Correction on page 10.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

RGC INTERNATIONAL INVESTORS, LDC Plaintiff, v. GREKA ENERGY CORPORATION, SABA PETROLEUM COMPANY f/k/a HVI ACQUISITION CORPORATION, RANDEEP S. GREWAL, WILLIAM N. HAGLER, DR. CHARLES A. KOHLHAAS, ALEX S. CATHCART AND DR. JAN F. HOLTROP, Defendants.	) Civil Action No. 17674

MEMORANDUM OPINION

Date Submitted: February 27, 2001
Date Decided: March 7, 2001
Date Corrected: March 13, 2001

Martin S. Lessner, C. Barr Flinn, and John J. Paschetto, Esquires, of YOUNG CONAWAY STARGATT & TAYLOR, Wilmington, Delaware; OF COUNSEL: Michael R. Klein, Robert F. Hoyt, and Christopher A. Wilber, Esquires, of WILMER, CUTLER & PICKERING, Washington, D.C., Attorneys for Plaintiff.

Edward P. Welch, Lorin M. Hochman, Andrew J. Turezyn, and Rosemary S. Goodier, Esquires, of SKADDEN, ARPS, SLATE, MEAGHER & FLOM, Wilmington, Delaware; OF COUNSEL: Marco E. Schnabl, William J. Hine, and William J. O'Brien and Mark Lebovitch, Esquires, of SKADDEN, ARPS, SLATE, MEAGHER & FLOM, New York, New York; Attorneys for Defendants Greka Energy Corporation, Saba Petroleum Company, Randeep S. Grewal, William N. Hagler, Alex S. Cathcart and Dr. Jan F. Holtrop.

Dr. Charles A. Kohlhaas, *Pro Se* Defendant.

STRINE, Vice Chancellor

Plaintiff RGC International Investors, LDC ("RGC") moves to dismiss counterclaims asserted by defendants Greka Energy Corporation and Saba Petroleum Company.[1] The counterclaims all have as their foundation the allegation that RGC engaged in a purposeful plan to drive down the market price of Saba's identically named predecessor corporation, "Old Saba," through a pattern of short sales transactions. RGC is alleged to have been motivated by its ownership of Series A Preferred Stock of Old Saba, preferred stock that could be converted into Old Saba common stock at market price. Thus, RGC supposedly drove down the price of the Old Saba shares, thereby reaping unfair profits because RGC could allegedly cover its short sales without substantial economic risk through the increased number of Old Saba shares RGC could obtain by converting its Series A Preferred because of the decline in Old Saba's trading price. This alleged conduct supposedly violated RGC's contractual obligation not to engage in market manipulation that would decrease Old Saba's stock price.

RGC moves to dismiss the counterclaims for many reasons. In particular, RGC points out that defendant Greka purchased Old Saba in a

---

[1] For ease of reference, I typically refer solely to Greka when I am referring to the party opposing RGC's motion. My references in phrases such as "Greka argues . . . " also refer to Saba, which Greka controls and with which Greka is in total alignment in this litigation.

merger. In that merger, Old Saba became defendant Saba, and is now a wholly-owned Greka subsidiary.

In connection with the merger, Greka and Saba entered into a Term Sheet with RGC. That Term Sheet required the parties to negotiate in good faith to consummate the payment of a Greka note in exchange for RGC's Series A Preferred. At the time Greka and Saba agreed to the Term Sheet, they knew that RGC had engaged in substantial short sales of Old Saba stock.

In a previous opinion in this case, the court granted a motion by Greka and Saba to dismiss all claims of RGC that were based on the contractual and other rights RGC possessed before the merger. RGC asserts that the counterclaims Greka and Saba now assert are barred by law of the case, because they all have their origin in RGC's pre-Term Sheet contract with Old Saba. Because Greka and Saba convinced the court that this prior contract could not be relied upon by RGC as a basis for recovery, RGC asserts that law of the case necessarily precludes Greka and Saba from now using that prior contract as the basis for its own counterclaims. The court agrees with this argument and will grant RGC's motion to dismiss.

Although Greka and Saba attempt to plead their counterclaims as arising in equity, and not under the prior contract, their own arguments hinge

the validity of the counterclaims on RGC's obligations under the prior contract. In their previous arguments, Greka and Saba argued that the prior contract was nullified by the Term Sheet and the merger.

Moreover, the court refuses Greka's and Saba's invitation to have the court invent an equitable cause of action under state law that would condemn RGC's short-selling activities. The judicial invention of such a cause of action would intrude on the authority of appropriate federal and state legislative bodies to regulate the securities markets, and be an exercise in judicial legislation. Furthermore, the court agrees with RGC that Greka may not excuse its failure to consummate the Note Exchange by pointing to pre-Term Sheet conduct of RGC that Greka and Saba knew about when they signed the Term Sheet.

For all these reasons, the court grants RGC's motion to dismiss.

I. Factual Background

The facts pled in support of the counterclaims are as follows.

Greka pleads that Old Saba was experiencing economic difficulties in the second half of 1997. During that calendar year, its stock price fell from $37 to $9 a share. "At the time, Old Saba was having difficulty servicing its considerable bank debt and had incurred significant increases in general and

administrative expenses at a time when oil prices were declining."[2] To obtain financing during this difficult period, Old Saba was forced to eschew more traditional forms of debt and equity financing and to offer investors preferred securities with an attractive conversion feature.

It was just such securities that RGC purchased from Old Saba on December 31, 1997. On that day, RGC paid Old Saba $10 million in exchange for 10,000 shares of Series A Convertible Preferred Stock (the "Series A Preferred") and warrants to purchase 224,719 shares of Old Saba common stock (the "Warrants"). The Certificate of Designations for the Series A Preferred contained a conversion feature that permitted each share of Series A Preferred to be convertible into a number of Old Saba common shares determined by dividing the "Conversion Amount" by the then effective "Conversion Price."[3]

The Conversion Amount was defined in the Certificate of Designations as the stated value of the Series A Preferred being converted and the unpaid dividends on those shares. The Conversion Price was the lesser of the market price for the three consecutive trading days before conversion, or $9.345. Thus, the further the market price of Old Saba

---

[2] CC ¶ 3.

[3] *Id.* ¶ 10 (*quoting* Cert. of Desig. at 7-8).

common stock fell below $9.345, the more common stock RGC would receive upon conversion of its Series A Preferred. Because there was no floor conversion price, Greka calls the Series A Preferred a "floorless convertible," a "death spiral equity," and a "toxic convertible."[4]

The Series A Preferred possessed a number of other protective contractual rights. In the case of a merger, for example, the Series A Preferred holders were entitled to the consideration that would have been payable had the Series A been converted in full before the merger. In the event that Old Saba failed to obtain registration for the Series A Preferred, the shares could be put to Old Saba for "Mandatory Redemption" at a price fixed by a contractual formula.

But the Series A Preferred holders were also subject to restrictions protecting Old Saba. In particular, the Securities Purchase Agreement (the "SPA") governing the Series A Preferred stated as follows:

> Each Buyer covenants and agrees that, during any period during which a Conversion Price (as defined in the Certificate of Designation) is computed, it will conduct all transactions in the Common Stock in compliance with applicable securities laws, will not manipulate the trading price of the Common Stock and will not be responsible for the low trading price of the Common Stock. In addition, the Buyer represents that it has not been responsible for the low trading price of the Company's Common Stock at any time prior to the execution of this Agreement.

[4] *Id.* ¶¶ 4, 5, 12.

* * *

> Subject to the immediately following sentence, for a period of one (1) year from the Closing Date, neither a Buyer [n]or any of its affiliates shall engage in the purchase or sale of any derivative securities, including without limitation, puts, calls, options, securities convertible into Common Stock, forward contracts for the sale or delivery of Common Stock, sales of Common Stock for deferred delivery and any arrangement, by which a Buyer or any of its affiliates shifts the economic burden of loss from a drop in the market price of the Common Stock to another. *Notwithstanding the foregoing or anything else contained herein to the contrary, the Buyers shall not be prohibited from engaging in long or short sales of the Common Stock.*[5]

Greka alleges that these protections were important to a relatively small company like Old Saba, with only 14 million shares of common stock outstanding with a daily trading float of only 4 to 5 million shares. Greka asserts that Old Saba was the perfect target for a trader holding a floorless convertible to engage in predatory short-selling.

In its counterclaim, Greka waxes on at length about this sort of market practice. But it does attempt this distillation, which will suffice for present purposes:

> Predatory short selling in all its variations shares certain common characteristics: (1) the issuer typically is a company in financial trouble that has little access to traditional forms of financing and accordingly has very limited bargaining power with which it can protect itself in negotiating the terms of that financing; (2) that financing is accomplished through a

[5] SPA § 4(n), (o) at 17-18 (emphasis added).

> "floorless convertible" which both guarantees the value of the short seller's investment and allows conversion into a greater number of shares of common stock as the price of the issuer's stock declines; (3) once the "floorless convertible" is in place, the short seller engages in large scale short selling (relative to the amount of outstanding regularly traded common stock) in an effort (i) artificially to drive the price of the common stock downward and to start a snowball effect whereby the stock price continues to plummet, while at the same time (ii) recouping a substantial part or all of the seller's investment in the issuer's "floorless convertible"; and (4) once the price of the common stock has dropped the seller can then convert some or all of its shares to "cover" its shorts and retain the rest of its equity (as either preferred or common) in what thereafter amounts to a "costless" investment (i.e., an investment where the amounts initially laid out have already been fully or substantially recouped).[6]

Greka — on "information and belief" — accuses RGC of engaging in this sort of strategy vis à vis Old Saba.[7] It pleads that RGC engaged in short sales "from possibly as early as November of 1997 . . . through the first two quarters of 1998 . . . of such a large percentage of Old Saba common stock (as compared with the amount of actively traded shares) that such sales had the effect, as RGC intended, of driving the price of RGC common stock down from approximately $9-10 a share to as low as $ 1 per share."[8]

---

[6] CC ¶ 25.

[7] *Id.* ¶ 34.

[8] *Id.*

Contrary to arguments it made earlier in this litigation,[9] Greka pleads that this dimunition in Old Saba's share price came at a time when there were no adverse announcements about Saba or other developments that would explain the price drop. It also asserts that the monthly level of short selling in Old Saba shares by mid-1998 was approximately double the previous year's average.

At or around the same time, RGC allegedly put pressure on Old Saba to register the Series A Preferred so that RGC could cover its short sales. When the registration process stalled, RGC supposedly pressured Old Saba into redeeming $2.15 million of the Series A Preferred. "On information and belief," Greka pleads that RGC used this cash to cover its short sales.[10]

Old Saba's then-CEO and largest stockholder, Ilyas Chaudhary, is alleged to have reacted to the decline in Old Saba's stock price by buying as many Old Saba shares on margin as he could in February and March 1998. Greka claims Chaudhury did so to prop up Old Saba's stock price, but that Chaudhury's efforts were unavailing and the price continued to fall. Chaudhury was then forced to sell his newly purchased Old Saba shares to

---

[9] *See, e.g.*, Greka 7/5/00 Br. at 11 ("Old Saba could not service its $20 million in bank debt as it came due. Old Saba's working capital deficit had increased to approximately $29.8 million by September 30, 1998, it had incurred significant increases in general and administrative expenses and oil prices were on the decline.")

[10] CC ¶ 35.

meet margin calls, adding to the downward pressure on Old Saba's stock price. According to Greka, that price hit the $1-2 level by June 1998, a "price range from which it never recovered."[11]

During the summer of 1998, Greka took an interest in purchasing Old Saba. In that time frame, Chaudhury contacted Greka's CEO Randeep Grewal to try to get Greka to buy out RGC's Series A Preferred position. Thereafter, Grewal met with representatives of RGC, who admitted that RGC had a short position of 653,000 shares in Old Saba. RGC also indicated that it wished to keep some of its Series A Preferred in order to cover its short position.

Greka conclusorily asserts that it is inferable that RGC's short position earlier in 1998 was far larger than its mid-year position of 653,000 shares and had been reduced simply because of the price-decreasing success of RGC's earlier short sales.[12] In any event, Greka claims that a short position of 653,000 shares equals approximately 15% of Old Saba's daily float and was sufficient on its own to cause Old Saba's stock price to fall.[13]

In the fall of 1998, Greka's interest in purchasing Old Saba became serious. On October 5, 1998, Greka purchased 690 of RGC's Series A

---

[11] *Id.* ¶ 38.

[12] *Id.* ¶ 41.

[13] *Id.* ¶ 42.

Preferred shares for $750,000 and procured an option on the remaining shares. At that time, Greka was again informed of the extent of RGC's short position in Old Saba. Indeed, the agreement between Greka and RGC had a specific section that identified RGC's short position as involving the aforementioned 653,000 shares, and that required RGC to use commercially reasonable efforts to unwind the short position within a contractually defined time period.[14]

On December 18, 1999, Greka entered into a merger agreement with Old Saba. The final merger agreement eventually required Greka to acquire all the shares of Old Saba common stock for 1,240,000 shares of Greka. The merger placed an implied value on Old Saba's shares of $2.02 apiece.[15] At that time, Greka had not worked out the terms on which it would acquire the Series A Preferred and had not exercised its option to purchase those shares.

Before the shareholder vote on the merger, Greka, Old Saba, and RGC executed the Term Sheet. The merger was then consummated without the payment of any consideration to Greka for its Series A Preferred and Old Saba Warrants.

Instead, Greka, Old Saba, and RGC proceeded under the Term Sheet.

---

[14] Goodier Ex. 5, § 4(cited in CC ¶ 41).

[15] Based on December 7, 1998 market prices. *See Goodier* Ex. 7, at 26-27.

The Term Sheet contemplated the exchange of RGC's Series A Preferred for a secured convertible note (the "Note") to be issued by Greka (the "Note Exchange"), and the exchange of the Old Saba Warrants for warrants on Greka common stock. The Term Sheet contained a provision that stated that "RGC will agree not to engage in any transactions in [Greka] Common Stock prior to the 31st trading day immediately following the Closing Date."[16] This provision was designed to ensure that RGC did not influence the conversion price of the Note contemplated by the Term Sheet, which was determined by a formula based on the trading price of Greka's common stock for the 30 consecutive trading days following closing.[17]

As was discussed in detail in the court's previous opinion in this case, the parties' efforts to reach specific agreement on the Note Exchange contemplated by the Term Sheet never bore fruit. On December 1, 1999, RGC attempted to exercise its Mandatory Redemption rights under the Certificate of Designations for the Series A Preferred against Greka. Pursuant to the formula in the Certificate, RGC demanded a payment of over $26 million. Greka rejected this demand. In responding to the demand, Greka informed RGC that the Certificate of Designations and the rights it

---

[16] Term Sheet at 2.

[17] *Id.*

provided for the Series A Preferred had "*disappeared and became a legal nullity at the effective time of the merger. Therefore, you [RGC] currently are unable to exercise any mandatory redemption rights you may have had under that certificate of designations*."[18] Greka informed RGC that it should focus on completing negotiations under the Term Sheet.

Apparently convinced that further negotiations were pointless, RGC initiated this lawsuit seeking a remedy that will give it the value of the Note or other damages to compensate it for its Series A Preferred.

II. Greka's Counterclaims

Greka has pled several counterclaims that have their basis in the same theory: that RGC engaged in a pattern of predatory short selling that drove Old Saba's stock price down, thereby allowing RGC to reap ill-gotten profits at the expense of Old Saba's common stockholders.

In the original full-blown iteration of its short-selling counter claims, Greka had pled contractual claims on behalf of Saba. These claims alleged that RGC had breached its contract with Old Saba by engaging in predatory short selling that violated the specific prohibitions contained in § 4(n) and (o) of the SPA by which RGC had purchased its Series A Preferred.[19]

---

[18] Lessner Reply Aff. Ex. B (emphasis added).

[19] *See* CC Causes of Action III, IV.

On January 5, 2000, Greka voluntarily dismissed these contractual counterclaims on behalf of Saba. It did so based on what it accurately perceived to be the law of the case.

In the previous opinion in this case, the court held that the parties to the Term Sheet — RGC, Greka, and Old Saba — had exchanged the rights they possessed under pre-existing agreements in exchange for the opportunity to consummate the Note Exchange contemplated by the Term Sheet.[20] As a result, the court dismissed — *at Greka's request* — contractual and other claims asserted by RGC that were buttressed upon the SPA and the Certificate of Designations governing the Series A Preferred. RGC was left solely with its contract and promissory estoppel claims based on the alleged wrongful failure of Greka to consummate the Note Exchange contemplated by the Term Sheet. As I put it at that time, "this litigation must focus on the legal consequences of [the Term Sheet] and the parties' subsequent conduct under it."[21]

When it voluntarily dismissed the contract-based counterclaims it asserted on behalf of Saba, Greka asserted a narrow reading of its earlier litigation posture. In particular, Greka insisted that it had never argued that

---

[20] *See RGC International Investors, LDC v. Greka Energy Corp.*, Del. Ch., C.A. No. 17674-NC, mem. op., Strine, V.C (Nov. 6, 2000) ("*Greka I*").

[21] *Greka I*, mem. op. at 2.

RGC could not sue Saba under the SPA or the Certificate of Designations. Rather, Greka said it simply argued that RGC could not sue Greka under those agreements.

The court, however, rejects Greka's attempt to cabin its earlier arguments. As noted, when Greka rejected RGC's Mandatory Redemption notice, it informed RGC that the Certificate of Designations had disappeared and was a "legal nullity."[22] In arguments to this court, Greka said that RGC could no longer make a demand for mandatory redemption to Saba because the Certificate of Designations no longer existed.[23] Therefore, any other assertions in Greka's papers that RGC can state contract claims against Saba were made purely as rhetorical flourish. Counsel for Greka and Saba admitted as much at the oral argument on this motion.

Thus, the substance of Greka's prior position is clear: RGC had traded in whatever rights it possessed under the SPA and the Certificate of Designations in exchange for the possibility of the Note Exchange under the Letter Agreement. That is, Greka argued that the parties to the Term Sheet — RGC, Greka, and Old Saba — had exchanged their old rights and

---

[22] Lessner Aff. Reply Aff. Ex. B.

[23] Greka 7/5/00 Br. at 37. When negotiating pursuant to the Term Sheet, Greka was representing itself and Old Saba. In that connection, Greka explicitly told RGC that the "Term Sheet does not provide" for the provisions from the Series A Preferred Stock of Saba . . . " Greka 9/1/00 Br. at 36 (quoting a letter from Greka to RGC).

responsibilities for those defined in the Term Sheet. These very same arguments undoubtedly would have been asserted by Greka had RGC attempted to amend its complaint simply to change the defendant to its contract claims from Greka to Saba, Greka's now wholly-owned subsidiary.

In recognition of the reality of its position, Greka dismissed its contract-based claims against RGC, rather than risk a ruling that would have undone the prior dismissal order and have permitted RGC to press its claims under the SPA and the Certificate of Designations against Saba and/or Greka. But Greka did not dismiss all of its counterclaims.

Instead, Greka is still pressing unjust enrichment claims on behalf of itself and Saba, as well as an unclean hands defense (collectively, the "Equitable Counterclaims").[24] The basis for all these claims is that RGC was inequitably advantaged by its alleged predatory pre-Term Sheet short selling to the detriment of Greka and Saba. As a result, any obligation Greka and Saba owe to RGC for RGC's Term Sheet-based promissory estoppel and contract claims should be offset by RGC's ill-gotten trading gains.

---

[24] I recognize that unclean hands is an affirmative defense, and not a counterclaim. I identify the defense as part of the Equitable Counterclaims because the defense is pled that way and for simplicity of reference only.

In addition, Greka has proffered an affidavit of its CEO, Grewal, in support of a new promissory estoppel claim it would like to assert in an amended counterclaim. In that affidavit, Grewal implies that RGC induced him to consummate the merger and execute the Term Sheet in exchange for an oral promise by RGC that it would refrain from manipulating the post-merger price of Greka's stock. Without that implied promise, Grewal claims that Greka would have simply waited for Old Saba to file for bankruptcy and have bought its assets at that time.

Grewal says that RGC later refused to commit this implied promise to writing in the Term Sheet negotiations, and that this was one of the reasons that the negotiations were never successfully concluded.[25] Based on RGC's refusal to accede to Greka's insistence on a contractual provision prohibiting RGC from "interfering with the trading markets for Greka Common Stock," Greka claims that its refusal to consummate the Note Exchange was justified. Because Greka allegedly agreed to commit to the Term Sheet on condition that RGC agree to restrictions on its ability to trade Greka shares, Greka argues that RGC violated a specific commitment. As a remedy for

[25] The Grewal affidavit further demonstrates Greka's view that the pre-Term Sheets contracts are a nullity. Greka attaches correspondence to Grewal's affidavit from the Term Sheet negotiations in which Greka took the position that RGC could not insist on receiving the protections of the SPA and Certificate of Designations in the final documentation of the Note Exchange, because such terms were not binding on Greka and were not "within the spirit of the Term Sheet." Greka Ans. Br. Ex. B (5/6/99 letter at Tab 3).

this alleged breach of promise, Greka makes a Carl Lewis-like leap in logic and claims that the court should examine RGC's pre-Term Sheet short selling conduct to determine if it was inequitable. If it was, the court should offset any recovery by RGC under the Term Sheet by the extent of RGC's ill-gotten gains. That is, RGC's failure to agree to a post-Term Sheet restriction on its trading in Greka shares should somehow expose it to liability for its pre-Term Sheet trading in Old Saba shares.

I first turn to RGC's motion to dismiss Greka's Equitable Counterclaims. Then, I will address RGC's arguments regarding Greka's newly minted and yet-to-be pled promissory estoppel claim.[26]

III. Legal Analysis

A. The Relevant Procedural Standard

In considering RGC's motion to dismiss, the court must assume the truth of all well-pleaded facts in the Equitable Counterclaims. But the court need not accept conclusory statements of facts as true. After considering the

[26] Greka has also pled another counterclaim on behalf of Saba that is styled as a promissory estoppel claim. That claim pleads that RGC induced Old Saba to sell it the Series A Preferred based on assurances in the SPA and other documents that RGC would not manipulate Old Saba's stock price. CC Cause of Action VI. Greka does not defend this claim in its brief, probably because the claim is untenably indistinguishable from a direct claim under the SPA. I consider the claim waived and to be otherwise dismissable based on the reasoning of this opinion.

record in this light, the court may dismiss the counterclaims if they fail to state a claim as a matter of law.[27]

B. Should The Equitable Counterclaims Be Dismissed?

RGC has raised a plethora of arguments as to why Greka's Equitable Counterclaims must be dismissed. I find it unnecessary to explore most of these arguments, some of which appear to be quite well-founded.[28]

The argument that RGC advances that strikes me as obviously correct is that the Equitable Counterclaims are barred by law of the case. In its prior motion to the court, Greka secured dismissal of all the claims of RGC that were not based on the Term Sheet itself. The successful argument it advanced was that the Term Sheet reflected an agreement among RGC, Greka, and Old Saba to exchange their pre-existing rights and

---

[27] *Grimes v. Donald*, Del. Supr., 673 A.2d 1207, 1213-14 (1996).

[28] There are several such arguments. For example, RGC contends that Greka has failed to plead facts that support a claim of market manipulation, under the pleading standard of either Court of Chancery Rule 9(b) or 8(a). In support of that argument, RGC points out, among other things, how cursory Greka's claim is, resting as it does on the simple proposition that RGC had a large short position as of a particular date, that RGC had a theoretical motive to want to drive down Old Saba's stock price, and that Old Saba's stock price declined. Without addressing this argument, I do note that Greka's contention that Old Saba's stock price fell solely because of RGC's short sales seems facially implausible, given Greka's admissions that (i) Old Saba's stock price dropped like a rock in 1997, the year before RGC is alleged to have engaged in its improper short selling, *see* CC ¶ 3; (ii) that Old Saba's strained economic condition was what required it to issue the Series A Preferred rather then secure more traditional financing, *see* CC ¶ 4; and (iii) that there were other objective, economic circumstances that could have explained the further drop in Old Saba's stock in 1998, *see* Greka 7/5/00 Br. at 11; *Greka I*, mem. op. at 7-9.

RGC further argues that Greka's Equitable Counterclaims are barred: by the so-called *Bangor Punta* doctrine, *see Courtland Manor, Inc. v. Leeds*, Del. Ch., 347 A.2d 144 (1975); by the equitable doctrine of waiver; because Greka and Old Saba lack standing and are not the real parties in interest pursuant to Rule 17(a); and by laches and the statute of limitations.

responsibilities for the opportunity to consummate the Note Exchange contemplated by the Term Sheet.

As a result, the court dismissed RGC's claims under the SPA and the Certificate of Designations. Not only that, the court dismissed equitable claims for breach of fiduciary duty brought by RGC, as being "wholly devoid of force, however, if the Term Sheet is taken into account, as it must be."[29]

The Equitable Counterclaims have their origin in the SPA, one of the very same agreements that Greka convinced the court RGC could not rely upon after the execution of the Term Sheet. Although Greka pleads its Counterclaims as "equitable" in nature, the Counterclaims all necessarily derive their essence from the provisions of the SPA that prohibited RGC from trading activity designed to lower the price of Old Saba's stock. That is, although Greka has withdrawn its SPA-based contract claims in form, in substance it has not. Rather, it simply seeks to raise these claims under the equitable headings of unclean hands and unjust enrichment.

Greka's own brief makes it clear that this is so. For example, Greka argues that RGC has unclean hands because it purchased the Series A

---

[29] *Greka I*, mem. op. at 41 (*see also id.* at 39) (stating that the "fiduciary duty claims are equally flawed by their failure to take into account the effect of the Term Sheet").

Preferred on the "*express condition*" that it not engage in trading to drive down Old Saba's stock price, but did precisely that in violation of the SPA.[30] Similarly, Greka justifies its unjust enrichment claim on the ground that "RGC's *breach of its contractual covenants* respecting market manipulation resulted in undue profits earned by RGC at Old Saba's expense."[31] It argues that the Equitable Counterclaims are not barred by the federal securities laws because the "pertinent question is whether a hedge fund that induces a company to issue floorless convertibles *on the basis of its promise* not to harm the company through predatory short selling *can then violate such promises* and thereafter seek equitable relief in this Court when it comes time to liquidate its investment. This is precisely the type of intra-corporate question that this Court determines all the time."[32] Greka's brief is replete with references of this type, which specifically ground the Counterclaims in RGC's alleged breach of the SPA.

As a result, the Equitable Counterclaims are barred by the law of the case. The court's prior holding — issued at Greka's behest — was that all the parties to the Term Sheet materially changed position in executing that

[30] Greka Ans. Br. at 12-13 (emphasis added).

[31] *Id.* at 21 (emphasis added).

[32] *Id.* at 33-34 (emphasis added).

document.[33] Therefore, the court barred RGC from suing under the SPA and the Certificate of Designations because those contracts were no longer operative. In so ruling, the court embraced Greka's own stated view as to the viability of those prior agreements.[34]

Having disarmed RGC of its ability to use the prior agreements as a weapon, Greka cannot turn around and seek to use those agreements as a sword against RGC. The mere fact that Greka has transmogrified its SPA-based claims into so-called "equitable" claims does not render those claims any more consistent with the law of the case. However styled, the Equitable Counterclaims are substantively based on RGC's alleged pre-Term Sheet violation of the SPA. Moreover, the court dismissed RGC's equitable claims in large measure because those claims were deficient when considered in light of the parties' change in position as reflected in the Term Sheet.

Greka's reliance on RGC's pre-Term Sheet violations of the SPA to buttress the Equitable Counterclaims is unavailing for another reason: Greka knew about RGC's short selling before it executed the Term Sheet.

---

[33] *E.g.*, *Greka I*, mem. op. at 2, 35, 36.

[34] *In re MCA, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 11740, 2000 Del. Ch. LEXIS 114, at *19 n.25, Chandler, C. (Aug. 4, 2000) (law of case doctrine "applies to and comprehends . . . all matters decided by implication") (quotation and citation omitted); *Odyssey Partners v. Fleming Co.*, Del. Ch., C.A. No. 14770, 1998 Del. Ch. LEXIS 40, at *4, Lamb, V.C. (Mar. 26, 1998) (the law of case doctrine applies "when a prior decision actually or necessarily decides an issue").

Indeed, Greka asserts that RGC "knew full well that Greka and [Old] Saba were aware of RGC's predatory short selling" at the time the parties entered into the Term Sheet.[35] Therefore, Greka and Old Saba executed the Term Sheet contemplating the Note Exchange with full knowledge that RGC may have violated the provisions of the SPA.

Given this undisputed fact, the unjust enrichment and unclean hands Counterclaims fail as a matter of law. Because Greka and Old Saba chose to execute the Term Sheet rather than have Old Saba assert a claim for breach of the SPA and risk RGC's invocation of its own contractual rights under the Certificate of Designations and SPA, it is inconceivable that RGC could be unjustly enriched by the consummation of the Note Exchange. When commercial parties eschew contractual conflict and enter into a new bargain, they cannot revive the claims they waived in order to excuse their failure to perform the new bargain.[36]

Likewise, the doctrine of unclean hands has no application here. By their own admission, Greka and Old Saba knowingly shook RGC's allegedly dirty hand when they signed the Term Sheet. Thus, RGC's pre-Term Sheet

---

[35] Greka Ans. Br. at 29-30.

[36] *See True North Communications, Inc. v. Publicis S.A.*, Del. Ch., 711 A.2d 34, 45 (1997) (where party bound itself not to take certain actions by contract, it could not "invoke general equity principles" to avoid an injunction enforcing the rights and obligations for which that party "specifically bargained").

conduct cannot serve as an equitable basis to excuse Greka and Old Saba from living up to any enforceable promises they made in connection with the Term Sheet, either as a matter of promissory estoppel or contract.[37] Put in other words, because RGC's allegedly reprehensible conduct was known by Greka and Old Saba before they inked the Term Sheet, that conduct lacks the necessary relationship to the parties' post-Term Sheet conduct to justify invocation of the doctrine of unclean hands.[38]

Finally, the absence of any claim before the court that seeks to hold RGC liable for violation of a contractual obligation to refrain from certain market conduct creates another fundamental problem for Greka. Namely, given the lack of a basis to hold RGC liable for breach of a contractual promise, Greka must necessarily ask this court to adopt a rule of Delaware public policy that condemns certain types of short-selling activity. By what metric is the court to conclude that particular short-selling should be condemned as inequitable and thus supportive of an unjust enrichment claim or unclean hands defense?

---

[37] Although I do not reach this argument, I note that RGC has contended that the doctrine of unclean hands may not be used to defend against breach of contract and promissory estoppel claims, which RGC contends are legal in nature.

[38] See DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 11-6(a), at 790 (1998) (describing general rule that the doctrine of unclean hands requires that the party's inequitable conduct be committed in connection with the matter in controversy).

Short selling is in itself a perfectly respectable trading practice, and indeed the SPA expressly permitted RGC to engage in short sales in Old Saba stock. Therefore, as a practical matter, the decision to evaluate whether RGC's trading practices support an unjust enrichment claim or an unclean hands defense will require the judicial articulation of a new equitable cause of action for market manipulation. The court respectfully refuses Greka's invitation for the court to create an equitable cause of action that would prohibit behavior that is regulated by federal and state securities laws.[39] Short-selling that violates the federal Securities Exchange Act of 1934 may be remedied by an action under § 10(b) of the Act and SEC Rule 10b-5;[40] that is, by an action which is within the exclusive jurisdiction of the federal courts.[41]

An exercise in judicial legislation of this sort would be disrespectful of the pre-eminent role played by the federal government in the regulation of the nation's securities markets. While Delaware courts have recognized equitable causes of action addressing certain activities also regulated by federal law, those causes of action regulate the fiduciary conduct of

---

[39] *See, e.g.*, 15 U.S.C. § 78i (1999) (Manipulation of Security Prices); 17 C.F.R. § 240.10a-1 (regulation governing short sales of securities); 6 Del. C. § 7303 (Delaware Securities Act provision comparable to Rule 10b-5).

[40] *E.g.*, *Wolgin v. Magic Marker Corp.*, 82 F.R.D. 168, 180-81 (E.D. Pa. 1979).

[41] 15 U.S.C. § 78aa.

corporate directors, an area of traditional state concern recognized by the federal government. Outside of that narrow area, the Delaware courts have consistently refused to regulate the securities markets through the judicial recognition of new equitable claims, especially when those claims (as here) would mirror statutory claims falling within the exclusive jurisdiction of the federal courts.[42]

In this case, Greka seeks to have the court recognize the right of an issuer of securities (Old Saba) to assert a so-called "equitable" claim of market manipulation against a holder. Such an equitable claim does not address an area of traditional state regulation. In fact, the creation of such an equitable claim would grant issuers a cause of action that they do not possess under federal law. As things stand, a claim of the nature Greka makes against RGC for alleged market manipulation may only be asserted under federal law by a purchaser or seller of securities.[43]

---

[42] *Standard Power & Light Corp. v. Investment Associates, Inc.*, Del. Supr., 51 A.2d 572, 579 (1947) (Refusing to consider an allegation that a proxy was procured in violation of the Securities and Exchange Act under the guise of unclean hands, because the "issue lies solely within the exclusive jurisdiction" of the federal courts and "this court will not usurp that jurisdiction or any portion thereof."); *American Hardware Corp. v. Savage Arms Corp.*, Del. Supr., 136 A.2d 690, 693 (1957) (Refusing to entertain a claim that a defendant breached the proxy rules of the SEC because the "issue [was] to be determined solely by the Commission itself and the federal courts. The courts of this State will not assume to trespass upon this exclusive jurisdiction."); *see also Malone v. Brincat*, Del. Supr., 722 A.2d 5, 13 (1998) (discussing deference due to federal law in areas of securities regulation that are not the traditional concern of state law).

[43] *See, e.g.*, *Global Intellicom, Inc. v. Thomson Kernagan & Co.*, 1999 U.S. Dist. LEXIS 11378, at *26, *31 (S.D. N.Y. July 27, 1999); *see also Gurary v. Winehouse*, 235 F.3d 792, 799 (2d Cir.

While Greka contends that the lack of an issuer's cause of action under federal law means that there would be no conflict with federal law were this court to recognize such a cause of action as a matter of state common law, I perceive things much differently. To my mind, the judicial creation of a state law issuer's cause of action in these circumstances would flout the well-reasoned judgment of Congress regarding the appropriate reach of the federal securities laws.[44] It also involves a judicial extension of state law that the General Assembly has not seen fit to take under the State's own statutory securities laws. When such an extension has no relationship to this State's traditional concern with enforcing the fiduciary duties of Delaware directors, by what authority of Delaware law has the right to make such a policy decision been invested in this court?[45]

While I will not discuss all the reasons the judiciary is ill-situated to establish equitable causes of actions governing sophisticated market behavior of the type addressed by Greka's Equitable Counterclaims, a few examples of the policy-based questions that emerge illustrate why such

---

2000) ("The 'in connection with the purchase or sale of a security' requirement of section 10(b) and Rule 10b-5 would prohibit a court from adopting a rule that would support Gurary's claim.").

[44] Having been the recent beneficiary of the so-called "Delaware carve outs" in the federal Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 16(d), 112 Stat. 3227 (1998), it is prudent for this State to be quite cautious about creating new forms of securities regulation by judicial fiat.

[45] Equity historically "follows the law" and does not create remedies where the parties' behavior is already closely regulated by the law. 27A Am. Jur. 2d *Equity* § 113 (1996).

causes of action are more appropriately created by legislative bodies and implemented pursuant to detailed regulations. What is the pleading requirement that would apply to the new equitable market manipulation cause of action? Would it be subject to the fraud pleading standard of Court of Chancery Rule 9(b)? Would the new equitable market manipulation cause of action have a *scienter* requirement? What sort of burden would the plaintiff have to prove injury? How would Greka do so when it benefited from purchasing Old Saba at a price that was supposedly artificially deflated by RGC's short selling?[46]

Under federal law, a large body of statutory, regulatory, and decisional law exists that grapples with difficult questions of this sort. While Greka's pleadings act as if RGC can be found liable for market manipulation simply because it held a large short position in Old Saba shares

---

[46] *See Gurary*, 235 F.3d at 798-800 (imposing Rule 11 sanctions on party who purchased securities after market manipulation had allegedly depressed price because the party benefited from the manipulation by purchasing at a lower price than he should have paid). To deal with this obvious problem, Greka contends that it is pressing this claim on behalf of Saba, too. Recognizing that it is difficult to show how Saba was injured as an entity by RGC's conduct, Greka asserts that Saba somehow represents the former Old Saba stockholders (i.e., the Greka stockholders who obtained their shares in the merger in exchange for Old Saba shares) who were allegedly harmed by RGC's conduct. This is an odd theory for Greka to advance, given that it acquired the Old Saba shareholders' stock on the cheap. This unusual representational theory of corporate standing is coupled with an argument that Greka was injured because it could have waited to acquire Old Saba's assets in bankruptcy, but was induced into the Term Sheet by RGC's promise to forsake market manipulation of Greka's shares. Because I decide this motion on other grounds, I do not reach RGC's argument that neither Saba nor Greka have stated a cognizable claim of injury to themselves as entities.

and Old Saba's stock price fell during the same period, federal law is to the contrary.

Under federal law, a plaintiff seeking to hold RGC liable for market manipulation would bear a heavy burden to show that RGC engaged in a conscious wrongdoing that deceived or defrauded other investors.[47] The mere fact that RGC engaged in substantial short selling would do little in isolation to prove liability, because short selling is permitted by the federal securities laws.[48] Rather, RGC would have to plead "what manipulative acts were performed [by RGC] . . ., when the manipulative acts were performed, and what effect the scheme had on the market for the securities at issue."[49]

If Greka would have me simply import these standards into the newly created equitable market manipulation cause of action it advocates under the guises of unjust enrichment and unclean hands, it thereby acknowledges its attempt to assert a federal claim that it may not press. If Greka would have

[47] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976); *see also Sullivan & Long, Inc. v. Scattered Corp.*, 47 F.3d 857, 865 (7th Cir. 1995) (for short-seller to violate Rule 10b-5, there must be "proof of either deception or manipulation").

[48] *In re Olympia Brewing Co. Securities Litig.*, 613 F. Supp. 1286, 1296 (N.D. Ill. 1985) ("[S]hort selling is simply not unlawful, even in large numbers and even if the trading does negatively affect the purchase price. . . . Where the selling appears in all other respects to be lawful, the court will not draw the inference that an unlawful conspiracy to manipulate the market price took place."); *Sullivan & Long*, 47 F.3d at 862 ("'[F]looding' a market with short sales is not a rational formula for keeping price falling. On the other side of each such sale is a buyer who thinks the market price will rise. If he is right, the short seller will lose money, and the more shares he has sold short, the more money he will lose.").

[49] *Arduini/Messina Partnership v. National Medical Financial Services Corp.*, 74 F. Supp.2d 352, 362 n.7 (S.D.N.Y. 1999) (quotation and citation omitted).

me come up with state-specific requirements outlawing inequitable market manipulation, it thereby asks me to engage in an act of judicial legislation. I decline both options.

For all these reasons, Greka's Equitable Counterclaims must be dismissed. Because I rest my dismissal on the aforementioned grounds, I do not reach RGC's other arguments.

C. Does The Promissory Estoppel Argument Made In The Grewal Affidavit Save The Equitable Counterclaims?

The Grewal affidavit puts the court in the position of considering a claim that has not been pled. Because this case is set for trial within a short time frame, however, I will address its implications briefly.

As I understand the affidavit, it asserts that Greka agreed to purchase Old Saba in the merger and to enter into the Term Sheet based on assurances that RGC would not manipulate the trading price of Greka after the merger. Greka admits it was willing to consummate the Note Exchange regardless of RGC's pre-Term Sheet conduct but asserts that its willingness to do so was dependent on RGC's agreement not to manipulate the price of Greka's stock. When RGC refused Greka's post-Term Sheet demand to reduce this oral promise to writing, Greka refused to consummate the Note Exchange. Thus, the affidavit contains nothing to support the existing Equitable

Counterclaims, which are founded on RGC's pre-Term Sheet trading in Old Saba shares.

Nor does the Grewal affidavit support the proposition that trial time should be spent examining RGC's pre-Term Sheet trading activity in Old Saba shares. Grewal contends that his demand that RGC agree not to manipulate Greka's stock price was based on the knowledge he then possessed regarding RGC's behavior. New information regarding RGC's pre-Term Sheet behavior simply could not, as a factual matter, have any bearing on the positions the parties took in negotiating the Term Sheet or in attempting to reach agreement on the documentation necessary for them to consummate the Note Exchange.[50]

---

[50] Greka insists that RGC's pre-Term Sheet behavior must be examined for another reason. In my prior opinion, I noted that RGC's prior rights under the SPA and the Certificate of Designations might be relevant in shaping a remedy in the event that Greka is found to have breached its contractual obligations under the Term Sheet or is otherwise responsible as a matter of promissory estoppel for the failure to consummate the Note Exchange. That is, I acknowledged the possibility that one might conceivably conclude that RGC was entitled to be put back in the position it occupied before the Term Sheet was executed.

Thus, Greka notes that it would be inequitable for the court to grant RGC a remedy based on the SPA and the Certificate of Designations without permitting Greka to prove that RGC had breached the SPA in materially relevant ways. This is a fair point. Therefore, to the extent that I later conclude that a remedy derived from the SPA or the Certificate of Designations is appropriate, the imposition of such a remedy will be preceded by an opportunity for Greka to renew its SPA-based market manipulation arguments.

But the possibility that any remedy the court grants will focus on contracts other than the Term Sheet is so improbably remote that there is no basis to hold up the procession of the trial. Rather, the most likely remedy if RGC is successful is that Greka will be required to consummate the Note Exchange or give monetary value equivalent to the Note. The Equitable Counterclaims pled by Greka provide no basis for offsetting any remedy of this kind.

But the question that remains is whether the affidavit would support a defense at trial to RGC's contract and promissory estoppel claims. RGC contends that it is quite obvious that the affidavit presents no basis for a defense. As RGC notes, the Term Sheet includes a specific provision that prohibited RGC from any trading in Greka stock during the thirty day period in which the conversion price for the Note was to be established. Therefore, RGC contends that Greka's demand for greater restrictions on RGC's trading activity than were specifically contemplated by the Term Sheet was obviously an unreasonable attempt by Greka to materially vary the transaction defined in the Term Sheet. In support of this argument, RGC notes that Delaware courts "will not readily imply a contractual obligation where the contract expressly addresses the subject of the alleged wrong."[51]

In view of the somewhat uncommon circumstances presented by this case involving an "agreement to agree," I decline, however, to prejudge this defense. The upcoming trial will focus on the circumstances that resulted in the failure of the parties to consummate the Note Exchange, despite their mutual agreement to negotiate in good faith towards that end. This will necessarily involve an examination of the positions advocated by RGC and

[51] *Abex Inc. v. Koll Real Estate Group, Inc.*, Del. Ch., C.A. No. 13462, 1994 Del. Ch. LEXIS 213, at *35, Jacobs, V.C. (Dec. 22, 1994).

Greka in the negotiations, and a determination of whether those positions were materially consistent with the transaction contemplated by the detailed Term Sheet. The parties may join issue over the relevance of Grewal's new factual assertions at trial and the briefing incident thereto.

IV. Conclusion

For the foregoing reasons, the Equitable Counterclaims pled by Greka and Saba are hereby DISMISSED. IT IS SO ORDERED.