserve[d] both the time value and intrinsic value of the

³¹ *Lillis*, 2007 WL 2110587, at *16.

³² Included in the discussion was the AT&T-MediaOne merger where “AT&T exchanged the MediaOne options for new options in AT&T.” *Id.* at *16. While the three elections in that transactions were recognized, for purposes of the analysis the court focused “on the adjustment calculated for those persons who elected to receive adjusted AT&T options.” *Id.* n.86.

³³ Mem Op. 27.

³⁴ *Id.* at 27-28.

options” by replacing them with new options, this adjustment was automatic and not done in deliberate recognition of Section XVIII.A.³⁵ Since a pure cash merger was never proposed in these transactions, they provide little evidence concerning the parties’ intended meaning of the term “economic position.” Therefore, no significant weight will be ascribed to the adjustments in these transactions in this analysis of the extrinsic evidence.

2. The Cash Election

According to the Supreme Court, “[t]he question presented in this case is whether, in order to protect option holders’ ‘economic position,’ the option holders must receive additional compensation where they receive cash and not stock.”³⁶ In order to discern the intent of the parties and answer this question, the Supreme Court directed a review of what it viewed as the most comparable transaction, the cash election in the AT&T-MediaOne merger.

On May 6, 1999, AT&T and MediaOne entered into a merger agreement. The agreement provided MediaOne stockholders and option holders with three choices to convert their MediaOne shares and options. Specifically, stockholders and option holders “could elect to receive (1) cash, (2) new stock or (in the case of option holders) new options, or (3) a combination of both cash and stock (or

³⁵ *Lillis*, 2007 WL 2110587, at *17.

³⁶ Mem. Op. 28.

options).”³⁷ Significantly, option holders were not required to convert all their options under one election. For example, an option holder could elect to receive cash for her in-the-money options and new options for her out-of-the-money options.³⁸

The defendants contend that since the cash election constituted an “adjustment” under Section XVIII.A, it independently must have complied with Section XVIII.A. Therefore, according to the defendants, “the payment of intrinsic value satisfied Section XVIII.A in transactions in which shareholders received only cash,” making the cash payment in the Cingular-Wireless merger permissible.³⁹

The plaintiffs, however, contend that the cash election was merely an alternative offered to option holders for the “convenience of exercising in-the-money options for cash, something they were free to do regardless of whether there was a merger, so long as the options were vested.”⁴⁰ According to the plaintiffs,

³⁷ *Id.*

³⁸ The Supreme Court noted that, on appeal, the plaintiffs claimed that “no option holder took the cash election” and that the record was “silent on that issue.” *Id.* at 9 n.5. Due to a sharp decrease in AT&T stock following the execution of the merger agreement, the all cash option was by far the most attractive alternative at the time the MediaOne security holders made the election. As a result, the cash election was oversubscribed “and all option holders making the cash election received cash and an option to acquire AT&T stock in adjusted amounts similar to the consideration issued under” the equity and cash election. Pls.’ Opening Br. 5. In other words, the MediaOne stockholders and option holders “overwhelmingly chose the all cash election, causing it to be oversubscribed and triggering the proration provisions of the merger agreement.” Defs.’ Reply Br. 22.

³⁹ Defs. Opening Br.24-25.

⁴⁰ Pls.’ Opening Br. 6.

the AT&T-MediaOne merger complied with Section XVIII.A only because the stock election permitted option holders to preserve the full economic value of their options.

I find the defendants' argument completely unpersuasive. There is nothing in the record to suggest that the cash election (option (1) above) was required to independently comply with Section XVIII.A. Rather, the cash election was simply one of three choices provided for security holders who preferred to convert all or a portion of their shares or options into cash. As the defendants note, "each of the three elections represented a different mix of risks and potential rewards"⁴¹ For purposes of construing the adjustment requirement of Section XVIII.A, it is sensible to view the three options together. In addition, once a decision is made to offer a cash election to stockholders, it only makes sense that the same election is made available for the convenience of option holders who could, in any case, exercise vested in-the-money options in order to choose the cash election. Finally, I note that at the effective time of the Media One-AT&T merger, the cash election represented such a significant premium to the AT&T stock price that it likely constituted more than full economic value and was greatly oversubscribed.⁴²

⁴¹ Defs.' Opening Br. 24.

⁴² The Supreme Court stated "[t]he record before us does not reflect whether any option holders sought cash that reflected both \$85 intrinsic value plus a time value component of \$X or even inquired if such an alternative was available." Mem. Op. 19 n.20. In response, the plaintiffs state "[t]he cash election was not available by the time of the close and AT&T presented no

C. The Plaintiffs Failed To Carry Their Burden

Courts may consider several different types of extrinsic evidence, including “overt statements and acts of the parties, the business context, prior dealings between the parties, [and] business custom and usage in the industry.”⁴³ The purpose of this inquiry is to discern the objectively reasonable meaning of the contract such “that an ‘objectively reasonable party in the position of either bargainer would have understood the nature of the contractual rights and duties to be.’”⁴⁴ Significantly, “[t]he intent of the parties is paramount in determining the meaning of an ambiguous contract.”⁴⁵

The Supreme Court’s instructions drastically change the landscape of the extrinsic evidence I can now consider. This court cannot consider the AT&T admissions and, as identified by the Supreme Court, the stock-for-stock transactions are unconvincing in the context of a cash merger. The only persuasive piece of extrinsic evidence put forward by the plaintiffs on remand is their conduct in connection with the AT&T-MediaOne merger. In response to AT&T’s offer to

evidence on the cash election.” Pls.’ Opening Br. 21 n.28. This fails to address the Supreme Court’s inquiry, even though the cash election was oversubscribed there could still be evidence concerning this issue.

⁴³ *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 834 (Del. Ch. 2007) (quoting *Supremex Trading Co. v. Strategic Solutions Group Inc.*, 1998 WL 229530, at *3 (Del. Ch. May 1, 1998)).

⁴⁴ *United Rentals*, 937 A.2d at 824 (citing *U.S. West, Inc. v. Time Warner, Inc.*, 1996 WL 307445, at *10 (Del. Ch. June 6, 1996)).

⁴⁵ *Lillis*, 2007 WL 2110587, at *17 (citing *Northwestern Nat’l Ins. Co. v. Esmark, Inc.*, 672 A.2d 41, 43 (Del. 1996)).

cash out the MediaOne options, the plaintiffs secured the stock election as a mechanism to preserve the full economic value of their options. The plaintiffs testified that this was necessary to comply with Section XVIII.A and, thus, demonstrates that a cash merger that pays option holders only the intrinsic value for their options violates Section XVIII.A. According to the plaintiffs, “AT&T’s acquiescence to MediaOne’s position speaks directly to the parties’ intent to preserve the time value of the adjusted options for the duration of their grant term.”⁴⁶

This history provides some support for the plaintiffs’ interpretation of Section XVIII.A because in connection with a potential cash out of their options they procured a means of preserving full economic value. In addition, the plaintiffs negotiated to preserve the full 10-year life of their options and secured AT&T’s agreement for the 1994 Plan to continue to control the roll-over options. However, the plaintiffs had obvious financial interest in preserving the full economic value of their options, regardless of any purported constraints under Section XVIII.A. In other words, the plaintiffs clearly intended to preserve the time value of their options in the AT&T-MediaOne merge, as in the Cingular-Wireless merger, but it is less clear that Section XVIII.A required that result.

In addition, this evidence must be weighed against the primary

⁴⁶ Pls.’ Opening Br. 30.

countervailing evidence adduced in the Trial Opinion, recognizing the general rule concerning anti-destruction provisions and the normal corollary effect of a cash merger on stock options. More specifically, “anti-destruction provisions like [Section] XVIII.A . . . are interpreted to tie the interests of option holders to the interests of the holders of the securities into which they are exercisable.”⁴⁷ In addition, the Trial Opinion notes:

it is generally the case that, when a corporation enters into a cash merger, in which all of its common stock is converted into the right to receive only a fixed amount of cash, option plans permit the adjustment of options into the right to receive the difference between the merger consideration and the exercise price of the option. Where that is the case, underwater options are cancelled for no consideration.⁴⁸

This general rule must continue to play a role in construing the meaning of Section XVIII.A.

Moreover, the first provision in the 1994 Plan recites that the purpose of the agreement is to align the financial interests of MediaOne’s employees, executive

⁴⁷ *Id.* at *12 (citing *Continental Airlines Corp. v. Am. Gen. Corp.*, 575 A.2d 1160, 1162 (Del. 1990) (“American General was found to be entitled to the same options granted to the Continental employee-stockholders in the merger We agree and, accordingly, affirm.”); *Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1352 (Del. 1985) (“‘Anti-destruction’ clauses generally ensure holders of certain securities of the protection of their right of conversion in the event of a merger by giving them the right to convert their securities into whatever securities are to replace the stock of the company.”); *Wood v. Coastal States Gas Corp.*, 401 A.2d 932, 939 (Del. 1979) (Anti-destruction clauses may be triggered by “events that will not merely dilute the conversion privilege by altering the number of shares of common but, rather, may destroy the conversion privilege by eliminating the stock into which a [security] is convertible.”); *Aspen Advisors LLC v. United Artist Theatre Co.*, 843 A.2d 697, 706 (Del. Ch. 2004) (finding a change in structure of the company “left the plaintiffs in the same position as they were in before”).

⁴⁸ *Lillis*, 2007 WL 2110587, at *12.

officers, and non-employee directors “with the stockholders of the Company.”⁴⁹

Recitals such as this are useful for discerning the intent of the parties in an ambiguous contract. Indeed, the Delaware Supreme Court has previously noted that “[t]he obvious source for gaining contractual intent is the recitals found at the beginning of the [a]greement because it is there that the parties expressed their purposes for executing the [a]greement.”⁵⁰ This supports interpreting Section XVIII.A in a manner consistent with the general rule.

The remaining extrinsic evidence is insufficient to overcome the general rule concerning anti-destruction provisions. The plaintiffs note that the Trial Opinion concludes that stock options “were a significant component of [the] plaintiffs’ compensation and this fact made it more likely that the 1994 Plan was intended to be protective of option holders.”⁵¹ In addition, the plaintiffs state that “[t]he Supreme Court did not disturb this finding, nor its weight, despite AT&T’s argument that it was irrelevant.”⁵² The Trial Opinion did identify that MediaOne

⁴⁹ Defs.’ Opening Br. Ex. A at 1.

⁵⁰ *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 822-23 (Del. 1992). The plaintiffs contend that the defendants improperly raised this argument because they did not mention it until their post-trial brief. However, this court is charged with construing the meaning of an ambiguous contract and reviewing the recitals at the beginning of the document is a useful means of interpretation. Thus, despite the plaintiffs’ objection, the court is not prohibited from employing it in this case. As this court previously noted in the Trial Opinion, the language of the 1994 Plan “must be construed in accordance with normal rules of contract interpretation.” *Lillis*, 2007 WL 2110587, at *12.

⁵¹ Pls.’ Opening Br. 35.

⁵² *Id.*

executives received a large portion of their compensation in stock options. However, it expressly states that “these facts alone do not require any particular construction” of Section XVIII.A and only made “it more likely that the terms of the 1994 Plan and the related agreements were designed to be more than usually protective of the economic interests of the option holders.”⁵³ As in the Trial Opinion, these facts continue to hold only minor evidentiary value.

Similarly, to support their interpretation the plaintiffs rely on their own testimony and the testimony of MediaOne’s in house counsel. That testimony “universally supported the conclusion that the 1994 Plan was intended to preserve the full economic value of the plaintiffs’ options in a transaction such as the Cingular-Wireless merger.”⁵⁴ While this evidence does factor into the analysis, it is not persuasive evidence, given these parties’ self-interest in the conclusion that Section XVIII.A preserves the full economic value of their options.

V.

In sum, the existence of the stock election in the AT&T-MediaOne merger and the other evidence just discussed when considered as a whole do not support a finding in favor of the plaintiffs. This court’s conclusion in the Trial Opinion concerning the interpretation of Section XVIII.A hinged primarily on AT&T’s

⁵³ *Lillis*, 2007 WL 2110587, at *17.

⁵⁴ *Id.*

admissions. Without that evidence, the plaintiffs have failed to demonstrate that, in the case of the all cash Cingular/Wireless merger, Section XVIII.A required an adjustment to preserve both the intrinsic value and the time value of their options.⁵⁵

⁵⁵ The Supreme Court stated in its opinion that:

The Vice Chancellor's Opinion does not expressly interpret Section XVIII.A of the 1994 Agreement to mandate that, in any future cash out merger, plaintiffs-appellees and other option holders in their class must be offered alternatives that would preserve the time value of their to-be-cashed-out options, namely: (i) options in the merged entity or an incremental increase in the cash-out price that specifically incorporates the time value of the options. If that is the interpretation that drove the analysis in the Opinion, it is not apparent from the text of the Opinion. For that reason (and others), we have decided to remand the case to clarify whether or not this interpretation was intended, and if so, its application to the specific transaction at issue here.

Lillis, Mem. Op. 18 n.19. The conclusion herein obviates a need to address this issue.