Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. Significant unreported cases that have not been published by a reporter system will be included. The courts' opinions are printed in their entirety, exactly as received.

To expedite the attorney's research, all cases are summarized and then headnoted according to the NATIONAL REPORTER key number classification system.* Indices are provided for case names, statutes construed, rules of court, and key numbers and classifications for this issue.

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AMERICAN INTERNATIONAL RENT A CAR, INC. v. CROSS

No. 7583

Court of Chancery of the State of Delaware, New Castle

May 9, 1984

Plaintiff, American International Rent A Car, Inc., sought a preliminary injunction restraining defendants American International Rent A Car Corporation and its directors from issuing any stock at a scheduled stock sale. Plaintiff maintained that the issuance of stock pursuant to a previous sale was void and that the scheduled stock sale was likewise void. Plaintiff alleged that the board had breached its fiduciary duty by withdrawing from the stockholders the right to vote on a proposed bylaw amendment allowing for issuance of additional stock and unilaterally deciding to amend the bylaw on its own. The court of chancery, per Vice-Chancellor Berger, held that plaintiff had not met its burden of rebutting the presumption of the business judgment rule. The court held that the board acted to amend the bylaw in the good faith belief that such action was in the best interests of the company and its stockholders. Further, the court stated that it is not a per se breach of fiduciary duty for a board to act in a manner which it may believe is contrary to the wishes of a majority of the company's stockholders.

Plaintiff's motion for a preliminary injunction was denied.

1. Injunction ⟹ 151

It is well settled that preliminary injunctive relief will not be granted unless plaintiff has established that it has a reasonable probablility of success on the merits and that it will suffer irreparable harm if the relief is not granted.

2. Corporations ⟹ 193

Corporate machinery may not be used to accomplish inequitable purposes even if the action taken technically complies with the law.

3. Corporations ⟹ 320(11)

Plaintiff has the burden of rebutting the presumption of the business judgment rule that the board acted to amend the bylaw in the good faith belief that such action was in the best interests of the company and its stockholders. That burden is not met when plaintiff

contends that the board amended the bylaw for the inequitable purpose of disenfranchising the stockholders if, although the board's action had the effect of withdrawing a vote from the stockholders, the board's purpose was to enable the company to go forward with a stock sale to obtain needed funds.

4. Corporations ⟹ 307

It is not a per se breach of fiduciary duty for a board to act in a manner which it may believe is contrary to the wishes of a majority of the company's stockholders.

David A. Drexler, Esquire, and Thomas C. Grimm, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

Allen M. Terrell, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for individual defendants.

Robert J. Katzenstein, Esquire, of Katzenstein & Furlow, Wilmington, Delaware, for corporate defendant.

BERGER, *Vice-Chancellor*

Plaintiff, American International Rent A Car, Inc., is seeking a preliminary injunction restraining defendants American International Rent A Car Corporation ("American International") and its directors from issuing any stock at a stock sale scheduled to take place today. In essence, plaintiff claims that a 1976 bylaw provision limiting to 12,500 the number of shares of stock any one stockholder could own was never validly repealed. Accordingly, plaintiff maintains that the issuance of stock pursuant to a stock sale in September, 1983 was void and a similar stock sale to be consummated later today, likewise, would be void. This is the Court's decision on plaintiff's motion for a preliminary injunction.

American International was incorporated in Delaware in 1968 for the purpose of establishing a national car rental franchise system. The original stockholders, each of whom operated car rental businesses as licensees of American International, intended that the stock ownership in the company be restricted to its licensees and that each licensee be required to purchase at least 1,000 but not more than 5,000 shares of the company's stock. American International was not intended to be a profit making enterprise. Its function was to sell new franchises and to provide support services, such as a central reservation system and national advertising, for existing franchises.

Although the business of American International has retained its original character, the intended restrictions on stock ownership apparently were not put into effect or, if duly adopted, were not enforced. By 1976, several licensees owned considerably more than 5,000 shares and others owned none. Some of those licensees owning little or no stock stopped paying their license fees and the company ran into financial difficulty.

In February, 1976, a special stockholders' meeting was held to consider methods to resolve American International's financial problems. It was agreed, among other things, that the maximum stock ownership of each licensee would be limited to 12,500 shares. On February 19, 1976, following the stockholders' meeting, the Board of Directors amended the bylaws to provide for the 12,500 share ownership limitation (the "bylaw restriction").

In August, 1983, American International was again facing financial difficulties. The evidence suggests that American International's financial condition was not as "dire" as the Board perceived it to be. However, the Board's good faith belief that immediate action was necessary has not been questioned at this stage of the proceedings. A Planning Committee formed by the Board recommended that additional funds be raised by selling 273,500 shares of stock to the company's existing stockholders. Such a sale would require that the 12,500 share limitation in the bylaws be lifted.

The Board accepted the Planning Committee's recommendation and called a stockholders' meeting for September 13, 1983. The notice to stockholders stated that the purpose of the meeting was to vote on an amendment to the bylaws which would eliminate the bylaw restriction. Accompanying the notice was a letter explaining that, if the bylaw restriction was removed, a special offering of stock would be made at the conclusion of the meeting.

At the meeting, some stockholders raised questions about the company's financial condition and objected to the planned sale. James L. Shapiro, one of American International's directors, described the meeting as "rowdy" and "out of control." One of the stockholders asked that a vote be taken on the bylaw amendment. Plaintiff's affidavit states that a motion was made and seconded and that ballots were distributed to the stockholders. Shapiro did not recall that anyone had complied with those formalities. In any event, no stockholder vote was taken. Instead, the Chairman of the Board recessed the meeting for lunch and, during that recess, convened a special meeting of the Board of Directors. The Board voted to amend the bylaw and, when the

stockholders' meeting reconvened, the Chairman went forward with the planned stock sale.

Several of the stockholders left the meeting after learning that the Board had acted on the bylaw amendment and after several requests for a stockholder vote were denied. Other stockholders, including plaintiff, decided not to purchase the stock offered for sale.

In February, 1984, the Board met and again decided to raise funds by selling $500,000 worth of stock at a sale scheduled to be held today. On February 10, 1984 a letter was sent to all licensees and stockholders advising them of the planned stock sale. The May 9th date was selected so as to enable the stockholders to vote the newly acquired shares at the annual stockholders' meeting for the election of directors on May 21, 1984.

Plaintiff filed this action on April 30, 1984. The thrust of the complaint is an attack on the action taken by the Board during the luncheon recess of the September 13, 1983 stockholders' meeting. The complaint alleges that, by removing from the stockholders the right to vote on the proposed amendment to the bylaw, the directors breached their fiduciary duties and acted for the primary purpose of entrenching their control of the company. The complaint also alleges that the stock sold following that meeting was issued in violation of 8 *Del. C.* §153 because it was sold at a price less than its par value. At oral argument plaintiff conceded that it had not developed evidence to support its entrenchment claim. In addition, plaintiff does not rely on either of its "technical" claims based upon improper notice and §153 in its application for injunctive relief.

[1]It is well settled that preliminary injunctive relief will not be granted unless plaintiff has established that it has a reasonable probability of success on the merits and that it will suffer irreparable harm if the relief is not granted. *Gimbel v. Signal Company, Inc.*, Del. Ch., 316 A.2d 559, *aff'd*, Del. Supr., 316 A.2d 619 (1976). For purposes of this motion, plaintiff's sole claim is that the Board breached its fiduciary duty by withdrawing from the stockholders the right to vote on the proposed bylaw amendment and adopting that amendment by Board action on September 13, 1983. Plaintiff acknowledges that the Board had the power to amend the bylaws. However, the Board chose to put the matter to a stockholder vote and the meeting at which the vote was to be taken was underway when the Board unilaterally decided to amend the bylaw on its own.

The record at this point does not establish whether, in light of the events of the morning, the Board members believed the stockholders

would have voted down the proposed amendment. It is undisputed that the morning session was marked by controversy and defendant Shapiro acknowledged that the group of stockholders opposing the amendment and stock sale represented approximately one-third of the shares outstanding. Plaintiff's President felt that it was "evident" from the tenor of the meeting that the proposal would be defeated.

It is reasonable to infer that the Board was, at least, concerned about the opposition expressed by some of the stockholders during the morning session. Shapiro testified that, because of what he perceived to be the stalling tactics used in the morning, he was concerned that the company might not get to the stock sale before the afternoon was over. From the Board's perspective, the stock sale was of paramount importance. Shapiro stated that it would have been a "financial disaster" for the company if the sale had not taken place.

[2] Plaintiff premises its argument on the principle that corporate machinery may not be used to accomplish inequitable purposes even if the action taken technically complies with Delaware law. *Schnell v. Chris Craft Industries, Inc.*, Del. Supr., 285 A.2d 437 (1971); *Petty v. Penn Tech Papers, Inc.*, Del. Ch., 347 A.2d 140 (1975). Applying this fundamental rule to the facts of this case, plaintiff contends that the Board amended the bylaw at its luncheon meeting for the inequitable purpose of disenfranchising the stockholders. The problem, as I see it, is that, although the Board's action had the effect of withdrawing a vote from the stockholders, the Board's purpose was to enable American International to go forward with the stock sale and thereby to obtain needed funds.

[3,4] At this stage of the proceedings, plaintiff has not met its burden of rebutting the presumption of the business judgment rule that the Board acted to amend the bylaw in the good faith belief that such action was in the best interests of the company and its stockholders. *See Aronson v. Lewis*, Del. Supr., No. 203, 1983, Moore, J. (March 1, 1984). Nor am I persuaded that it is a *per se* breach of fiduciary duty for the Board to act in a manner which it may believe is contrary to the wishes of a majority of the company's stockholders. If the Board has such a belief it would be expected that the stockholders' opposing views be given due consideration by the Board. However, I do not believe that stockholder opposition automatically overrides the other factors that the Board considers in exercising its business judgment. If a majority of American International's stockholders in fact disapproved of a Board's amendment of the bylaw, several recourses were, and continue to be, available to them. They could vote the

incumbent directors out of office. Alternatively, they could cause a special meeting of the stockholders to be held for the purpose of amending the bylaws and, as part of the amendment, they could remove from the Board the power to further amend the provision in question.

For the forgoing reasons, I conclude that plaintiff has not established a probability of success on the merits. As a result, it is unnecessary to consider the defense of laches or the issue of irreparable harm. Plaintiff's motion for a preliminary injunction is denied.

IT IS SO ORDERED.

ANDRESEN v. BUCALO

No. 6372

Court of Chancery of the State of Delaware, New Castle

March 14, 1984

The plaintiff, John Andresen, brought suit against Microbyx, a closely held corporation, and its directors, Louis Bucalo, Elizabeth M. Curran, and Charles M. Lynne, to set aside two agreements between the corporation and Bucalo. Under the two agreements Bucalo was issued 250,000 shares of stock in consideration for the assignment of patent rights by Mr. Bucalo. The plaintiff contended that the patent rights were already the property of the corporation as consideration for 200,000 shares received by Bucalo upon forming the corporation. The court of chancery, per Vice-Chancellor Hartnett, held that 1) there had been a breach of fiduciary duty by all the defendants; 2) any patents granted on the products invented were the property of Microbyx Corporation; and 3) Bucalo must account to the corporation for the patent rights either by returning the ownership of the rights to Microbyx Corporation or compensating Microbyx Corporation for their value.

1. Corporations ⟹ 319(7)

Where agreements entered into by the corporation were made for the benefit of the defendant, and the directors who approved the agreements were controlled by the defendant, the agreements under attack are not protected by the presumption of propriety of the business judgment rule.

2. Corporations ⚷ 319(7)

Where the business judgment rule does not shield the transaction from judicial scrutiny, the agreements must be examined to see if they are fair to the corporation.

3. Equity ⚷ 39(1)

The court of chancery has broad discretion to tailor remedies to suit the existing situation.

A. Gilchrist Sparks III, Esquire, and Lawrence A. Hamermesh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

Charles S. Crompton, Jr., of Potter Anderson & Corroon, Wilmington, Delaware; and Harvey Tropp, Esquire, of New York, New York for defendants.

HARTNETT, *Vice-Chancellor*

This action was commenced as a stockholder's derivative suit by John A. Andresen, the plaintiff. The defendants are Louis Bucalo, Elizabeth M. Curran, Charles M. Lynne and the corporation, Microbyx Corporation, a Delaware corporation. The individual defendants are all directors of the corporation. After trial I find, in effect, that there has been a breach of fiduciary duty by all the individuals involved.

Although the suit purports to be a stockholder's derivative suit, in actuality the controversy is between Mr. Andresen and Mr. Bucalo because Microbyx Corporation is a closely held corporation which was formed by Mr. Andresen and Mr. Bucalo and is controlled by them. Needless to say, it is difficult to apply the general principles of Delaware corporation law to this controversy which appears to be mostly a spite suit.

I

It would be impossible to recite all the many facts and disputes adduced at the three days of trial and in the many depositions and exhibits. The best I can do is to summarize my findings as to the essential facts from my review of the evidence and the arguments and post-trial briefing.

The corporation was formed in 1972. The initial issuance of shares of stock was 200,000 shares to Mr. Andresen and Mr. Bucalo as tenants in common. The consideration by Mr. Andresen was $500, and his

agreement to obtain financing for the enterprise. Mr. Andresen and Mr. Bucalo had numerous business transactions prior to the forming of Microbyx Corporation and, sometime prior to 1972, Mr. Bucalo had left his former place of employment to become associated with Mr. Andresen. Mr. Andresen was, at that time, a New York stockbroker engaged in the sale and promotion of new capital ventures. Mr. Bucalo was in inventor who had conceived a number of ideas which he and Mr. Andresen felt could be the basis for development if enough promotion capital could be raised.

A different corporation was formed by Mr. Andresen and Mr. Bucalo to develop each of Mr. Bucalo's ideas. The last corporation so formed was defendant Microbyx Corporation which was formed in 1972. It was created in order to develop Mr. Bucalo's ideas concerning the collection and analysis of menstrual blood. There have been but two stockholder meetings of Microbyx Corporation—one on December 28, 1973 and one on December 3, 1980 which was held pursuant to an order of this Court. There have been no formal meetings of the Board of Directors since December 28, 1973.

It is undisputed that Mr. Andresen, as part of the consideration for the shares of stock that he received in the corporation, agreed to perform certain services in attempting to obtain financing for the corporation by the sale of shares of stock in it. There is a dispute as to how much of a commitment Mr. Andresen made. Mr. Andresen claims that his commitment was to use his best efforts to obtain financing and that he would not receive a finder's fee for any of the financing that he obtained. Mr. Bucalo, on the other hand, claims that Mr. Andresen had a firm commitment to raise at least $1,000,000 for the corporation and that upon his failure to raise that money he forfeited his right to his shares of stock. The issue of forfeiture, however, was not addressed in the post-trial briefs. Mr. Bucalo also claims that Mr. Andresen received a six percent finder's fee for the amount of money which he was able to raise for the corporation. In any event, it is undisputed that Mr. Andresen raised only $340,000 for the corporation. I find from the evidence that Mr. Andresen received a 6% finder's fee for some of the money he raised. I also find that Mr. Andresen's obligation was only to use his best efforts in locating capital and that he did not make a commitment to raise any specific sum. Mr. Bucalo eventually was able to raise $400,000 for the corporation by the licensing of certain patents to third parties.

The primary dispute between the parties centers around the ownership of certain patents which it is conceded are now in the ownership

of the corporation, but which are subject to forfeiture. There is a dispute as to whether Mr. Bucalo agreed at the time the corporation was formed that the patents would be owned by the corporation or whether they would be owned by him. I find that there was a agreement at the time that the corporation was formed that Mr. Bucalo was to be engaged by the corporation to develop and invent products and devices in Microbyx's business area and that nay patents granted on the products so invented would be the property of Microbyx Corporation. I also find that the disputed patents were developed with the resources of Microbyx Corporation. See *Dinwiddie v. St. Louis & O'Fallon Coal Co.*, 4th Cir., 64 F.2d 303 (1933); *Douse v. Federal Rubber Co.*, N.D. Ill., 254 F. 308 (1918).

In 1973 the first two patents relating to the blood ideas of Mr. Bucalo were issued and Mr. Andresen withdrew as an officer and director of the corporation because he believed that he would be in a better position to obtain financing for the corporation if he were neither an officer or director. Subsequently, other directors were appointed to serve in his stead and several agreements were entered into by the corporation with Mr. Bucalo relating to the patents. Mr. Bucalo also was issued 125,000 shares of stock in the corporation on two occasions without the payment of any sum of money by Mr. Bucalo.

Mr. Bucalo, as the inventor, has received 18 patents involving the collection and testing of blood. All the rights to the patents in North America have been assigned by Mr. Bucalo to the corporation subject to certain terms and conditions favorable to Mr. Bucalo. The rights to the patents outside North America have not been assigned to the corporation.

In 1973, 1974, 1975, 1976, 1978 and 1980 the corporation, acting through Mr. Bucalo, and Mr. Bucalo, acting for himself, entered into agreements. The 1975 and 1976 agreements resulted in the patents obtained during Mr. Bucalo's tenure are president of Microbyx Corporation being assigned to the corporation by Mr. Bucalo but subject to certain conditions for the benefit of Mr. Bucalo. These conditions are an obligation to pay royalties by Microbyx Corporation to Mr. Bucalo and the right of Mr. Bucalo to reclaim the patents upon a default in payments by Microbyx. In 1978 and again in 1980 Mr. Bucalo and the corporation agreed to the issuance of 125,000 shares of stock of Microbyx to Mr. Bucal in trade for Mr. Bucalo assigning to the corporation certain patents which, however, as previously noted, I have found were already the property of Microbyx Corporation.

The plaintiff seeks to set aside the issuance of the 125,000 shares

of stock to Mr. Bucalo in 1978 and 1980 and to set aside the agreements whereby Mr. Bucalo can reclaim the patents or to obtain royalties on the patents. Plaintiff also seeks to impose a constructive trust in favor of Microbyx Corporation on rights in foreign countries arising out of patents obtained by Mr. Bucalo relating to the collection of blood samples.

II

The arriving at a decision in this case is most difficult because, after listening to the full day of testimony of Mr. Andresen and the full day of testimony of Mr. Bucalo, I am convinced that both colored and twisted the facts to bolster their own views of the controversy. In my view the best interests of the stockholders of the corporation, other than Mr. Bucalo and Mr. Andresen, would be that neither of them control the corporation.

Mr. Andresen's testimony was replete with contradictions. Mr. Bucalo's testimony, while not as contradictory, contained numerous inconsistencies between his testimony at trial and the prior testimony which he gave at his deposition. From the testimony of both I can render but one conclusion—both of them are superb promotors and hve great affinity for raising money from others to be used in the promotion of their endeavors. Both obviously have engaged in a great deal of "puffing" or worse when attempting to adduce others to invest in the corporation. Both seem to have no hestitation to refer to the potential of the corporation as being in the millions or even billions of dollars. It is somewhat difficult for a judge of this Court, who receives such modest compensation for his service as a judge, to comprehend that a corporation such as this with no tangible assets could ever have a potential of millions or even billions of dollars. Perhaps I am too unsophisticated in high finance to appreciate the elusive potential of the corporation. It may be that at the time the corporation was conceived it had such potential. Now, however, it is abundantly clear that this corporation has no tagible assets and has little or no potential for the future.

The bottom line in this controversy is who is entitled to the patents because it is clear that only the patents have any potential value to anyone and that potential is highly speculative at best.

III

As indicated previously, it is difficult to apply the principles of Delaware corporate law to what is essentially a corporation formed for the benefit of two men with little regard for the rights of the other

stockholders. I find, however, that there can be no doubt that the directors' acts in adopting the agreements under attack are not protected by the presumption of propriety of the business judgment rule.

[1] The directors who approved the agreements were Mr. Bucalo or persons who were controlled by him or who exclusively relied upon him for information. Mr. Bucalo obviously was the prime beneficiary of the agreements. He therefore had a conflict of interest and the business judgment rule affords him no protection. *Schreiber v. Pennzoil Co.*, Del. Ch., 419 A.2d 952 (1980); *Mitchell v. Highland Western Glass Co.*, Del. Ch., 167 A. 831 (1933); *Sinclair Oil Corp.v. Levien*, Del. Supr., 280 A.2d 717 (1971); *Aronson v. Lewis*, Del. Supr., No. 203, 1983, Moore, J. (Mar. 1, 1984).

Defendant Curran, who became a director in 1973, was an employee of Mr. Bucalo and was his secretary. Although her duties were later termed to be those of an "administrative assistant" and although she was undoubtedly an efficient employee, nevertheless I find that she did not exercise any independent or informed judgment as to the fairness of the agreements to the corporation.

There was no testimony introduced from defendant Lynne who also served as a director and I find no evidence that he exercised any independent or informed judgment as to the fairness of the agreements to the corporation.

[2] I therefore find that the acts of the directors in approving the agreements with Mr. Bucalo are not protected by the business judgment rule. *Aronson v. Lewis*, supra. Because the business judgment rule does not shield the transactions from judicial scrutiny, the agreements must be examined to see if they were fair to the corporation. *Sinclair Oil Corp. v. Levien*, supra.

IV

As previously indicated, I have found that the rights to the patents have always belonged to Microbyx Corporation because Mr. Bucalo initially agreed that the patents would be the property of Microbyx Corporation.

I have also found that none of the agreements are protected by business judment rule because the directors of Microbyx Corporation were controlled by Mr. Bucalo or because the directors did not make an independent or informed decision as to the merits of the agreements. The agreements therefore must be examined with scrutiny to ascertain if they were fair to Microbyx Corporation. I find that they were not. The agreements relating to the patents, in effect, provide that Mr. Bucalo assigned the rights to the patents which Microbyx

Corporation already owned to Microbyx Corporation in consideration for payment of royalties and other benefits to Mr. Bucalo.

The agreements resulting in the issuance of stock to Mr. Bucalo also must be tested by the same fairness to the corporation standard. It is clear that the issuance of 125,000 shares of stock in 1978 and in 1980 to Mr. Bucalo cannot pass muster. The shares were purportedly issued in consideration for the assignment of patent rights by Mr. Bucalo to the corporation—which rights were, however, already owned by the corporation.

V

Plaintiff also seeks to impose a constructive trust on the foreign rights to patents which Mr. Bucalo apparently has assigned to entities not before the Court. It is clear that these patent rights also belong to Microbyx Corporation and Mr. Bucalo must account to the corporation for them either by returning the ownership of the rights to Microbyx Corporation or compensating Microbyx Corporation for their value.

VI

The most difficult part of this case is for me to find a remedy which will protect the innocent in this fiasco. The innocent are the other stockholders—other than Mr. Andresen and Mr. Bucalo. Both of them have used the corporation for their own selfish ends and neither can be permitted to exercise unfettered control over the corporation because to do so would be to place the other stockholders in jeopardy.

[3] This Court, fortunately, has broad discretion to tailor remedies to suit the situation as it exists. *Guarantee Bank v. Magness Construction Co.*, Del. Supr., 462 A.2d 405 (1983). The true situation here is that unless I intervene, the corporation will be manipulated for the sole benefit of Mr. Andresen or Mr. Bucalo with little concern for the rights of the other stockholders. I will, therefore, insist that the final remedy include provisions which will protect the other stockholders.

At this stage I am unable to definitely frame a remedy which will, in my judgment, protect the stockholders who are not aligned with Mr. Andresen or Mr. Bucalo. I, therefore, solicit from the parties suggestions as to how to effectively protect the independent stockholders. In seeking these proposals, however, I am not limiting the Court to remedies that the parties may propose.

I also suggest that each side submit a proposed order reflecting this decision.

BERSHAD V. CURTISS-WRIGHT CORP.

KULIK V. DORR-OLIVER, INC.

Nos. 5827, 5830

Court of Chancery of the State of Delaware, New Castle

February 1, 1984

Plaintiffs individually and on behalf of a proposed class of minority stockholders of Dorr-Oliver sought judicial review of a consummated merger between Dorr-Oliver, Inc. and Dorr, Curtiss-Wright Corp. Upon motions for summary judgment, the court had previously held that the defendants had satisfied their fiduciary duty of complete candor in respect to proxy materials sent to the Dorr-Oliver minority stockholders. Plaintiffs sought reargument and certification of an interlocutory appeal based upon an alleged undisclosed offer made to Dorr, Curtiss-Wright for the purchase of Dorr-Oliver stock. The court found insufficient evidence to show that this offer was ever communicated to Dorr, Curtiss-Wright, and denied plaintiffs' motion for reargument and application for certification.

Defendants sought reargument on the grounds that the court's finding of a proper proxy statement and the requirement of merger approval by a majority of Dorr-Oliver's minority stockholders satisfied the requisite showing necessary to have the plaintiffs' complaint dismissed for failure to state a cause of action. The court denied this motion.

Upon motion of the plaintiffs, those plaintiffs who did not vote in favor of the merger and did not accept any benefit from the merger were granted relief from the dilemma of not utilizing the rights available under *Del. Code Ann.* tit. 8, § 262, and losing those rights by reason of the law being changed by *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

1. Corporations ⟹ 198(3)

Casual inquiries regarding the possible acquisition of all or part of a corporation need not be disclosed to the shareholders in a subsequent proxy solicitation seeking merger approval.

2. Contracts ⟹ 18

Where the evidence is insufficient to show that an offer for the proposed purchase of stock was ever communicated to the intended seller, no offer can be deemed to have been made.

Joseph A. Rosenthal, Esquire, of Morris & Rosenthal, Wilmington, Delaware for plaintiff.

Robert K. Payson, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendant Curtiss-Wright Corp.

A. Gilchrist Sparks III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant Dorr-Oliver, Inc.

LONGOBARDI, *Vice-Chancellor*

This action was commenced by the filing of a complaint on March 14, 1979, by Plaintiff John Bershad ("Bershad") on his own behalf and on the behalf of the proposed class of minority shareholders of Dorr-Oliver, Inc. ("Dorr") against a majority shareholder of Dorr, Curtiss-Wright Corporation ("Curtiss"). Plaintiffs later filed an amended complaint alleging that the May 31, 1979, merger of Dorr and a wholly-owned subsidiary of Curtiss was improper because it was a result of a fraudulent scheme (evidenced by a lack of proper purpose), the consideration paid to the minority shareholders was grossly inadequate and the Defendants had breached their fiduciary duty of complete candor in respect to the proxy materials sent to the Dorr minority shareholders.

After some discovery, Plaintiffs moved for partial summary judgment on the issue of complete disclosure in the proxy statement. Defendants cross-motioned for summary judgment as to all issues. Subsequent to the filing of the summary judgment motions, Plaintiffs applied for and were granted leave to depose the Chairmen of the Boards of both Curtiss and Kennecott Corporation in a quest for information pertaining to discussions which occurred one and one-half years after the merger in question. In connection with these depositions, the Defendants opposed Plaintiffs' requests to produce certain documents. Plaintiffs moved to compel pursuant to Chancery Court Rule 37.

By Opinion and Order of this Court dated March 21, 1983, Plaintiffs' motion for partial summary judgment was denied, Defendants' motion for summary judgment was granted in part and denied in part and Plaintiffs' motion to compel production was granted. This Court found that the Defendants had met their burden of showing that the proxy materials satisfied the disclosure requirements and, therefore, the vote on the merger was an informed one. I held that according to *Weinberger v. UOP, Inc.*, Del.Supr., 457 A.2d 701 (1983), this left the Plaintiffs with the burden at trial of proving unfairness as to the price at which the minority shareholders who voted against the merger were cashed out.

One week following the March 21, 1983, opinion of this Court, the Defendants filed a motion for reargument. Defendants contend that the combination of a finding by this Court of a proper proxy statement and the fact that the merger had been conditioned upon a majority vote of the minority shareholders of Dorr, together adds up to the requisite showing necessary to have the Plaintiffs' amended complaint dismissed for failure to state a cause of action.

On that same day, Plaintiffs filed a motion for reargument pursuant to Chancery Court Rule 59(f) and for relief from an Order pursuant to Chancery Court Rule 60(b)(2) and an application for certification of an interlocutory appeal pursuant to Chancery Court Rule 42(c). Plaintiff asserts that recent discovery had led him to newly discovered evidence which shows that this Court erred in holding that the total mix of information included in the proxy materials had disclosed all the data required by law. The Plaintiffs were granted leave to conduct discovery as needed for the motions for reargument.

Such discovery having been taken and legal memoranda having been submitted, this is my decision on Plaintiffs' motion for reargument, motion for relief from an Order and application for certification of an interlocutory appeal and on Defendants' motion for reargument.

The undisputed facts in this case are set forth in detail in this Court's March 21, 1983, opinion. I therefore need only summarize them here. On April 10, 1979, a proxy statement was sent to the Dorr stockholders along with a Notice of an Annual Meeting to be held on May 10, 1979. The proxy materials explained that a vote would be taken on the proposed merger of Dorr with a wholly-owned subsidiary of Curtiss wherein the minority shareholders of Dorr would receive $23.00 in cash for each of their common shares. The proxy statement also advised the shareholders that in the event that a majority of the minority shareholders did not approve the merger, it would not be consummated and Curtiss had no contingency type plans to make a tender offer or to propose a different merger plan. The materials did state that if the merger plan that was proposed failed to pass, Curtiss intended to purchase more Dorr stock in the future. The proxy statement also disclosed Curtiss' present intention not to sell its interest in Dorr or to sell Dorr as an entity.

Further, the proxy materials informed the minority shareholders of inquiries received concerning the purchase of Dorr common stock. It stated:

> From time to time, the Company [Dorr] and Curtiss-Wright have been approached by other parties expressing an interest

> in the acquisition of the Company or all or part of Curtiss-Wright's holding of Common Stock of the Company. None of these inquiries has developed to the point where any offer was made.

Proxy Statement at 21-22.

The annual meeting was held as scheduled and a majority of the minority Dorr shareholders voted in favor of the merger. The merger was realized May 31, 1979.

Plaintiffs contend that the stockholders should have been informed of Curtiss-Wright's policy of discouraging any offers for the purchase of Dorr-Oliver. As a consequence, they contend the proxy statement which disclosed only "inquiries" rather than firm offers was in fact a half-truth. Plaintiffs maintained that the Defendants were obligated to explain in the proxy statement that "none of these inquiries were developed to the point where any such offer was made because Curtiss had smothered all such interest out of hand." Defendants contend that the total mix of information from the proxy statement revealed Curtiss' policy of buying Dorr stock and that the stockholders had knowledge of Curtiss' policy not to sell Dorr stock.

In concluding that summary judgment was appropriate, the Court said:

> The Plaintiffs contend that the proxy statement is inadequate because it does not completely disclose Curtiss' policy of discouraging offers from third parties. In this respect, no additional amount of evidence could or need be produced and none is needed to make a legal determination of the adequacy of the proxy statement. Indeed, the issue is as narrowly drawn today as it would be after a complete trial;. . . .

Bershad v. Curtiss-Wright/Kulik v. Dorr-Oliver, Del.Ch., C.A. Nos. 5827, 5830 at 9, Longobardi, V.C. (March 21, 1983).

Even though Plaintiffs have moved for summary judgment on this issue, they moved for reargument on the grounds of newly discovered evidence. The newly discovered evidence, they contend, was evidence in the form of an alleged letter from Thyssen Bornemisza, N.V. that offered to buy Dorr stock for $40 per share, $17 more than the "cash out" figure. The allegations had serious substantive implications about the value of the stock but, more importantly, the adequacy and truthfulness of the proxy disclosures. The Plaintiffs sought leave to develop this thread of evidence by requesting permision to

pursue discovery which might substantiate their allegations. That discovery is now complete.

The draft letter in question was prepared by an employee of Drexel Burnham Lambert Incorporated ("Drexel") for Mr. David Gavrin ("Mr. Gavrin"), then Vice-President of Drexel, addressed to Mr. T. Roland Berner ("Mr. Berner"), chairman of Curtiss. However, the deposition testimony of Mr. Garvin does not state that this draft letter was even typed in finished form nor that it ever was delivered to any representative of Curtiss.

[1] The existing record aptly demonstrates the wisdom of the law which provides that casual inquiries need not be disclosed. The following quotation from "Elgin National Industries, Inc. v. Chemetron Corporation", D.Del., 299 F.Supp 367 (1969) seems most appropriate:

> The wisdom of passing on to stockholders approaches made to management concerning exchange or merger offers lies within the bona fide discretion of the directors. To make public every "casual" approach looking toward the joinder of two companies would in many instances be disconcerting to stockholders, occasion innumerable inquiries concerning the terms, the extent of the discussion, possibility of consummation and the like, and, perhaps play an important part in the unfortunate gyrations of the market price of the stock.

Id. at 371. In other words, it is most difficult to substantiate the motives and true meaning of anything said during business negotiations. Trying to establish what was really intended under those circumstances can amount to nothing more than speculation and the Court seriously questions the value of such speculation considering the public investment context.

At the meeting among representatives of Curtiss, Drexel and Indian Head, it is readily apparent that no firm offer was made by Indian Head. To characterize any of these discussions otherwise than to say they were preliminary negotiations pure and simple would be engaging in speculation and that is the essence of the argument why mere "inquiries" need not be disclosed.

[2] Because this new evidence cannot be regarded as an offer as a matter of law and because it raises no factual dispute on the question of "disclosure", Plaintiffs' motion for reargument is denied. This Court also denies Plaintiffs' application for certification under Rule 42(c).

The Court also denies Defendants' motion for reargument. Those

Plaintiffs who did not vote in favor of the merger and did not accept any benefit from the merger are granted relief from the dilemma of not utilizing the rights available under 8 *Del. C.* §262 and losing those rights by reason of the law being changed by the *Weinberger* decision. It is that small group of Plaintiffs, if any yet exist, who may persist in this litigation

IT IS SO ORDERED.

CRAFT V. BARIGLIO

No. 6050

Court of Chancery of the State of Delaware, New Castle

March 1, 1984

Plaintiffs Carleton Craft, Beryl Craft, and Craft, Inc. brought this action to rescind the purchase of a pizza and delicatessen business they acquired from defendants, Anthony Bariglio and Sharon L. Bariglio. Plaintiffs sought rescission based upon alleged misrepresentations which induced them to enter into the agreement.

The court of chancery, per Chancellor Brown, held that 1) the defendants were guilty of making misrepresentations of material facts to the plaintiffs which persuaded plaintiffs to enter into the agreement; 2) plaintiffs established fraud as would normally warrant rescission of the agreement; 3) the court was unable to effectuate a decree which would restore the parties to the status prevailing prior to the agreement; and 4) plaintiffs' demand for rescission as well as the accompanying demand for a money judgment must be denied. The court fashioned an equitable remedy giving the plaintiffs sixty days to complete the purchase at a discounted rate, after which time inaction by the plaintiffs would result in judgment entered for defendants in the amount of the total delinquent payments due.

1. Fraud ⟹ 31

An action in equity to rescind will lie where there has been fraud.

2. Vendor and Purchaser ⟹ 33

To show fraud sufficient to warrant rescission, a plaintiff must

demonstrate that the defendant either misrepresented a material fact or concealed such a fact from the plaintiff at a time when the defendant had a duty to disclose.

3. Fraud ⟹ 20

In an action for fraud in which misrepresentation is alleged, the plaintiff must show justifiable reliance on defendant's representations.

4. Fraud ⟹ 11(1), 12

Contracts ⟹ 94(7)

Mere expressions of opinion as to probable future results, when clearly made and understood as such, do not constitute false representations even though they may relate to material matters.

5. Contracts ⟹ 94(7)

What might be considered to be a mere matter of opinion when expressed to one in an equal bargaining position may rise to the level of a misstatement of fact when made by one with special or superior knowledge.

6. Contracts ⟹ 94(3)

Material misrepresentations, even though innocently made, may be sufficient to warrant rescission in a court of equity.

7. Contracts ⟹ 94(4)

Fraud ⟹ 20

Justifiable reliance upon defendant's representations can be shown where a reasonable person would consider such representations to be important in determining his course of action.

8. Evidence ⟹ 434(8)

The doctrine of merger by deed or merger by contract does not preclude a claim for rescission where a plaintiff was induced to enter into the contract because of fraudulent misrepresentations. Such fraud may be proved by parol evidence.

9. Fraud ⟹ 20

The purchaser of a business is under no duty to investigate the accuracy of representations made by the seller concerning its profitability and operational affairs, even if such an opportunity exists.

10. Contracts ⟹ 270(2)

A party who discovers he has been misled into entering a contract by false representations must act with reasonable diligence if it is his intention to seek rescission as opposed to affirming the contract and suing for damages. He cannot derive all benefits from the transaction and then when called on to comply with its terms, claim misrepresentation.

11. Contracts ⟹ 265

Rescission will not be granted unless the court can and does restore the parties substantially to their positions prior to the contract.

Charles Snyderman, Esquire, of Wilmington, Delaware, for plaintiffs.

Alfred J. Lindh, Esquire, of Lindh & Halberstadt, Wilmington, Delaware, for defendants.

BROWN, *Chancellor*

Carleton Craft and Beryl B. Craft, his wife, and B & J Craft, Inc., the corporate entity of which they are the sole shareholders (hereinafter referred to collectively as "the plaintiffs"), brought this action to rescind the purchase of a pizza and delicatessen business located in Claymont which they acquired from the defendants pursuant to an executive agreement of sale. This is the decision after final hearing.

The written agreement of sale was dated May 25, 1979, the same date upon which a final settlement of the transaction was held. Under the terms of the sale the plaintiffs paid a total of $20,000 in cash plus the additional sum of $8,537.30 which represented the value of the inventory of the business that was transferred to them as part of the transaction. The plaintiffs also executed promissory notes which obligated them to pay T.L.T., Inc., the corporate defendant owned by the defendants Anthony G. Bariglio and Sharon L. Bariglio, his wife, the further sum of $130,000 in 120 consecutive monthly installments of $1,577.27 each commencing July 1, 1979. These promissory notes, however, gave the plaintiffs the option of satisfying them in full by the payment of $65,000 by January 2, 1980. Thus, the purchase price of the business acquired by the plaintiffs was either $150,000 plus the value of the inventory if paid over a period of ten years or, alternatively, $85,000 plus the value of the inventory if paid within six months. On the evidence, the plaintiffs intended to avail themselves of the latter provision and were capable of so doing. Thus, their contemplated purchase price of the business, which included the

assignment of the lease on the property on which the business was located, was $93,537.30.

Inasmuch as the plaintiffs seek rescission based upon alleged material misrepresentations which induced them to enter into the agreement of purchase and sale, the events leading up to the execution of the contract of sale are pertinent. The plaintiffs became interested in purchasing a business when they saw a sign on the property of the defendants Bariglio indicating that they had a business for sale. At the time, the plaintiffs Craft lived in the same neighborhood as the Bariglios. Mrs. Craft and Mrs. Bariglio had known each other from their school days.

The plaintiffs Craft had no prior experience or expertise in running a delicatessen and pizza business. At the same time, they cannot be classified as completely unsophisticated purchasers. Mrs. Craft is a school teacher and thus presumably she has a college education. Mr. Craft has a two-year college business degree in accounting and, in addition to working for a period of time as an assistant comptroller for Wilmington Dry Goods, he has been employed for many years as the corporate treasurer for a well-known Delaware wholesale distributor. As such, he has considerable familiarity with the keeping of records for a business.

The Crafts soon learned that the defendants had three businesses for sale. In addition to the business in Claymont the defendant had a grocery and delicatessen business in Lima, Pennsylvania and a pizza business in New Castle which they were willing to sell. The Bariglios also had a pizza business in a bowling alley in New Jersey plus a Swanky Frank operation in Dover. In addition, Anthony Bariglio, along with others, had just entered into the purchase of a restaurant in Georgetown, Maryland, and he and his wife were intending to move to that area. Thus, it was their decision to sell off their business interests in the Wilmington vicinity.

In late March or early April of 1979 the Crafts met with the Bariglios at the home of the latter. At some point the Crafts were given three one-page documents. One was a "re-cap" sheet, or flyer, prepared by the Bariglios to promote the possible sale of the Claymont business. The other two documents were "statements of income" for the Claymont store for the years 1977 and 1978. Anthony Bariglio indicated that he had installed a pizza oven and other related equipment and had added the sale of pizzas and subs to the business during the latter months of 1978. He therefore suggested that the 1978 figures were the more realistic for the plaintiffs to rely upon. The "re-cap"

sheet contained in part a forecast of the gross sales that the Bariglios considered the business would be capable of achieving in the future based upon their experience in the preceding months after having initiated the sale of subs and pizzas.

The statement of income for 1978 showed annual gross sales of some $307,000, a gross profit after the cost of purchases of some $114,500, and a net profit after operating expenses of $38,665. The re-cap sheet touted the pizza-delicatessen operation as having a gross business of $340,000 per year and a net profit of $35,000 per year. The statement of income reflected payroll for the year as being some $35,600. The re-cap sheet put payroll at $1,000 per week. When asked about this apparent discrepancy by the Crafts, Anthony Bariglio answered that there was $15,000 or so that could be taken out in cash—"skimmed off" as the Crafts understood it—to be used as the owners saw fit, i.e., for payroll purposes, to pay themselves, etc.

The re-cap sheet also indicated that management of the business was "Absentee." When asked about this by the Crafts, Anthony Bariglio indicated that this was true, that his wife generally came in and worked the cash register over the noon hours, but that he, particularly with his other business commitments, was rarely in the store. Since Mr. and Mrs. Craft both had full-time employment elsewhere, they were particularly interested in this absentee management aspect.

During the course of further discussions between the parties the Bariglios turned over to the Crafts a daily receipts journal for the business for a part of 1978 as well as the general ledger for the business for 1978. Anthony Bariglio also provided the Crafts with inventory and depreciation figures. The Crafts took this information to their accountant for a review and were advised that the purchase of the business by them appeared to represent a good opportunity. The accountant suggested further that they ask for the corporate income tax returns on the business, but Anthony Bariglio refused to produce them, stating as one of his reasons that the tax returns represented a consolidation of two businesses. Carleton Craft also noticed that the general ledger contained no figures for accounts payable. He was familiar with general ledgers and he considered accounts payable to be a general ledger item. When asked about this, Anthony Bariglio stated that there were no accounts payable and that he paid his bills promptly.

The Bariglios did, however, offer one other thing of significance. They suggested that the Crafts actually take possession and run the business for a period of time, and look at all bills and records of

the business and personally experience its day-to-day operation in order to satisfy themselves that they wanted to purchase it on the terms proposed by the defendants. The Bariglios apparently had no pressing need to sell the business prior to June or July of 1979 and therefore it was suggested that the Crafts could, if they so desired, sign an agreement, work the business for several weeks, and, if not satisfied, walk away from the transaction without obligation. The Crafts, however, were not interested in doing this. They stopped in to observe the business on several occasions and sent their daughter to work at the store for a couple of days. However, rather than to avail themselves of the defendants' offer, they decided to purchase the business on the defendants' terms and, further, they chose to press on to a prompt settlement of the transaction.

For this purpose the plaintiffs retained counsel. The defendants, on the other hand, were not represented by counsel and indicated that they would be willing to go to settlement based upon the documents prepared and provided by the Crafts' attorney. On this basis settlement was held on May 25, 1979. Although it basically followed the outline of a proposed form of agreement suggested initially by Anthony Bariglio, the agreement of sale actually signed by the parties was in the form drafted by the plaintiffs' counsel. The agreement contained no warranties as to any of the representations made by the defendants in the course of negotiating the sale. The promissory notes, the bill of sale, the assignment of the lease, the security agreement as to the business equipment and fixtures, and the notice to creditors were all prepared by the plaintiffs' counsel. The bill of sale placed a value of $125,000 on the equipment, lease and trade name being transferred. The balance of $25,000 due on the $150,000 purchase price was assigned to a covenant not to compete. The total value placed on the equipment alone in the agreement of sale was $80,261.46.

Following settlement on May 25 the plaintiffs assumed ownership and control of the business. Thereafter the factors which have given rise to this litigation soon made themselves apparent. For one thing, the plaintiffs began receiving various unpaid bills and notices of past due accounts for purchases made by the defendants prior to the time of settlement. The number of these of which the plaintiffs became directly aware were more than a dozen and they totalled several thousand dollars in amount. A constable, during business hours, appeared and levied an attachment on certain equipment because of an unpaid bill. None of these newly-appearing creditors had been indicated on the list provided by the defendants at settlement for the purpose of giving notice to creditors.

Secondly, the plaintiffs Craft found it increasingly necessary to work many hours at the business in order to insure its proper operation. Moreover, they came upon information which indicated that Anthony Bariglio had in fact spent many hours on a weekly average in personally working at the business despite his previous representation that he was rarely at the store.

Thirdly, in the course of going through available bills and records the plaintiffs discovered that at various times obligations of the business had apparently been paid directly by the Bariglios from their personal funds rather than from funds belonging to the business. The plaintiffs also discovered information which, to them, indicated that certain expense items set forth on the 1978 statement of income were understated. From this they concluded that during the course of their negotiations to purchase the business the defendants had misrepresented the expenses of the business and, accordingly, had misrepresented its profitability.

The plaintiffs made their first monthly installment payment on the balance of the purchase price in July when it came due. As they began to discover things which indicated that something was wrong, however, they paid their next two monthly payments into escrow with their attorney after giving defendants notice that they were so doing. In October, through their attorney, they advised the defendants that they felt that the value of the business had been misrepresented to them. They suggested that the purchase price be adjusted downward by $35,000 so as to enable the plaintiffs to complete the purchase within six months by paying the defendants only an additional $30,000 rather than the $65,000 figure called for under the terms of the agreement. In the alternative, plaintiffs proposed that the entire transaction be rescinded. Defendants rejected this proposal, but offered to reduce the discounted purchase price by $10,000 in order to avoid litigation provided payment in full was made by December 12, 1979. On November 30 plaintiffs made a formal demand for rescission. On December 11, 1979 they filed this suit. They have made no payments on the balance due on the purchase price other than the three monthly payments previously mentioned, two of which were paid into escrow.

The case as it now comes for decision is in a disturbing posture. Because of somewhat protracted and complex discovery with various problems attendant thereto, because of interludes along the way attributable to efforts by the parties to settle the dispute voluntarily, because of the desire of the plaintiffs to brief the issues post-trial based upon a transcript of some six days of testimony, and because of the backlog in this Court resulting in the case being tried and argued in

less than timely fashion given the nature of the matter, what we have now come down to is a situation wherein the Court is being asked to rescind the sale of an ongoing pizza and delicatessen business more than four years after the transfer of ownership. During this time the plaintiffs have changed the name of the business and have operated it to the complete exclusion of the defendants and, since they have seen fit to maintain their own books and records without independent accounting assistance despite the fact that the matter has been in ongoing litigation, I think it reasonable and practical to assume that they have extracted from the business over that time whatever economic benefits it may have generated. In addition, except for one monthly payment of $1,577.27 the plaintiffs have paid the defendants absolutely nothing on the balance of $130,000 due on the purchase price over the four-year period that they have operated the business.

To make matters even worse, plaintiffs want to be compensated monetarily for the trouble and expense to which they feel they have been put in preserving the business over the past four years in order that it can be returned to the defendants once rescission is granted. For one thing plaintiffs contend that they have been forced to invest in the business from their own funds some $22,700 more than they have received back from it. They claim that they could have been expected to earn a return of 15% on that investment had they been able to invest those monies in other income areas. Thus, under their computations, they ask for interest in the amount of $22,761 on their allegedly forced investment of $22,700 as well as for a return of the investment itself. In other words, they seek a recovery of $45,461 against the defendants for this item.

Plaintiffs further contend that they were forced to pay their children from their own funds for working in the business while it has been under their ownership and control. They seek recovery in the sum of $3,072 for this expense.

Plaintiffs also rely on the fact that it was represented to them by the defendants that they could operate the business as absentee owners. They say that this representation proved to be false and the Crafts assert that they have been required to work an average of 38 hours per week in the business between them in order to keep it going. They place a value on what they characterize their uncompensated work hours in the total sum of $60,769. With interest computed in, they demand $74,280 for this claimed item of damage.

Also, as stated earlier, as of the time of settlement on the contract of sale the plaintiffs paid the sum of $20,000 on the purchase price plus an additional $8,537.30 representing the value of the

inventory then on hand. When recission is granted, they want this returned also.

Thus, in addition to asking that the defendants be made to take back the business which the plaintiffs have operated for some years now without any payment on the purchase price to the defendants at all, plaintiffs also seek a money judgment against the defendants in the sum of $147,544.81, plus costs, counsel fees and the cost of their expert witnesses together with a lien against the business for the amount of the judgment once the business is returned. When it is considered that the total purchase price for the business at the outset was $150,000 plus the value of the inventory to be paid over a period of ten years, or, alternatively, a discounted purchase price of $85,000 plus the cost of the inventory if paid in cash within approximately six months from the date of settlement, it would seem that the demands of the plaintiffs before a court of equity have reached the point of being somewhat extreme, to state the proposition charitably.

Defendants deny that any material misrepresentations of fact were made to the Crafts in order to induce them to enter into the agreement of purchase. They take the position that they sold the plaintiffs a valuable ongoing business situated in an ideal location and that they did so after being completely candid with the plaintiffs as to how the business operated and after advising them as to how best to operate it. They say that the difficulty, if any, experienced by the plaintiffs in failing to derive a respectable profit from the business is attributable solely to their inexperience and mismanagement of the business after they took over.

Defendants point out that following settlement the plaintiffs failed to retain the services of the highly qualified pizza maker who had been working for the defendants and permitted their children and other employees to make pizza. Thus, the quality of the product fell off and sales went down. Defendants contend further that the plaintiffs priced many items too low in the process of attempting to attract business, something defendants say is borne out by reference to the plaintiffs' gross profit percentage. While defendants offered expert testimony to the effect that the gross profit percentage for a pizza-delicatessen business of the type involved here should range from a low of 33% to a high of 45%, they point out that prior to trial the plaintiffs' monthly gross profit percentage ranged from a low of 23% to a high of only 36% for the balance of 1979 and averaged only 23.6% for 1980. It continued to be far below average thereafter.

Defendants further point to the fact that the gross sales for the business after the plaintiffs took over eventually came to exceed even

the $340,000 figure projected by the defendants on the flyer, or re-cap sheet shown to the plaintiffs during negotiations for the sale. For one 12-month period prior to trial plaintiffs' gross sales exceeded $500,000. Defendants find it difficult to believe that plaintiffs have actually experienced the loss they claim on such an increasing volume of business, and they contend that if the plaintiffs have suffered such a loss it is surely the result of their failure to properly oversee the business as to pricing, portion control, waste, pilferage and the like. In any event, defendants contend that even the plaintiffs' records reveal that the volume of business was there and thus defendants assert that they in no way deceived the plaintiffs as to the value and potential of the business they were buying.

As to the accounts payable that were not disclosed, defendants point out, and plaintiffs concede, that they were all paid by the defendants after their existence came to light. Thus, the fact that there were accounts payable that were not disclosed to the plaintiffs prior to the time of settlement did not cost the plaintiffs anything in the long run.

Defendants further rely on the fact that it was the plaintiffs, not themselves, who were represented by counsel in the transaction, and that the agreement of sale prepared by plaintiffs' counsel contained no warranties to be made by the defendants as to accounts payable, absentee management or profitability. Thus they argue that any such representations that they may have made in the process of negotiating the transaction were merged in the executed agreement of sale and, in the absence of any express warranties being contained in the agreement, they argue that such representations cannot be relied upon by the plaintiffs now as a basis for setting aside the sale.

The defendants further charge that if the Crafts were required in their judgment to spend many hours working personally in the business and if they were required to put additional monies into it in order to keep it going pending trial, it again is attributable to their mismanagement and lack of prior experience in operating a pizza and delicatessen business, and thus not something for which the defendants can be held responsible. Defendants are also suspicious of plaintiffs' records, noting, for example, that there is no income indicated from the sale of party trays or from scrap ends from lunch meat, etc. which defendants sold for dog food when they operated the business and from which, combined, they derived $6,000-$7,000 per year in income.

Finally, defendants are understandably distressed that the plaintiffs have taken the business and operated it since October of 1979 without paying the defendants one cent on the balance due on the

purchase price. They point out that the plaintiffs are clearly in default on the promissory notes and, in reliance on the acceleration provisions in the note which become activated in the event of a default, defendants demand judgment on their counterclaim for the balance of $130,000 due, less the one monthly payment they have received. They say that the plaintiffs are clearly in default under the agreement and that the only reason that they are cast as defendants in this action is because the plaintiffs beat them in the race to the courthouse.

Preliminarily, I note that this case strikes me as being fairly representative of the overly litigious society in which we now live. The case as it now stands would seem to represent a no-win situation for both sides. The plaintiffs would have it believed, in effect, that they have been virtually enslaved for some four years to an unprofitable business which they do not want. They claim to have incurred grave financial loss in the process of preserving what they characterize as a continuing unprofitable business while they await a legal determination of their claim that in equity and good conscience the defendants should be made to take it back. The defendants, on the other hand, by refusing to take it back, have surrendered a business which they claim is profitable if properly run, and have done without the profits as well as the use of the installment payments they expected to receive from the balance due on the purchase price for a period of over four years. In the process each side has undoubtedly incurred substantial counsel fees and related expenses in a type of case which, under the facts and the law, clearly mandates that each side must bear its own counsel fees and litigation expenses. It would seem that reasonable men would have worked out some realistic solution long ago, even if it meant that each side had to swallow some initial out-of-pocket loss and sue for damages in a court of law later on in an effort to recover it. Now, however, the situation has been permitted to swell to such proportions that it defies any realistic solution under which either side can be made whole regardless of who wins. But the parties are entitled to insist on a determination of their rights on the battle lines drawn between them if they so choose, and the Court will take the case as it finds it.

Returning to the merits of the matter, I also note preliminarily that the various defensive arguments relied upon by the defendants do not meet squarely the grounds on which the plaintiffs seek rescission. Rather, they seem to be offered more to demonstrate that the plaintiffs are not entitled to recover the substantial monetary damages which they seek. This is so because the defendants attempt to show that the disappointment and misfortune of the plaintiffs, if any, is

attributable to their failure and inability to operate the business efficiently after they acquired it while it is the position of the plaintiffs that they would not have been induced to acquire it in the first place had it not been for the material misrepresentations of fact made by the defendants.

[1-3]Under the law of this State it has been held that where a contract of sale has been executed, a plaintiff's sole remedy is a suit at law on the warranties and that an action in equity to rescind the contract will not lie unless there has been fraud. To show such fraud as will warrant rescission, a plaintiff must demonstrate that the defendant either misrepresented a material fact or concealed such a fact from the plaintiff at a time when the defendant had a duty to disclose it. The plaintiff must also show justifiable reliance on the defendant's representation or duty to disclose. *Holley v. Jackson*, Del.Ch., 158 A.2d 803 (1959). See also *Kern v. NCD Industries, Inc.*, Del.Ch., 316 A.2d 576 (1973); *Eastern States Petroleum Co. v. Universal Oil Products Co.*, Del.Ch., 3 A.2d 768 (1939).

[4,5]Mere expressions of opinion as to probably future results, when clearly made and understood as such, do not constitute false representations even though they may relate to material matters. *Esso Standard Oil Company v. Cunningham*, Del.Ch., 114 A.2d 380 (1955); *Eastern States Petroleum Co. v. Universal Oil Products Co., supra*; *Nye Odorless Incinerator Corporation v. Felton*, Del.Super., 162 A.504 (1931). However, what might be considered to be a mere matter of opinion when expressed to one in an equal bargaining position may rise to the level of a misstatement of fact when made by one with special or superior knowledge. *Stevens v. Johnston*, Del.Ch., 117 A.2d 540 (1955); *Esso Standard Oil Company v. Cunningham, supra; Eastern States Petroleum Co. v. Universal Oil Products Co., supra.*

[6]Moreover, while intent to defraud or deceive is an essential element to a recovery for fraudulent misrepresentations in an action at law, such intent is not essential to equitable relief if a false statement has in fact been made, *In re Brandywine Volkswagen, Ltd.*, Del.Super., 306 A.2d 24 (1973), *affirmed*, Del.Supr., 312 A.2d 632 (1973), and rescission may be an available remedy in equity even where the false representation was made innocently. *Norton v. Poplos*, Del.Supr., 443 A.2d 1 (1982).

[7,8]As to the right of a plaintiff to rely upon specific representations, it has been held that justifiable reliance requires that the representations relied upon involve matters which a reasonable person would consider important in determining his course of action in the transaction in question. *Lock v. Schreppler*, Del.Super., 426 A.2d 856 (1981).

In addition, the doctrine of merger by deed or merger by contract does not preclude a claim for rescission where a plaintiff was induced to enter into the contract because of a fraudulent misrepresentation. *Norton v. Poplos, supra; Pryor v. Aviola*, Del.Super., 301 A.2d 306 (1973); *Stevens v. Johnston, supra.* Nor is proof of such fraud or misrepresentation barred by the parol evidence rule. *Esso Standard Oil Company v. Cunningham, supra.*

Concerning the duty to investigate representations made in connection with the sale of a business, it is stated generally in Black, *On Rescission And Cancellation* (2nd Ed.) § 118 at page 363 as follows:

> "Where a representation is made of a fact (as distinguished from an expression of opinion), and relates to a matter as to which the parties have not equal means of information, but is peculiarly within the knowledge of the person making the representation, the person receiving and acting upon it in the making of a contract has an absolute right to rely on the truthfulness of the representation, and is not required to seek means of information to determine its falsity, although such means are available. Under this rule, representations may be fully relied on without investigation, and are legally equivalent to a warranty of the matter referred to, when made by the seller of a business concerning the profits which he has received from it in the past . . . ."

And compare, *Thomas v. Grise*, Del.Super., 41 A.883 (1898); *Norton v. Poplos, supra; Pryor v. Aviola, supra.*

Measuring the facts of the case against these standards, I find that the defendants were guilty of making misrepresentations of material facts to the plaintiffs which, in large degree, persuaded the plaintiffs to enter into the agreement. It is true that the representations contained in the flyer, or re-cap sheet, to the effect that the business was capable of doing $340,000 in gross sales and that it would produce an annual net profit of $35,000 based thereon, may well fall within the category of mere opinion as to probable future results. At the same time, this representation of opinion was fortified by the 1978 statement of income which purported to list all the operating expenses of the business on a monthly basis and which indicated that in 1978 the defendants had realized a net profit of $38,665 on gross sales of only $307,000.

On the evidence it appears that this 1978 statement of income was deceptive since it did not reflect the payment of various business expenses by the defendants from their personal funds as contrasted

to payment from the funds of the business. Defendants do not dispute that various bills were paid from their personal bank accounts. Because of this I find that these payments were not reflected in the statement of income. Had these payments been reflected in the 1978 statement of income, the net profit figure contained in the document would have been reduced accordingly. To the extent that they were not, the net profit figure contained in the document on which the plaintiffs relied in making their decision to purchase was inaccurate and, I think it fair to say, the defendants are chargeable with knowledge of this.

Of even more significance, the general ledger given to the plaintiffs as reflecting the affairs of the business for 1978 contained no entries for accounts payable. When questioned specifically about this apparent omission, Anthony Bariglio stated, in effect, that the general ledger was accurate and that the business had no accounts payable since he paid his bills promptly. This, of course, was not true as later events disclosed. The business did have accounts payable and, taken collectively when viewed against the nature of the business, they were of a fairly substantial nature. Thus, the representation as to the accounts payable, which was made as an inducement to have the plaintiffs buy, was false, and Anthony Bariglio had to know that it was false at the time.

Moreover, the fact that the defendants paid all of the existing accounts payable after settlement and after such delinquent accounts had been brought to light does not cure the misrepresentation. Certainly, the assurance that the business had no accounts payable, and that it was thus able to pay all of its obligations immediately as they came due, constituted a representation that the business was more profitable than it actually was, or, at least, that it had a greater cash flow than it actually did. Had the plaintiffs been told of the true status of the accounts payable, they may well have viewed the defendants' proposal in a different light. The fact that the defendants paid these obligations after the transaction was consummated cannot overcome the hard fact that the plaintiffs were not told of the existence of these obligations prior to the time that the contract was entered into, especially since they inquired specifically about their possible existence.

Finally, there is the defendants' representation as to absentee management. It is difficult to believe that persons with the Crafts' education and background could truly believe that a retail pizza and delicatessen business could be run profitably and efficiently by simply stopping around on Friday nights to pick up the receipts. Nonetheless, they were both employed full-time at other jobs and the defendants were on notice by their questions that they were not looking to pur-

chase a business which made any substantial call upon their time. Both by the re-cap sheet and by oral representations the defendants indicated that the Claymont store would suit the Crafts' situation and could be managed by them on an absentee basis. By way of assurance, Anthony Bariglio indicated to them that the time that he and his wife spent at the business was inconsequential.

I am prepared to believe that because of his many business involvements and because of his personal industry Anthony Bariglio, by his standards, may have felt that the time spent by him at the Claymont store was insubstantial. However, there is testimony by his own brother, who served as the employee-manager of the business, that Anthony Bariglio often spent 20 hours, and sometimes as much as 30 hours per week working at the Claymont location. I think that the failure to disclose this to the plaintiffs prior to the execution of the agreement of sale, particularly when they had made it know that they were not interested in purchasing the business if it required extensive participation by them on a regular basis, constituted a misrepresentation of the true situation and, in view of the defendants' superior knowledge as to the true status of affairs, it constituted a representation on which plaintiffs were entitled to rely.

[9]In passing, I take note of the fact also that the defendants offered the plaintiffs the opportunity to work the store for a period of time prior to any closing on the transaction so as to satisfy themselves of the value of the business that they were proposing to buy. Had the plaintiffs elected to accept this offer they might well have learned of the things about which they now complain and no doubt this whole affair could have been avoided. In this respect the defendants were certainly fair and reasonable, just as they were in permitting the plaintiffs to select their attorney to handle the transaction and to have him prepare all of the papers. Nonetheless, the law seems to be that the purchaser of a business is under no duty to investigate the accuracy of representations made by the seller concerning its profitability and operational affairs, even when there is an opportunity to do so. Thus, the offer of the defendants, although generous, provides no defense to the fact that material misrepresentations concerning the business were made by them.

That the defendants made this offer also suggests that at least a part of their shortcomings with regard to the representations made may be attributable to the less than text-book manner in which they did business and kept their records. As indicated earlier, business bills were sometimes paid from personal funds. Together with their Lima, Pennsylvania and New Castle enterprises, they were operating three

businesses of a similar nature and the evidence indicates that oftentimes one large purchase was made from a supplier, with the products being divided either three ways or two ways between the stores with an accompanying arbitrary allocation of the cost being made between the stores on a percentage basis. Thus, record entries as to costs, even when made, were oftentimes no more than approximations.

Also, I think it fair to say that the records maintained by the defendants were in deplorable shape. In 1979, when Anthony Bariglio sought assistance from his accountant for the purpose of preparing income tax returns, the accountant advised that the records of the business were in such condition that it would take weeks to straighten them out and he suggested that Bariglio prepare his own returns and just do the best job that he could. Thus, it may be that some of the inaccuracies in the figures utilized by the defendants in inducing the plaintiffs to purchase were made innocently. However, under the authorities previously cited, the fact that a material misrepresentation was innocently made does not constitute a bar to equitable relief.

In summary, I find that the defendants have attempted to uphold the validity of the transaction on the basis that the business was actually a good and profitable one just as represented by them provided that it was operated properly, and that as a consequence the plaintiffs should not be heard to complain of a few minor misstatements concerning the performance and operation of the business during the calendar year preceding the execution and consummation of the agreement of sale. But even assuming that the first portion of this premise could have been true, the gist of the matter is that the defendants made representations as to the net profits, the expenses and the management of the business which were not true, and I find on the evidence that these misrepresentations directly influenced the plaintiffs, as they were intended to do, to enter into the agreement. Accordingly, I find that the plaintiffs have established fraud such as would normally warrant rescission of the agreement. But whether rescission is now an available remedy is, of course, another matter.

[10]An application for rescission of a contract is addressed to the sound discretion of the Court. It is an application governed by equitable principles. One requirement is that a party who discovers that he has been misled into entering into a contract by false representations must act with reasonable diligence if it is his intention to seek rescission as opposed to affirming the contract and suing for damages. He cannot be permitted to derive all possible benefits from the transaction and then, when he is called upon to comply with its terms, claim to be

relieved of his obligation of the grounds of misrepresentation. *Glenn v. Tide Water Associated Oil Co.*, Del.Ch., 101 A.2d 339 (1953).

[11]This requirement goes hand in hand with another equitable principle which governs an application for rescission, namely, that rescission will not be granted unless the Court can and does, by its decree, restore the parties substantially to the position which they occupied before making the contract. *Black, On Rescission and Cancellation* (2nd Ed.) § 616. It is settled law that if a plaintiff chooses the remedy of rescission, there must be a restoration of the status quo ante, not only of the plaintiff but of the defendant as well, and if under the facts of the particular case "a just and equitable restoration of the substantial status quo ante" cannot be accomplished, rescission will be denied. *Hegarty v. American Commonwealth Power Corp.*, Del.Ch., 163 A.616, 619 (1932). See also, *Hessler v. Ellis*, Del.Ch., 167 A.2d 848 (1961). I think that these equitable principles are applicable here and I think further that they require that plaintiffs' application for rescission be denied.

In this case I cannot ignore the fact that although the plaintiffs entered into the possession and operaton of the business in June, 1979, and discovered the factors on which they seek rescission by the end of July at the latest, they made no formal demand for rescission on the defendants until November 30, 1979, and brought this action to seek rescission only on December 11, 1979. It bothers me that during the intervening four-month period they were content to bargain with the defendants, using the misrepresentations of fact as a tool to attempt to bring about a revision of the contract so as to acquire the business at a more favorable purchase price. If the business was so hopelessly unprofitable as they would now have the Court believe, and if they had good reason to believe it at the time, one wonders why they would have wanted it at any price.

This factor must also be weighed against the subject matter of the contract. The transaction here did not involve the sale of a parcel of land, or goods or commodities, which could be kept intact and returned in substantially the same condition as received. Rather, the subject matter of the transaction was an ongoing pizza and delicatessen business. That type of business, of necessity, is dependent for its success upon the efficiency and manner in which it is operated. To an extent, it is a subjective thing. As such, its goodwill is its clientele and a change in management for the worse can quickly cause customers to evaporate. And on the evidence I am convinced that a goodly portion of the plaintiffs' early difficulties derived from their inexperience in operating the type of business that they had purchased.

Moreover, since the filing of this suit the plaintiffs have changed the name of the business and have installed certain innovations which were not there as of the time that the defendants sold it to them. It is now four years after the fact and it is unlikely that the present operation of the business is the same as that which prevailed at the time of the sale. Perhaps to a lesser degree, I am satisfied that a similar change in circumstances had occurred by November 30, 1979 when the plaintiffs, some four months after discovering the misrepresentations on which they now rely, first made a demand for rescission on the defendants. The plaintiffs seem to concede that such a change has taken place by their contention that the business now, as a result of their guidance, is worth two-to-three times as much as it was of the time that they purchased it.

While I find nothing wrong in their effort to attempt to use the misrepresentations initially as a basis for negotiating an attempted reduction in the contractual purchase price, I nonetheless feel that the plaintiffs made a choice at that point as to the course of action to be taken. Having made that choice, I feel that the circumstances require them to live with it now. The nature of the business purchased by them, in my opinion, does not permit them to discover material misrepresentations of fact, hold them as a trump card from July until December while attempting to renegotiate the transaction, operate the business as they see fit all the while, and then sue for rescission only after they are unable to obtain a revision of the contract on new terms satisfactory to them. Under such circumstances, and viewing the situation as I now find it, I do not feel that the parties can be returned substantially to the status quo that prevailed on May 25, 1979. Stated another way, I fail to see how the Court could realistically effectuate a decree which would restore the parties to the status that existed as of the time that the contract of sale was executed. Accordingly, the demand of the plaintiffs for rescission is denied. Since the monetary demands of the plaintiffs were tied to their demand for rescission—they did not choose to accept the benefits of the contract and sue for damages since that would have required an action at law—it follows from the denial of rescission that their demand for an accompanying money judgment against the defendants must also be denied.

At the same time, I do not feel that this decision means that judgment must be automatically entered in favor of the defendants on their counterclaim. Rather, I find this to be an appropriate case for equity to mold its relief to fit the situation so as to do justice to the parties insofar as possible. In so doing, I take note that the defendants have been found guilty of inducing the plaintiffs to enter into the agree-

ment through the misrepresentation of material facts. On the other hand, I take note also that the plaintiffs have availed themselves of the opportunity presented by the discovery of this fact by operating the business for some four years without paying the defendants anything on the balance due on the purchase price. In an effort to balance the matter out, I conclude that the following should be ordered.

The plaintiffs shall have a period of 60 days from the date of the entry of the final order in this case in which they may complete the purchase of the business at the discounted rate by paying the defendants the sum of $65,000, together with interest thereon at the rate of 6% per annum, compounded annually, from October 1, 1979, the date on which they unilaterally stopped all payment on the contract, to September 26, 1983, the date on which final arguments were made and the case submitted for decision. In addition, the two escrow payments shall be turned over to the defendants.

This, I think, compensates the plaintiffs to a degree for the fact that misrepresentations were made to them in that it affords them an opportunity at this late date to still purchase the business at the discounted figure provided that they pay at least a minimal rate of interest attributable to the payments that they have withheld from the defendants. At the same time it gives recognition to the fact that the plaintiffs bear some responsibility for permitting the situation to get to the stage where rescission has become impractical in that it requires them to pay a minimal amount of interest to the defendants, even though they were the initial wrongdoers, for the use of the business by the plaintiffs without making further payments on the purchase price.

In the event that the plaintiffs shall fail to avail themselves of this opportunity within the 60-day period, then judgment will be entered against them and in favor of the defendants for the total amount of all delinquent installment payments due on the $130,000 promissory notes as of the date of the entry of the final order, and thereafter the plaintiffs shall make monthly installment payments on the promissory notes according to their terms until the total remaining balance on the $130,000 due on the purchase price is paid in full. If the business is now worth two-to-three times as much as it was at the time that the transaction was entered into, as plaintiffs contend, it would seem that the choice would be a simple one.

In conclusion, and so as to complete the record, I acknowledge that the plaintiffs also sought to compel rescission based upon an alleged compromise and settlement of the dispute which supposedly occurred prior to trial. Carleton Craft testified to his understanding of the terms of this alleged compromise and settlement even though he did not attend

the conference at which the compromise was allegedly reached. His testimony on this point was admitted over defendants' objection on the condition that it would be connected up by the testimony of a witness who did attend the conference, namely, the plaintiffs' attorney at the time. However, the attorney was never called. Accordingly, defendants moved to strike the testimony of Carleton Craft on this subject at the close of plaintiffs' case, it obviously being heresay. At the time, a ruling was reserved on that motion on the thought that the plaintiffs' witness might still appear. He did not do so. Therefore, the motion of the defendants is granted and the testimony of Carleton Craft as to the alleged compromise and settlement may be considered stricken from the record.

In summary, to the extent that the complaint seeks rescission and accompanying monetary damages, judgment will be entered for the defendants. Judgment will be entered on the counterclaim in favor of the defendants in the manner indicated herein, subject to the right of the plaintiffs to pay off the discounted balance due on the purchase price within 60 days in the manner stated. Defendants shall pay the costs of the Register. Otherwise each side shall bear its own costs and litigation expenses, including attorneys fees and the cost of expert witnesses.

Counsel are asked to agree upon and submit a form of order. If they are unable to do so within 10 days, the Court will enter its own order.

DICKINSON MEDICAL GROUP, P.A. v. FOOTE

No. 834-K

Court of Chancery of the State of Delaware, New Castle

May 10, 1984

Dickinson Medical Group brought action seeking a temporary restraining order against a former employee, Dr. Sandra Foote. Dickinson alleged that the patient material Foote took with her upon terminating her employment constituted confidential and proprietary business information and was protected by the Delaware Uniform Trade Secrets Act. Foote used the patient material in the office she subse-

quently opened in the same town. The court of chancery, per Chancellor Brown, held that (1) Dickinson's patient lists were "trade secrets" and thus protected; (2) the misappropriation of the trade secret could be enjoined; (3) the liquidated damage clause in the employment contract did not relate to damages for deliberate misappropriation of proprietary information; and (4) the potential for immediate irreparable harm to Dickinson was present.

Order granted.

1. Torts ⟹ 10(5)

Confidential customer lists of patients are "trade secrets." The term is defined to include a compilation that derives independent economic value, actual or potential, from not being generally known nor readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use, and which also is the subject of efforts to maintain its secrecy that are reasonable under the circumstances. DEL. CODE ANN. tit. 6, § 2001 (1982).

2. Torts ⟹ 10(5)

Appropriation of a trade secret includes use by one person of the trade secret of another without express or implied consent. This applies where the person used improper means to acquire knowledge of the trade secret. This misappropriation may be enjoined. DEL. CODE ANN. tit. 6, §§ 2001, 2002 (1982).

3. Damages ⟹ 77

The liquidated damage clause in an employment contract is limited to damages for breach of the covenant not to compete. Therefore, it may not relate to damages for deliberate misappropriation of proprietary information.

4. Injunction ⟹ 134

Preliminary injunctive relief is proper where the potential for immediate irreparable harm is present. Misuse of customer lists of patients could result in an immediate loss of business which would be difficult to ascertain.

William A. Denman, Esquire, of Schmittinger & Rodriguez, P.A., Dover, Delaware, for plaintiff.

William J. Wade, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendant.

BROWN, *Chancellor*

Plaintiff Dickinson Medical Group ("Dickinson") an incorporated professional medical association located in Milford, seeks a temporary restraining order against the defendant Sandra Foote. The defendant is a doctor. She is also a board certified oncologist and claims to be the only practicing board certified oncologist south of Dover.

Dr. Foote was employed by Dickinson under a written contract of employment entered into on September 20, 1981. By its terms the contract is renewable on a year-to-year basis thereafter. On April 27, 1984, in the midst of an ongoing dispute over the computation of her compensation, Dr. Foote gave notice to Dickinson that she viewed the employment contract to have been repudiated by Dickinson, and that as a result she was immediately terminating her employment.

Simultaneously with their termination of her employment, and without the knowledge or consent of Dickinson, Dr. Foote obtained and took with her an original computer print-out setting forth the names and addresses of all patients of Dickinson treated by her during the period of her employment. She also took certain medical profiles of Dickinson setting forth applicable charges made by Dickinson for various services rendered to its patients. She did not, however, take any patient files or records.

Dr. Foote has since opened her own office in Milford for the practice of medicine. Dickinson contends, and Dr. Foote does not deny at this point, that she intends to use the names and addresses on the print-out for the purpose of contacting those patients treated by her while working for Dickinson in an effort to solicit those patients for herself in her new practice in direct competition with Dickinson. It is the position of Dickinson that the patient list constitutes confidential and proprietary business information of Dickinson of the type that is protected by the Delaware Uniform Trade Secrets Act found at 6 *Del.C.* §2001 *et seq.* Pursuant to 6 *Del.C.* §2002 Dickinson seeks an order temporarily enjoining Dr. Foote from using the patient list for purposes of such competing business solicitation pending further proceedings.

It is significant that Dickinson is not attempting to prevent Dr. Foote from practicing medicine in the same community even though there is a noncompetition clause in the employment contract which, read literally, would prohibit her from doing so. It is also significant that Dickinson is not seeking money damages here in addition to injunctive relief. The employment contract contains a provision for liquidated damages in a fixed sum in the event that the non-competition clause is violated. Dickinson concedes that the issue of damages, as well as the issue of the breach of the contract as charged by Dr. Foote,

will have to be litigated in an action at law. It does contend, however, that it will be irreparably harmed if Dr. Foote is permitted to use its proprietary information to lure its patients away from it in the meantime.

Dr. Foote contends that her unauthorized appropriation of the patient list will result in no irreparable harm to Dickinson. In the first place, she argues that the liquidated damage clause in the employment contract provides Dickinson with an adequate remedy at law. She also states that Dickinson has no other oncologist on its staff and that as a result the patients she intends to contact could not obtain treatment (which I understand to be primarily that of chemotherapy) from Dickinson anyway.

Moreover, she points to 6 *Del.C.* §2707, effective July 13, 1983, which specifically states that a covenant not to compete among physicians is void and unenforceable. This, she says, reflects a public policy that a doctor-patient relationship is not to be adversely affected by a private dispute between physicians. She views Dickinson's application to be an effort to do just that.

Finally, Dr. Foote contends that public interest supports her intention to contact the patients formerly treated by her since such patients should have a right to know where she is and know that she is still available to treat them. In fact, she suggests that she has a professional responsibility to contact them so as to insure a continuation of treatment in cases where it is needed. Otherwise, she fears that she could well be open to liability for not being available to those who need her specialized services.

As presented, this matter has aspects which I find personally to be disturbing. On the one hand, Dickinson's application makes it clear that is considers the names and addresses of the chemotherapy and related patients in issue to be a thing of value to it. In other words, it is claiming, in essence, that it has earned the right to make a profit from those unfortunate persons suffering from various forms of cancer which is superior to that of Dr. Foote. Somehow this lacks the ring of humanitarianism that once was associated with the practice of medicine. Prior to this application, I never had reason to equate a list of persons suffering from cancer and other illnesses with a proprietary "customer list" as that term is normally employed in the world of commerce. But I guess business is business, regardless of the form it takes.

On the other hand, while I appreciate the contention of Dr. Foote that she is only attempting to maintain a line of communication with those that she is and has been treating, I cannot overlook the fact

that on the present record she does not dispute that she surreptitiously misappropriated for her own use and benefit confidential information compiled by her former employer at what is said to be a substantial expense, and that she necessarily intends to use that information so as to offer her professional services in direct competition with those offered by her former employer.

Were it not for the innocent patients necessarily caught up in this private dispute, it would be tempting for this Court to wash its hands of the matter, to leave the parties where it found them, and to thus relegate them to their remedies at law. To do so, however, would be to engage in moralizing, and this would not be appropriate for the situation.

[1] Accordingly, in deference to the maxim that equity will not suffer a wrong without a remedy, I shall grant the temporary restraining order. The cold, hard fact of the matter is that under 6 *Del.C.* §2001 a "trade secret" is defined to include a "compilation" that "[d]erives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use" and which also "[i]s subject of efforts that are reasonable under the circumstances to maintain its secrecy." On the present record, Dickinson's confidential customer list of its "patients" would seem to fall within that category.

[2] By the same statute, misappropriation of a trade secret includes use by one person of the trade secret of another without express or implied consent where the person used improper means to acquire knowledge of the trade secret. By 6 *Del.C.* §2002 an actual misappropriation may be enjoined. Again, on the present record, the conduct of Dr. Foote would seem to fall within the ambit of the statute.

[3,4] The liquidated damage clause in the employment contract is limited to damages for breach of the covenant not to compete. Therefore, it is arguable that it would not relate to damages for deliberate misappropriation of proprietary information. Since misuse of the customer list of patients could well result in an immediate loss of business to Dickinson which would be difficult of ascertainment, it would seem that the potential for immediate irreparable harm to Dickinson is present.

Because of these factors I find that Dickinson has carried its burden of demonstrating that it is likely to succeed upon the merits of its application at a final hearing. Therefore, I find that it has demonstrated its entitlement to preliminary injunctive relief.

At the same time, this Court can fashion its remedy to fit the occasion. Therefore, I find it appropriate to add a condition to the relief being granted. The condition will be this. Within five business days of the date of the restraining order Dickinson shall give notice by mail to those persons named in the print-out taken by Dr. Foote that it and Dr. Foote have severed their professional relationship and that Dr. Foote is now conducting the practice of medicine at her new location. The notice should also state that while Dickinson continues to consider the person as its patient and is available for medical advice as needed, the person is nonetheless free to consult Dr. Foote at her new office if he or she so desires and that Dickinson will cooperate with the patient hereafter to assure that the patient receives the services of the physician or physicians of his or her choice.

Since Dickinson has indicated that it has no objection to turning over the records to any of its patients who state a desire to utilize the services of Dr. Foote hereafter, this should pose no undue burden upon it. It will further serve to notify the patients of the present situation and of the professional whereabouts of Dr. Foote in lieu of her making what could be viewed as the unsupervised business solicitation which Dickinson fears. I think that this is only fair to the patients involved.

Dickinson shall file an affidavit within the five business day period showing that the condition has been satisfied. Upon a failure to do so the restraining order will be dissolved at the expiration of the five day period.

In view of the condition requiring that notice of Dr. Foote's whereabouts be given to the various patients, I am convinced that bond in the sum of $2,000, with surety, will be adequate for the present. The temporary restraining order will become effective upon the posting of bond in that amount.

HUFFINGTON v. ENSTAR CORP.

No. 7543

Court of Chancery of the State of Delaware, New Castle

April 25, 1984

Plaintiff, a stockholder of the defendant corporation, sought to enjoin the defendant's twenty-eight day postponement of a scheduled

stockholders' meeting. Additional injunctive relief was also sought with respect to the possible exercise of other corporate powers.

Plaintiff contended that the postponement was intended to frustrate a proxy contest initiated by the plaintiff. Defendant contended the meeting was postponed in order to give the stockholders additional time to consider the proxy contest and to give the board sufficient time to conclude a sale of the corporation precipitated by the possibility of an unfriendly takeover.

The court of chancery, per Vice-Chancellor Longobardi, recognized that a corporate board's right to freely conduct the corporation's business at a time and in a fashion serving the corporation's best interests is constrained when such action amounts to management usurping an unfair advantage in its dealings with the corporation's stockholders.

However, the court held that the plaintiff failed to adequately show the misuse of corporate governance in the frustration of the legitimate rights of stockholders. In the absence of a showing of such inequitable conduct, the court refused to assist the plaintiff in substituting his judgment for that of the duly elected board.

1. Corporations ⟹ 310(1)

A corporate board, in the exercise of its business judgment, should be free to conduct the corporation's business at time in a fashion which serves the corporation's best interests.

2. Corporations ⟹ 310(1)

A corporate board's right to conduct the corporation's business is not unfettered when its action amounts to management usurping an unfair advantage in its dealing with the corporation's stockholders.

3. Corporations ⟹ 189(2), 193, 310(1)

If a corporate board's postponement of the corporation's annual meeting is to be condemned, it may be based on attendant circumstances that make it reasonably probable to assume that management intended to frustrate the vote of dissident stockholders.

4. Corporations ⟹ 189(13), 522
Evidence ⟹ 98

The court of chancery is loath to intervene in the internal management of a corporation unless and until a plaintiff can make a case that an exercise of corporate governance, otherwise proper, is used as a tool to frustrate the legitimate rights of its stockholders.

5. Corporations ⟹ 189(13), 193, 522
Evidence ⟹ 98

The court of chancery will not interfere with a corporate board's postponement of the corporation's annual meeting unless a plaintiff satisfies the burden of showing that an exercise of corporate governance, otherwise proper, is used as a tool to frustrate the legitimate rights of its stockholders.

A. Gilchrist Sparks III, Esquire, and Kenneth J. Nachbar, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware for plaintiff.

Charles F. Richards, Jr., Esquire, and Jesse A. Finkelstein, Esquire, of Richards, Layton & Finger, Wilmington, Delaware for defendant.

LONGOBARDI, *Vice Chancellor*

In this case Plaintiffs, Roy M. Huffington and Roy M. Huffington, Inc. are seeking an injunction which will require the Defendants, Enstar Corporation and its directors, to reinstate a stockholders meeting originally scheduled for May 24, 1984. They also seek to enjoin the Defendants from issuing, purchasing or selling shares or series of stock or other securities, except for those situations contractually existing prior to March 19, 1984, from further changing the date of the 1984 annual meeting, from further amending or entering into any contract or agreement between Enstar and its officers or directors and finally from amending Enstar's by-laws. These sweeping proposals for relief are requested because the Plaintiffs contend the Defendants have postponed the annual meeting merely to frustrate or deny the proxy contest initiated by the Plaintiffs. Defendants contend the meeting was postponed twenty-eight days merely to give the stockholders additional time to consider the proxy contest and to give the Board sufficient time to conclude a sale of the corporation. This is the Court's decision on Plaintiffs' motion for preliminary injunction.

The record in this case is replete with references to undisputed facts which would lead one to reasonably conclude that Defendants considered Plaintiffs a nagging inconvenience. As a matter of fact, because of it, they on three occasions attempted either to buy their shares of stock or offered them and their appointees seats on the Board. On each occasion, the Plaintiffs rejected the offers.

In February, 1984, the Board scheduled the annual stockholders meeting for May 24, 1984. Ominous signs about a possible takeover began appearing almost immediately thereafter. A heavy volume of

trading in Enstar's stock was noted and the directors feared an unfriendly takeover. One of the immediate problems was that posed by the Plaintiffs. In an effort to resolve their differences, the Defendants offered the Plaintiff Huffington the four vacant seats on the Board; that is, they offered Plaintiff and his nominees seats on the Board as management's slate. Huffington abstained from disclosing his intentions to accept the offer and requested additional time to consider his position. The Defendants requested he respond promptly because of the necessity of preparing proxy materials. In any event, the record date was moved from Marck 28 to April 4. Twelve days later, Huffington announced his decision to seek control of Enstar and that he might sell the company.

Recognizing the possibility of some confusion, the Board met again and appointed a special advisory committee comprised of outside directors to advise the Board on the course they should pursue. The advisory committee, in consultation with an investment banker, proposed an immediate sale of the corporation. Many of the factors listed by the Defendants indicate that that decision was an exercise of reasonable business judgment. In addition, Huffington was again offered the four seats so that a "common front" could be available for any prospective purchasers. Further, Huffington was offered the entire Board's resignations if the sale was not completed by the annual meeting. Huffington refused the offer and demanded immediate control of the corporation and of the impending sale. This was not acceptable to the Board.

The advisory committee then recommended that a more orderly sale would be advantageous to Enstar's stockholders. Accordingly, the committee recommended that the meeting be postponed twenty-eight days to June 21, 1984.

[1,2] The reason for the move becomes the critical issue in this case. Admittedly, the Board has the legal right to fix the date of the annual meeting. The Board, in the exercise of its business judgment, should be free to exercise and conduct its business at a time and in a fashion which serves the corporation's best interests. The right, however, is not unfettered and examples of situations where the exercise of lawful rights has been struck down are now well known in Delaware corporate practice.

In *Schnell v. Chris-Craft Industries, Inc.*, Del. Supr., 285 A.2d 437 (1971), management, after notice of a proxy contest being prepared, moved the stockholders meeting scheduled for January 11, 1972, back to December 8, 1971. The plaintiffs, stockholders in opposition to management and those who were preparing the proxy contest, argued

that the shortened time prevented them from adequately preparing and conducting the proxy contest and thereby insuring management an unfair advantage. Interestingly, the shortened time gave the dissident plaintiffs about thirty-six days before the meeting to accomplish what they sought to do. Under accepted factual findings concluding that the shortened time practically guaranteed the proxy contest would be unsuccessful, the Supreme Court struck down the board's decision and moved the date to its originally scheduled time.

In concluding that those actions amounted to management usurping an unfair advantage, the court said:

> In our view, those conclusions amount to a finding that management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office; and, to that end, for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management. These are inequitable purposes, contrary to established principles of corporate democracy. . . .
>
> When the by-laws of a corporation designate the date of the annual meeting of stockholders, it is to be expected that those who intend to contest the reelection of incumbent management will gear their campaign to the by-law date. It is not to be expected that management will attempt to advance that date in order to obtain an inequitable advantage in the contest.

Id. at 439.

Another case supporting the same principle of law is *Lerman v. Diagnostic Data, Inc.*, Del.Ch., 421 A.2d 906 (1980). In that case, the directors, in the face of a proxy contest, amended the by-laws to require a seventy day notice of an intention to nominate candidates to the board and then set the date for an annual meeting sixty-three days later.

[3]Applying the principles of *Schnell* and *Lerman* to the facts of the case *sub judice*, one must consider that the lengthening of time in which to conduct the proxy contest must be viewed in context of the particular circumstances of this case. In other words, the *Schnell* principle could be applicable in a time shortening or a time lengthening situation. Admittedly, if the action of the Board in this case is to be condemned, it must be based on attendant circumstances that make it reasonably probable to assume that management intended to frustrate the vote of dissident stockholders.

Viewed in its entirety, one must conclude that this law suit is nothing more than a continuation of the bitter contest between the Plaintiffs and the Defendants. This is a proxy contest pure and simple. The Plaintiffs are not being forced to prepare their proxy contest so hastily that they are denied sufficient time to effectively prepare for the contest. Furthermore, they are not being denied the opportunity to vote or to participate in the annual meeting. They are given more time to prepare for it. The patent conclusion, therefore, is that this is not a *Schnell* or *Lerman* situation.

What then is inequitable in the conduct of moving the date twenty-eight days hence? The Plaintiffs contend that it gives the Board the opportunity to sell the corporation, that they are better qualified to sell the corporation, that an expeditious sale would be tantamount to a *scorched earth* policy that will leave nothing for the Plaintiff or his fellow stockholders.

The argument is not without superficial appeal. This Board could be viewed as having acted contrary to the wishes of its stockholders on at least one occasion. Viewed fairly, however, the "poison pill" amendments, measure enacted by the Board when "takeover" fever gripped the industry, could be considered legitimate exercises of Board discretion designed to protect the stockholders against a less than arms-length sale. Conversely, Plaintiffs are entitled to their right to the proxy contest in spite of the fact that their actions might be viewed as completely selfish; that is, an exercise of a power play to preserve their dominant role in an Indonesian joint venture controlled by Enstar.

In the final analysis, however, one must concede that what is at the core of the complaint is Plaintiffs' desire to control the sale of this corporation. They want this Court to intervene in the internal governance of this corporation and to substitute its judgment for that of this Board. The hyperbole subtly suggests "lame ducks" should not conduct a sale of the corporation. The fallacy, however, is rather basic. The "worst scenario" suppositions of the Plaintiffs are based on speculation. For instance, they want the Court to assume that there will be a sale and yet there is no guarantee that a sale will occur. They want the Court to assume that the Board will breach its fiduciary duties and conclude a sale that is not in the best interests of the stockholders or which is not fair. Should we speculate that this would occur? Even if it did occur, would not the stockholders have an opportunity to either seek an injunction to prevent the sale or to vote it down? And finally, why must this Court assume that if there is to be a sale, the Plaintiffs would conduct a more beneficial sale than the Defendants, the elected management of this corporation?

The situation in this case is much more similar to that in *American Hardware Corp. v. Savage Arms Corp.*, Del. Supr., 136 A.2d 690 (1957). In that case, plaintiffs sought to enjoin the conduct of any business at a regularly scheduled stockholders meeting and fix a subsequent date for another meeting. The numerous allegations of the complaint were dismissed in spite of the fact that there was little time left for preparation of the proxy contest. Basically, the plaintiffs in that suit, just as the Plaintiffs in this suit, sought help from the court in substituting their judgment for that of the duly elected Board. In the absence of any inequitable conduct, the court said, "In our opinion, the circumstance of a proxy contest in itself furnishes no sufficient reason for the courts to interfere." *Id.* at 693.

[4,5] This Court is loath to intervene in the internal management of a corporation unless and until a plaintiff can make a case that the exercise of corporate governance, otherwise proper, is used as a tool to frustrate the legitimate rights of its stockholders. In this case, the Court is not convinced that the Plaintiffs have carried that burden. For these reasons, the motion for preliminary injunctive relief is denied.

IT IS SO ORDERED.

JOSEPH v. SHELL OIL CO.

No. 7450

Court of Chancery of the State of Delaware, New Castle

May 8, 1984

This is an action for a preliminary injunction brought on behalf of the minority shareholders of Shell Oil Company. It attacks a tender offer made by defendant SPNV Holdings, Inc., which was formed to obtain Shell stock owned by minority shareholders. The court of chancery, per Vice-Chancellor Hartnett, held that plaintiff had shown with reasonable probability that the court, if deciding on the merits, would find that at least some of the defendants stand on both sides of the transaction and therefore owe a fiduciary duty to the minority shareholders. Accordingly, by failing to make available essential information needed for appraisal, the defendants had not complied