[3] The motion to quash service of process and to dismiss the complaint for lack of personal jurisdiction, to the extent that it relies on the unconstitutionality of 10 *Del. C.* § 3114, is denied. An appropriate form of order may be presented.

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## FIELD v. ALLYN

No. 5951

*Court of Chancery of the State of Delaware, Sussex*

August 9, 1979

Plaintiff, a shareholder of defendant Pittsburgh and Lake Erie Railroad Co., sought a temporary restraining order to prevent defendant Pittsburgh and Lake Erie Co. (a holding company) from bringing about a short-form merger pursuant to DEL. CODE ANN. tit. 8, § 253. Plaintiff alleged: that the financial arrangements made by defendant to gain controlling stock interest in the corporation violated standards under the corporate opportunity doctrine; that defendant should not be permitted to vote shares obtained in this manner to effect a cash out merger of the minority shareholders; that allowing the merger would result in irreparable harm to the minority and to the corporation itself. The Court of Chancery, per Vice-Chancellor Brown, held that on the record before the Court injunctive relief under the corporate opportunity doctrine was unwarranted. The temporary restraining order was denied, without giving court approval to the actions of the defendants.

1. Injunctions ⇐ 151

Application for a temporary restraining order seeking to prevent the completion of a short-form merger under DEL. CODE ANN. tit. 8, § 253, will be disposed of only upon arguments offered by counsel, when counsel indicates that these are sole basis of request for relief.

2. Injunctions ⇐ 134, 137(1)

Where application for injunctive relief is based upon corporate opportunity doctrine and the defendant corporation is controlled by one to whom such standards have no application, such relief is improper.

3. Corporations ⇐ 315, 316(3)

It is not wrong *per se* for a corporate officer to purchase shares in his own corporation where he is not in conflict with any existing plan or expectant interest of the corporation.

4. Corporations ⇐ 315, 316(1)

When a business opportunity comes to a corporate officer, which, because of the nature of the opportunity is not one which is essential or desirable for his corporation to embrace, being an opportunity in which it has no actual or expectant interest, the officer is entitled to treat the business opportunity as his own and the corporation has no interest in it, provided the officer has not wrongfully embarked the corporation's resources in order to acquire the business opportunity.

5. Corporations ⇐ 318, 320(11)

Injunction ⇐ 137(1)

Where the entity that acquires a controlling stock interest has a principal other than the two executive officers of the controlled corporation, namely a separate corporation with a fifty-one percent voting interest, there is no clear showing that corporate fiduciaries have embarked the corporation's resources in order to gain a business opportunity for themselves, so as to support a temporary restraining order.

6. Corporations ⇐ 1.5(2), 1.5(3), 377(2)

An outside business organization has no independent fiduciary duty not to use a portion of that acquired to defray the costs of acquisition.

7. Corporations ⇐ 174, 182.3

Once one becomes a majority shareholder, he owes a duty to the minority, regardless of how he came by his majority position.

8. Injunctions ⇐ 136(1), 137(4), 151

A temporary restraining order will not issue where the court is not satisfied that plaintiff has demonstrated a likelihood of success on the merits under the legal theory upon which application for injunctive relief was premised.

BROWN, *Vice-Chancellor*

Plaintiff, as a shareholder of the defendant Pittsburgh And Lake Erie Railroad Company (the "P & LE"), seeks a temporary restraining order to prevent the defendant Pittsburgh And Lake Erie Company (the "Holding Company") from bringing about any short form merger pursuant to 8 *Del. C.* § 253 which would eliminate the 7.4 per cent minority shareholders of P & LE from further equity participation in the corporation. The Holding Company owns the remaining 92.6 per cent of P & LE and thus it is in a position to accomplish a "cash-out" merger of the minority shareholders under § 253 without advance notice to the minority. Plaintiff says that this will result in irreparable harm to both the minority as well as the corporation itself.

The issue presented by this application is obviously a narrow one. There is some difficulty, however, in ascertaining just what that issue is. Plaintiff says that the case is, pure and simple, controlled by *Guth v. Loft,* Del. Supr., 5 A.2d 503 (1939). The appearing defendants, the Holding Company and Beloit Corporation, dispute this. They say that plaintiff's demand for relief is really founded on *Singer v. Magnavox Co.,* Del. Supr., 380 A.2d 969 (1977), and that under the principles of that case plaintiff has made no showing of a likelihood of ultimate success on the merits. Also, referring to the recently released opinion in *Roland International Corporation v. Najjar,* (Del. Supr.—August 6, 1979), they argue that there is no threat of immediate, irreparable injury in view of the tacit recognition in that decision that this court of equity has the power to grant appropriate relief from a § 253 merger which does not measure up to the *Singer* standard of entire fairness.

[1] Personally, I have some concern with regard to the proper business purpose of a majority shareholder in eliminating minority interests as recognized in *Tanzer v. International General Industries,* Del. Supr., 379 A.2d 1121 (1977). However, despite the fact that this proper purpose issue is included within the allegations of the complaint, the plaintiff made it abundantly clear, as I understood it, that this was not a basis on which he was seeking the temporary restraining order. Accordingly, I shall dispose of the application only upon those arguments offered by counsel.

The facts pertinent to this application, obviously oversimplified for present purposes, are as follows. The defendant Allyn is the president of P & LE. The defendant Neuenschwander is the executive vice president of the P & LE. Commencing in March 1978 they commenced negotiations for the purchase of the 92.6 per cent of P & LE owned at the time by Penn Central. Eventually, this controlling stock interest in P & LE was put up for bid by Penn Central. Allyn and Neuenschwander formed an investment group with the defendants Garland, Smyth and Beloit Corporation, and eventually made the high bid of some $60 million. The stock thus acquired from Penn Central was taken in the name of the Holding Company. Beloit Corporation, Allyn, and Neuenschwander are the only identified shareholders of the Holding Company. While this may be well and good as far as it goes, it is the manner in which this acquisition was accomplished that troubles plaintiff.

In order to finance the acquisition, a loan of some $60 million was obtained from group of Pittsburgh banks. The loan, however, had the following conditions. Upon the acquisition of the 92.6 per cent stock interest from Penn Central, the stock was immediately pledged by the Holding Company as security for the loan. Furthermore, the Holding Company is obligated to utilize its 92.6 per cent majority position to obtain the remaining 7.4 per cent of P & LE stock. Upon obtaining 100 per cent stock ownership of P & LE, the Holding Company is required

to cause P & LE to sell a previously appraised $110 million of its rolling stock to an agent of the banks for the price of $60 million. The bank's agent, in turn, will then lease back this rolling stock to P & LE for a period of 10 years at an annual rental of 10 per cent of the purchase price plus predetermined interest. At the end of the 10 year term, ownership of the rolling stock will revert to P & LE. The Holding Company guarantees P & LE's obligations under the lease. Finally, the Holding Company will cause P & LE to declare a dividend to it in an amount equal to the net proceeds from the sale and lease-back of the rolling stock. The Holding Company will use the proceeds of this dividend to repay the bank loan.

The Holding Company is now midstream in this plan. It is the process of attempting to corral the remaining outstanding minority shares. In attempting to do so it has made a tender offer which expired yesterday. The offering circular for the tender offer fully discloses (or so it appears at this juncture) all of the foregoing information concerning the involvement of Allyn and Neuenschwander and the financing arrangements under which the transaction is being made. The appearing defendants stress the point that complete candor has been the trademark of the acquisition plan every step of the way. Indeed, plaintiff relies on the facts set forth in the offering circular as the basis for his application.

Thus it seems that the president and vice president of P & LE have aligned themselves with others so as to become the sole owners of P & LE and in doing so they have obtained the necessary capital to accomplish the acquisition based upon a commitment to remove the minority shareholders from P & LE and to repay their borrowed capital from the assets of the corporation they are acquiring with the borrowed funds.

[2-4] To the extent that plaintiff would utilize these facts to seek injunctive relief under the corporate opportunity doctrine expressed in *Guth v. Loft, supra,* I find his position without merit on the present record. There is nothing to indicate any ongoing plan by P & LE to acquire its own stock and there is nothing to show any real corporate benefit to P & LE in doing so. In other words, there is nothing to indicate that corporate interests would be furthered by using $60 million in corporate assets to retire 92.6 per cent of the corporation's outstanding stock so as to transform the remaining 7.4 per cent shareholders into 100 per cent shareholders. It is not wrong *per se* for a corporate officer to purchase shares in his own corporation, and it is not improper for him to do so where he is not in conflict with any existing plan or expectant interest of the corporation. *Equity Corporation v. Milton,* Del. Supr., 221 A.2d 494 (1966). At page 497 of that decision it is stated as follows:

> "A corollary of the *Guth* rule is that when a business opportunity comes to a corporate officer, which, because of the

> nature of the opportunity, is not one which is essential or desirable for his corporation to embrace, being an opportunity in which it has no actual or expectant interest, the officer is entitled to treat the business opportunity as his own and the corporation has no interest in it, provided the officer has not wrongfully embarked the corporation's resources in order to acquire the business opportunity."

The latter part of the above quotation, however, points to plaintiff's other contention. He says that the acquisition of the 92.6 per cent interest in P & LE has been acquired based upon the consideration that the assets of P & LE, once they are under the control of the defendants, will be used to repay the loan which enabled the acquisition to take place. Thus it is argued that Allyn and Neuenschwander, as officers of P & LE, have wrongfully utilized the resources of P & LE for their own personal gain. Having thus wrongfully obtained their position as controlling shareholders, plaintiff argues, defendants should not now be permitted to vote such shares to bring about a § 253 merger so as to cash out him and the other remaining minority shareholders.

[5, 6] I have difficulty with this argument on the present limited record. If the facts were such that the two officers alone were the ones who had acquired the controlling stock interest on the strength of a promise to cause their personal loan to be repaid through the finances of the corporation, plaintiff's claim would appear strong indeed. There, arguably, corporate fiduciaries would be embarking the corporation's resources in order to acquire a business opportunity for themselves. However, such is not the factual situation here.

Here the entity which has acquired the controlling stock interest is a corporation which has a principal other than the two officers of P & LE. Specifically, Beloit Corporation appears to be a 51 per cent voting shareholder of the Holding Company and has committed itself for some $15 million toward the enterprise of the Holding Company. Insofar as I am aware, Beloit Corporation has no fiduciary obligation to the minority shareholders of P & LE. Thus, to the extent that the plaintiff relies on the fiduciary duty of Allyn and Neuenschwander under *Equity Corporation v. Milton,* the same rationale presumably would not apply to Beloit Corporation, an outside business organization which has no independent fiduciary duty not to utilize a portion of that acquired in order to defray the cost of acquisition.

[7] While it is clear under *Singer* and *Najjar* that once one becomes a majority shareholder he owes a duty to the minority, regardless of how he came by his majority position, the present application is not premised on an alleged violation of that duty. Rather, relief is sought under the *Guth* and *Equity Corporation v. Milton* standards. Where

relief on this basis is sought against a corporation controlled by one against which the standards have no application, does the fact that other shareholders may be in violation of their fiduciary duty by participating in the corporation justify the issuance of temporary injunctive relief against the corporation itself? This point was not argued at the hearing. Indeed, it was not raised by the Court. But on the present record I am not prepared to say that it does.

[8] Should it be established, for instance, that the participation of Beloit Corporation (as opposed to anyone else) was not critical to the willingness of the banks to lend the necessary money, and that the arrangement could only be made because of the prospective ownership involvement of two long-standing, key officers of P & LE, plaintiff's argument might have more sting. At this time, however, I am not satisfied that the plaintiff has demonstrated a likelihood that he will succeed on the merits on the legal theory upon which he has made his application for restraining order.

Accordingly, without intending in any way to give the Court's blessing to the activities so far attributed to the defendants, the motion for the temporary restraining order will be, and it is hereby denied.

IT IS SO ORDERED.

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## STELLINI v. ORATORIO

No. 5780

*Court of Chancery of the State of Delaware, New Castle*

September 5, 1979

Plaintiffs, former directors and officers of the defendant corporation, brought this action for reinstatement, challenging the validity of action taken at shareholders and directors meeting. Specifically, by an affirmative vote of fifty-three percent of the stock, the number of directors of the corporation was reduced from five to three and plaintiffs were not re-elected to directorial positions. Subsequently, their employment was terminated. Plaintiffs contended that their removal was invalid because: (1) the notice of the shareholders meeting was defective; (2) shareholders did not first vote to remove plaintiffs as directors before voting a new slate of directors; (3) they had no notice or opportunity to be heard on the reasons for removal; and (4) the vote to remove them violated a bylaw provision.

Plaintiffs and defendants filed cross motions for summary judgment. The Court of Chancery, per Vice-Chancellor Hartnett, granted defendants' motion and denied plaintiffs' motion declaring the actions of the defendants to be valid under DEL. CODE ANN. tit. 8 § 228.

1. Corporations ⇐ 294

In an action seeking reinstatement as directors of the defendant corporation, plaintiffs who were originally appointed with the understanding that they were to serve in such capacity "until the first annual meeting of the stockholders or until their successors shall be elected or appointed and shall qualify" enjoy no vested interest in a directorship of the corporation.

2. Corporations ⇐ 294

Plaintiffs, who were originally appointed as directors of the corporation with the understanding that they would serve "until the first annual meeting of the stockholders or until their successors shall be elected or appointed" held office with the actual or implied knowledge that such right could be extinguished by the vote or consent of the majority stockholders.

3. Corporations ⇐ 283(2), 298(1)

In an action by former directors of a corporation for reinstatement, the fact that both a meeting and a written consent were employed to relieve them of their positions is irrelevant to the outcome of the case.

4. Corporations ⇐ 191, 192

The Delaware legislature has provided a method for corporate action without the formality of a shareholders' meeting. DEL. CODE ANN. tit. 8, § 228.

5. Corporations ⇐ 283, 283(1)

Statutory method can be used to elect and remove directors of a corporation.

6. Corporations ⇐ 297

Action is valid under applicable statute where action taken by a corporation is of the type that may be taken at an annual or special shareholders' meeting, is consented to in a writing setting forth the action taken, and is signed by holders of outstanding stock having not less than the minimum number of votes that would have been necessary to authorize or take such action at a meeting. DEL. CODE ANN. tit. 8, § 228.

7. Corporations ⇐ 283(3), 294, 298(4)

Where board of directors is duly constituted, action taken at a board meeting wherein plaintiffs were relieved of directorial positions was proper.

8. Corporations ⇐ 182.3

Where directors allowed their stock ownership to fall below fifty percent, they continued as directors and officers of the corporation at the pleasure of the majority stockholders.

HARTNETT, *Vice-Chancellor*

This action was brought by Emidio and Frank Stellini (plaintiffs) to seek their reinstatement as directors and officers of the defendant corporation—Custom Computer Services, Inc. (Custom Computer). The plaintiffs and defendants filed cross Motions For Summary Judgment. The issues raised in the cross motions center on the validity of, and the action taken during, a certain shareholders' and directors' meeting on September 29, 1978, and confirmed by written consent of a majority of the stockholders of Custom Computer. For the reasons set forth, I grant defendants' motion for summary judgment and deny plaintiffs' motion for summary judgment.

From the establishment of Custom Computer in 1972 until October of 1976, plaintiffs, together with the individual defendants Robert Oratorio and John W. Thomasson were the sole shareholders, directors and officers of Custom Computer. Defendant-Robert Sanderson became a shareholder and employee in October of 1976. Since that time plaintiffs have owned 47% of the issued and outstanding voting common stock, while the individual defendants owned the balance. All five shareholders were fulltime employees of Custom Computer until September 29, 1978.

During a business meeting in September of 1978 attended by all of the five shareholders, defendant-Oratorio asked that a shareholders meeting be held. A notice of the meeting, dated September 19, 1978, was typed and issued under the signature of Frank J. Stellini, President, setting forth a special meeting to be held on September 29, 1978, "for the purpose of establishing the number of and to elect directors." On September 29, 1978, by affirmative votes of 53% of the stock, the number of directors was established at three and Messrs. Oratorio, Thomasson and Sanderson were elected directors—the plaintiffs were not reelected as directors. Immediately following the shareholders meeting, a meeting of the new directors was held during which the three individual defendants were elected officers of the corporation. Thereafter, acting in his capacity as President of the corporation, defendant-Oratorio terminated the employment of the plaintiffs. The employment termination, however, is not the subject of this suit.

It is clear from the record that while plaintiffs were present at both of these meetings, they did not object to the motions, make alternative motions, or vote on any motions. Not until after the meeting did the plaintiffs object in any manner to the proceedings.

Immediately following the meetings, the individual defendants executed written consent documents pursuant to 8 *Del. C.* § 228 establishing the number of directors at three and electing themselves as directors, and pursuant to 8 *Del. C.* § 141 and § 229, electing themselves as officers and terminating the employment of the plaintiffs. Notice of such actions was thereafter promptly forwarded to the plaintiffs by letter.

The plaintiffs now seek reinstatement as directors and officers alleging that their removal was invalid because: (1) the September 19, 1978, notice was defective; (2) the shareholders did not first vote to remove plaintiffs as directors before voting in a new slate of directors; (3) they were removed for cause without receiving notice or an opportunity to be heard with respect to the reasons for their removal; and (4) the vote to remove them violated a By-law provision which required unanimous shareholder consent to any business conducted not specified in the notice.

[1-3] I fail to see how anything in the record presently before me entitles the plaintiffs to be reinstated as directors or officers. Appointed as directors by the incorporator in 1972, the plaintiffs were to serve in such capacity only "until the first annual meeting of the stockholders or until their successors shall be elected or appointed and shall qualify." Clearly, as directors, the plaintiffs had no vested interest in a directorship of Custom Computer. Rather, any right which they may have held in the office of director was acquired with the actual or implied knowledge that such right could be extinguished by the vote or consent of the majority stockholders of the defendant corporation. *Everett v. Transnation Development Corporation,* Del. Ch., 267 A. 2d 627 (1970). In the present case the plaintiffs lost their positions on the Board of Directors by failing to be reelected, such failure occurring both by vote and by written consent of the majority stockholders. The fact that both a meeting was held and a written consent was used does not, in my view, alter the result. At most, the effect that either action has upon the other is to relegate one to the status of irrelevancy.

[4, 5] In 8 *Del. C.* § 228, the General Assembly, in its wisdom, saw fit to provide a method for corporate action without the formality of holding a shareholders meeting. Specifically, the statute provides:

> (a) Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted.
>
> * * *
>
> (c) Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders or members, as the case may be,

> who have not consented in writing. In the event that the action which is consented to is such as would have required the filing of a certificate under any other section of this title, if such action had been voted on by stockholders or by members at a meeting thereof, the certificate filed under such other section shall state, in lieu of any statement required by such section concerning any vote of stockholders or members, that written consent has been given in accordance with the provisions of this section, and that written notice has been given as provided in this section.

This section has been used to elect directors, *Sundlun v. Executive Jet Aviation, Inc.*, Del. Ch., 273 A.2d 282 (1970), and to remove directors, *Everett v. Transnation Development Corporation,* supra. FOLK, *The Delaware General Corporation Law* § 228.

[6] Whether the action taken by the defendants as majority shareholders is characterized as a removal of plaintiffs as directors or merely as a failure by plaintiffs to be reelected as directors, the record supports the validity of said action under 8 *Del. C.* § 228. It was the type of action which may be taken at any annual or special meeting of the stockholders and it was consented to in a writing setting forth the action so taken and signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Furthermore, prompt notice was given to the shareholders who did not consent in writing. The fact that no prior notice was given is, by the very terms of the statute, irrelevant.

The Board of Directors' meeting immediately followed the September 29, 1978, stockholders' meeting. At that directors meeting, defendants Oratorio, Thomasson and Sanderson were elected as officers of Custom Computer. Plaintiffs were present at this meeting and did not object to the proceedings. Following the election of the new officers, defendant-Oratorio, in his capacity as president of the corporation, terminated the employment of plaintiffs Stellini as employees of Custom Computer. Thereafter, acting in their capacity as directors, the individual defendants executed written consent documents pursuant to 8 *Del. C.* § 141(f) electing themselves as officers of the corporation, and terminating the employment of the plaintiffs, effective September 29, 1978, at 4:00 p.m.

[7] Plaintiffs have alleged that the action taken at the board meeting following the shareholder meeting was improper because it was not the action of a duly elected Board of Directors. Since plaintiffs do not argue otherwise, they apparently concede that if the board was duly constituted, the action taken by it on September 29 was proper. 8 *Del. C.* § 142(b) specifically provides that "Each officer shall hold his office until

his successor is elected and qualified or until his earlier resignation or *removal.*" (emphasis added) The facts here show that the services of Emidio and Frank Stellini as officers of Custom Computer were terminated by a duly constituted Board of Directors of the corporation on September 29, 1978.

While I am aware of the holding of this Court in *Cambell v. Loew's, Inc.*, Del Ch., 134 A.2d 852 (1957), a case which arose prior to the 1967 revision of 8 *Del. C.* § 228, I find that case is not pertinent to the facts in this case. There is nothing in the record to indicate that the stockholders were told that plaintiffs were to be removed as directors or officers for cause and thus entitled to an opportunity to refute any accusations brought against them; nor is there any evidence that the plaintiffs had any sort of employment agreement which granted them tenure.

[8] Therefore, having let their stock ownership fall below 50%, the plaintiffs continued as directors and officers of the corporation at the pleasure of the majority stockholders, and that pleasure ended abruptly on September 29, 1978, with the execution of the written consent by the three individual defendants. Having reached this conclusion, consideration of other issues raised is not necessary. Defendants' motion for summary judgment is therefore granted and plaintiffs' motion for summary judgment is denied.

So ordered.

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## AMSELLEM v. SHOPWELL, INC.

No. 5683

*Court of Chancery of the State of Delaware, New Castle*

September 6, 1979

Plaintiffs, holders of 15.8% of the shares of defendant corporation, originally brought a stockholder's derivative action against the corporation, Shopwell, Inc., as nominal defendant and the individual members of the board of directors. The complaint sought to enjoin an exchange offer announced by defendant, to set aside certain amendments to defendant's certificate of incorporation, and damages. Plaintiffs alleged that the amendments to the certificates of incorporation, dealing with the election and term of office of corporate directors and requiring an eighty percent super-majority stockholder vote to approve certain corporate transactions, were violative of Delaware's corporation law and of the fiduciary duty owed by defendants to Shopwell and its stockholders. Specifically, plaintiffs alleged that the amendments merely furthered the self-interest of the individual defendants. As a result of the original complaint, the defendant corporation withdrew the exchange offer and

petitioned the court for an order to void the charter amendment with regard to the eighty percent vote, which was granted in September, 1978.

Plaintiffs subsequently filed an amended complaint challenging the charter amendment with respect to the method of election of directors and claiming damages arising from mismanagement and waste. Defendants raised affirmative defenses and counterclaimed.

Following extensive discovery proceedings, the parties agreed to a settlement. When eight stockholders objected to the proposed settlement agreement, an amended agreement was negotiated, which all parties approved, except for one, Simkins Industries, who requested a stay of sixty to ninety days to conduct discovery.

The Court of Chancery, per Vice-Chancellor Hartnett, approved the settlement of the action but denied Simkins' request for a stay to allow discovery.

1. Compromise and Settlement ⟸ 2

The voluntary settlement of disputes is favored in the law, and it is especially appropriate in complex litigation because it promotes judicial economy.

2. Compromise and Settlement ⟸ 4

In reviewing an application for settlement of a stockholders' derivative suit, the court must ensure that the interests of the class are represented within the agreement in accordance with the fiduciary duties of the plaintiffs to the remainder of the class.

3. Compromise and Settlement ⟸ 4

The court's duty in reviewing settlements pursuant to DEL. CT. CH. R. 23.1 requires it to consider the nature of the claim, possible defenses to it, legal and factual obstacles facing the plaintiff in the event of trial, and whether the settlement appears reasonable in the court's own business judgment. DEL. CT. CH. R. 23.1.

4. Compromise and Settlement ⟸ 4, 15(2)

It is inappropriate to try the issues or merits of the case or to allow counsel to do so in the settlement hearing, since the benefits of judicial economy would thereby be lost.

5. Corporations ⟸ 213

Where plaintiffs' original complaint alleged improper management activities, relief proposed in a settlement agreement may be prospectively prophylactic rather than retroactively compensatory, because of the attendant difficulty of proof.

6. Corporations ⇐ 320(11)
Compromise and Settlement ⇐ 23(1)

Assumptions of bad faith on the part of management are not recognized by the court in a proceeding for approval of a proposed settlement agreement.

7. Corporations ⇐ 320(11)
Compromise and Settlement ⇐ 23(1)

In the absence of evidence to the contrary, the presumption is that directors acted in good faith in reaching a decision to purchase stock.

8. Corporations ⇐ 376

A corporation has a right to purchase its own stock for any proper corporate purpose. DEL. CODE ANN. tit. 8, § 160(a).

9. Corporations ⇐ 316(3), 376

A corporation's right to purchase its own stock may be used to purchase the shares of a troublesome minority in order to preserve or make more efficient the operations of the corporation.

10. Corporations ⇐ 316(1)

In order to effect purchases of shares of a troublesome minority, a premium may be paid for the stock purchased, and the premium so paid need not be offered to the corporation's other stockholders.

11. Corporations ⇐ 316(3)

It is not improper *per se* for a plaintiff stockholder to end up having his stock purchased by the nominal defendant corporation at a slight premium if the benefits to the corporation outweigh the suspicions aroused.

12. Corporations ⇐ 307, 310(1), 316(1)

The valuation of a block of stock together with its control factor is within the discretion of the directors of a corporation so long as they exercise good faith and act on a business-oriented motive.

13. Corporations ⇐ 310(1), 316(3)

It is unreasonable to believe that the corporation could expect or be expected to avoid paying for the control factor of a block of stock, since any other purchaser would be required to do so in the marketplace.

14. Corporations ⇐ 214
Costs ⇐ 172

A monetary recovery by the corporation is not necessary to support the award of counsel fees so long as the litigation confers some benefit on the corporation.

15. Corporations ⟸ 214

Costs ⟸ 172

The proposition that a monetary recovery is not necessary to support the award of counsel fees so long as the litigation confers some benefit on the corporation applies to settlements as well as to final adjudications.

16. Corporations ⟸ 214

Costs ⟸ 172

Where long-term benefits of a prophylactic relief and the elimination of a disruptive minority accrues to the corporation and the immediate benefit of convertibility of common stock into marketable debentures accrues to present shareholders, it is not inappropriate to award counsel fees.

17. Discovery ⟸ 80

Pretrial Procedure ⟸ 17, 20

Discovery is favored and usually is allowed to proceed where the party seeking it specifies areas to be investigated.

18. Discovery ⟸ 97(3)

Pretrial Procedure ⟸ 17

Additional time for discovery will be denied where party requesting it has had adequate opportunity to review the materials requested and has not utilized the opportunity.

19. Compromise and Settlement ⟸ 2, 15(2)

A proposed settlement of a lawsuit necessarily requires objectors to the settlement to move with utmost promptness so as not to chill the settlement.

HARTNETT, *Vice Chancellor*

This is my decision approving the settlement of this action and denying a stay to allow discovery.

This suit was brought as a stockholder's derivative action by Jacques Amsellem (Amsellem) and Societe Monegasque des Magasins Printania (Societe), owners of about 15.8% of the outstanding shares of Shopwell, Inc. (Shopwell), against Shopwell, the nominal defendant, and each of the members of Shopwell's board of directors, who together own about 36.3% of Shopwell's outstanding shares. The original complaint sought to enjoin an exchange offer announced by Shopwell, to set aside certain amendments to Shopwell's certificate of incorporation adopted by Shop-

well's stockholders at the 1978 annual meeting, and damages. The certificate of incorporation amendments altered the method of election and term of office of the members of the board of directors of Shopwell and required an 80% supermajority stockholder vote to approve certain corporate transactions. Plaintiffs alleged that these actions were taken only to further the self-interest of the individual defendants and charged violations of both Delaware corporation law and the individual defendants' fiduciary duties to Shopwell and its stockholders.

As a result of the original complaint Shopwell withdrew the exchange offer and petitioned the Court for an order voiding the charter amendment requiring a supermajority vote. The petition was granted and an order to that effect issued on September 13, 1978.

Plaintiffs then filed an amended complaint on October 10, 1978, realleging the claim for damages and challenging the charter amendment as it related to the method of election and term of members of the board of directors of Shopwell. The amended complaint also contained an additional claim for damages purportedly arising from corporate mismanagement and waste. The additional claim was supported by allegations of excessive salaries and perquisites, corporate payment of personal expenses, and other improper expenditures. Shopwell and the individual defendants denied all wrongdoing, raised certain affirmative defenses, and counterclaimed.

Defendants moved to dismiss the action for lack of personal jurisdiction over the individual defendants and for failure to join indispensable parties. Plaintiffs responded by filing an action in the United States District Court for the Southern District of New York. The federal action was subsequently stayed by order of the District Court following an agreement by the defendants to withdraw their motion to dismiss the present action and to submit to the jurisdiction of this Court.

Plaintiffs undertook extensive discovery relevant to the amended complaint. This discovery involved the production of thousands of documents and the voluminous depositions of the individual defendants. Defendants claim that the magnitude of the discovery hindered their ability to carry out their duties in the day-to-day operation of Shopwell. Eventually the parties agreed that an agreement of compromise would be mutually beneficial. A compromise was reached between the parties and embodied in a Settlement Agreement dated July 10, 1979. On July 13, 1979, a settlement hearing was scheduled for August 17, 1979, with notice to all Shopwell stockholders.

Eight stockholders objected to the proposed settlement agreement. Of these, Norte & Co. (Norte), Galdi Securities Corporation (Galdi), Sheldon Barr (Barr), and Simkins Industries (Simkins) were represented by counsel. Counsel for Norte, Galdi and Barr requested and were granted access to the pleadings, depositions, and plaintiffs' discovery file relating to the action and the proposed settlement agreement. Sim-

kins did not request access to these documents from the plaintiffs nor did it attempt to undertake any discovery of its own. It was, however, offered the results of the investigation of Norte, Galdi and Barr but never undertook to obtain any of the information.

After a comprehensive review of the documents, Norte, Galdi and Barr voiced specific objections to the agreement and proposed certain changes designed to eliminate or mitigate those objections. Significant and lengthy negotiations between the three objectors and the parties to this suit resulted in an amended agreement of compromise with which Norte, Galdi, Barr and the parties were in accord. Norte, Galdi and Barr subsequently withdrew their objections to the settlement and submitted affidavits in support of the amended agreement.

Simkins continues to object to the settlement. It has filed an objection with supporting memorandum and has moved for a stay of sixty or ninety days in which to conduct discovery or review the documents it deems pertinent to the action and the amended agreement of settlement.

For the reasons set forth below, I deny Simkins' request for more time in which to conduct discovery and approve the settlement in the amended form as filed on August 16, 1979.

I

[1, 2] The voluntary settlement of disputes is favored in the law. *William v. First National Bank of Pauls Valley,* 216 U.S. 582, 595 (1910); *Neponsit Investment Co. v. Abramson,* Del. Supr., C.A. No. 202, — A.2d — (July 10, 1979); *Rome v. Archer,* Del. Supr., 197 A.2d 49, 53 (1964); *In re Ortiz's Estate,* Del. Ch., 27 A.2d 368, 374 (1942). Settlement is particularly appropriate in complex litigation because it promotes judicial economy. In a derivative suit such as this one, however, the Court must ensure that the interests of the class are represented within the agreement in accordance with the fiduciary duties of the plaintiffs to the remainder of the class. *Rome v. Archer,* supra; *Steigman v. Beery,* Del. Ch., 203 A.2d 463, 466 (1964).

[3, 4] The Court's duty in reviewing settlement agreements pursuant to Chancery Court Rule 23.1 is set forth in *Rome v. Archer,* supra. It must consider the nature of the claim, the possible defenses to it, the legal and factual obstacles facing the plaintiff in the event of trial, and whether in the Court's own business judgment the settlement appears reasonable. See also, *Neponsit Investment Co. v. Abramson,* supra; *Krinsky v. Helfland,* Del. Supr., 156 A.2d 90, 94 (1959); *Gladstone v. Bennett,* Del. Supr., 153 A.2d 577, 583 (1959); *Brown v. Fleming-Hall Tobacco Co.,* Del. Supr., 92 A.2d 302, 309-310 (1952); *Perrine v. Pennroad Corp.,* Del. Supr., 47 A.2d 479, 487-488 (1946); *In re Ortiz's Estate,* supra. On the other hand, it is inappropriate for the Court to try the issues or merits of the case or to allow counsel to do so in the

settlement hearing, since the benefits to judicial economy would thereby be lost. *Neponsit Investment Co. v. Abramson,* supra, and cases cited therein.

Both the original settlement agreement and the amended settlement agreement provided for Shopwell to take certain action with respect to the wrongdoing alleged in the complaint. As part of this settlement Shopwell agreed to obtain an opinion from an independent financial advisor selected by its outside directors as to the fairness of any tender to be made by it for its equity securities within the five-year period following the date of the agreement. This is intended to resolve the underlying dispute occasioned by an abandoned 1978 exchange offer.

Shopwell agrees to establish certain oversight and control committees and monitoring systems to prevent any activity such as that alleged by plaintiffs to be mismanagement and waste. An audit committee composed of outside directors is to be established in the bylaws with specified broad oversight powers and duties. The bylaws are also to reflect the establishment of a Compensation Committee to determine from time to time the propriety of the salaries and bonuses of the principal officers and directors of the corporation. The majority of this committee are to be outside directors. In addition, the corporation agrees to centralize responsibility for and control over corporate disbursements for business-related expenses, use of company property, and certain perquisites, and to adopt a statement defining the corporation's policy on potential conflicts of interest, including disclosure of potential conflicts of interest.

The original settlement also provided for the purchase of plaintiffs' Shopwell common stock by Shopwell at $6\frac{5}{8}$ per share, amounting to $1,706,600. This is the troublesome part of the settlement. The parties urge that this provision was intended to put an end to the discord resulting from plaintiffs' ownership of a large block of Shopwell common stock and their attempts to alter company policies and operations unrelated to those alleged to have been breaches of fiduciary duty. It is also claimed that it is to the advantage of Shopwell for it to acquire undervalued stock for investment purposes, to maintain a pool of shares for use in potential employee stock plans or acquisitions, and, in the event the purchased shares are retired, to increase the remaining stockholders' *pro rata* share of the corporation. The purchase of plaintiffs' shares was to be financed by internally generated cash, bank borrowings including letters of credit, and the sale of up to $2,133,000 of new 12% subordinated debentures falling due in 1989, in a private placement.

Finally, the original settlement agreement provided for the payment by Shopwell of $300,000 toward plaintiffs' counsel fees and expenses in bringing the suit for the benefit of Shopwell and the stockholders.

The amended agreement negotiated between the parties to this suit and objectors Norte, Galdi and Barr provides certain benefits not present in the original agreement. The amended agreement maintains the non-

pecuniary aspects of the original agreement, but alters the price at which plaintiffs' Shopwell common stock is to be purchased and provides for a public exchange offer involving shares not held by plaintiffs or Shopwell's directors, officers, their families, or associates. Plaintiffs' shares are to be purchased at $6 per share rather than $6⅝ per share, resulting in a reduction of the purchase price of $161,000. The benefit to Shopwell of this amendment is obvious.

The public exchange offer provides for an exchange of one $7.50 12% subordinated debenture due in 1989 for one share of Shopwell common, to a limit of 175,000 shares. The entire issue of these shares is to be subject to redemption at any time, or any part of the issue may be redeemed from time to time at the principal amount beginning one year after the date of issue. The outstanding debentures will be prepaid to the extent of 10% of their principal amount each year from the sixth through the ninth years from the date of issue, inclusive. If more than 175,000 shares are tendered in the exchange offer, shares are to be accepted on a *pro rata* basis.

Finally, the new agreement provides for a payment by Shopwell of $90,000 to counsel for Norte, Galdi and Barr, plus expenses not to exceed $1,000, all of which is to be divided among counsel as they deem appropriate. This is in addition to the counsel fees provided for in the original settlement agreement.

[5] Plaintiffs' primary claims in this action were based on management activities considered by plaintiffs to be improper and detrimental to the corporation. These activities were alleged to involve excessive salaries and perquisites, corporate payment of personal expenses, and other improper expenditures. Each of these is subject to control through internal monitoring, but each is obviously difficult to prove in a lawsuit. Because of the nature of this type of claim, and the attendant difficulty in proof, the relief sought on a claim such as this may well be prospectively prophylactic rather than retroactively compensatory. The relief embodied in the settlement agreement as it relates to the issues of mismanagement and waste is therefore both typical of and appropriate to this type of case. It is not so burdensome as to be overly expensive or difficult to implement, yet provides considerable protection against the evils of which plaintiffs complained.

The provision of the agreement by which Shopwell agrees to purchase plaintiffs' shares of Shopwell common at a slight premium over the market price is hotly contested. Objector Simkins contends that the practical effect of the purchase will be to increase the control of the individual defendants, who have been charged with serious wrongdoing, over the corporation at no cost to them personally, and to rid the defendants of the divisive shareholders who have sought to prosecute them by this action. Simkins also contends strongly that the plaintiffs will be unjustly enriched by the purchase of their 15.8% block at a premium over

market, impoverishing the remaining stockholders while conferring no benefit on the corporation.

Shopwell asserts, to the contrary, that the purchase of plaintiffs' stock is a good faith business judgment exercised on a reasonable factual basis in the context of an overall settlement and designed to aid the company financially both by the purchase of a good investment sought by Shopwell for many years and by ending the disputes occasioned by plaintiffs' attempts to impose business and operational theories on the corporation. The individual defendants assert that the purchase will increase the value of all remaining shares *pro rata;* enable Shopwell to acquire shares it has sought for proper corporate purposes for the past five years; and eliminate the threat by Amsellem to change corporate policy and the market orientation of the corporate defendant.

[6, 7] Simkins' objections to the purchase of plaintiffs' Shopwell common as they relate to the increased control of the incumbent management rest on an assumption that the management intends to or will operate the business with a lack of good faith, and that the purchase is intended to aid them in this pernicious endeavor. Assumptions of bad faith on the part of management are not recognized by the Court in this type of proceeding. *Wayne v. Utilities and Industries Corp.,* Del. Ch., C.A. No. 5733 (1979). Indeed, the presumption is that the directors acted in good faith in arriving at their decision, absent evidence to the contrary. *Kaplan v. Goldsamt,* Del. Ch., 380 A.2d 556, 568 (1977); *Kors v. Carey,* Del. Ch., 158 A.2d 136, 141-142 (1960). The record of this case reveals no such contrary evidence.

[8, 9, 10, 11] Simkins' second objection, involving the elimination and unjust enrichment of the plaintiffs, is also without merit. A corporation has the right to purchase its own stock for any proper corporate purpose. 8 *Del. C.* § 160(a). This right may be used to purchase the shares of a troublesome minority in order to preserve or make more efficient the operations of the corporation. *Cheff v. Mathes,* Del. Supr., 199 A.2d 548 (1964); *Kors v. Carey,* supra. In order to effect the purchase, a premium may be paid for the stock purchased, and the premium so paid need not be offered to the corporation's other stockholders. *Martin v. American Potash and Chemical Corp.,* Del. Supr., 92 A.2d 295, 302 (1952); *Kaplan v. Goldsamt,* supra, at 569. It is not improper *per se* that the corporation agrees in this case to purchase plaintiffs' stock in settlement of the derivative suit. The benefits to Shopwell in doing so outweigh the suspicions aroused when a plaintiff ends up by having his stock purchased by nominal defendant at a slight premium.

Simkins takes objection to the price to be paid for plaintiffs' stock as being excessive and constituting unjust enrichment. It is apparent from the facts, however, that the premium to be paid for the substantial 15.8% block of Shopwell common is slight at most. It is normal for a

large block of stock to carry a somewhat higher price than the sum of its individual components because of the factor of control the block contains. In the present case the control factor of plaintiffs' stock has been used in a manner characterized by Shopwell and the individual defendants as disputatious and troublesome.

[12, 13] The valuation of the block together with its control factor is within the discretion of the directors of the corporation so long as they exercise good faith and act on a business-oriented motive. *Kaplan v. Goldsamt,* supra. As *Martin v. American Potash and Chemical Corp.,* supra, makes clear, it is unreasonable to believe that the corporation could expect or be expected to avoid paying for the control factor, since any other purchaser would be required to do so in the marketplace.

The premium being paid for the 15.8% block in this case is only about 8.3% over the current market price. Far larger premiums have been accepted by this Court as fair and reasonable, and I find the present premium to be well within the range of discretion allowed directors in purchasing the corporation's stock on its behalf.

Simkins also maintains that the purchase of plaintiffs' stock will unduly burden the corporation with debt. This burden, it is alleged, will hinder Shopwell's financial integrity. All of the evidence before the Court indicates that this is simply not so. In fact, apart from the contentions of the parties themselves, Shopwell's independent financial consultants have rendered an opinion that both the purchase of plaintiffs' shares and the method of financing it are fair to Shopwell and its stockholders. Simkins has failed to controvert this opinion.

Any doubt this Court may have had concerning the purchase of plaintiffs' shares at $6 per share have been further alleviated by Shopwell's agreement to conduct a public exchange offer for 175,000 of its own shares, offering one $7.50 12% subordinated debenture due in 1989 for each share of Shopwell common tendered. While it is entirely proper for a corporation to buy the shares of one stockholder at a premium without offering the premium to the remaining investors under certain circumstances, in the context of a settlement agreement terminating a derivative action such an offer appears to be a derogation of the entire benefit of the litigation to the one bringing it rather than to the class he represents.

The public exchange offer ensures that those stockholders who continue to object can terminate their investment in Shopwell for a sum likely to be in excess of that paid to the plaintiffs. The affidavit of Galdi, a certified public accountant, investment advisor and investor in his own right, indicates that Shopwell's current $100 10% debenture without sinking fund trades at 80% of its face value, and that the proposed $7.50 12% subordinated debenture due in 1989 would trade at between 90% and 95% of face, or between $6.75 and $7.125. If the $7.50 12% debenture were to trade no better than the $100 10% debenture, a return of

$6 could still be expected. Any Shopwell stockholder eligible to participate in the public exchange offer may therefore acquire at least as much as plaintiffs and probably between $.75 and $1.125 more on a share for share basis.

Finally, with regard to the terms of the agreement, Simkins asserts that plaintiffs' and objectors' counsel fees should not be awarded because there is no monetary recovery or tangible benefit to the corporation.

[14, 15] A monetary recovery by the corporation is not necessary to support an award of counsel fees, so long as the litigation confers some benefit on the corporation. *Chrysler Corp. v. Dann,* Del. Supr., 223 A.2d 384 (1966); *Baron v. Allied Artists Pictures Corp.,* Del. Ch., C.A. Nos. 4445, 4678 (November 28, 1978); *Lewis v. Great Western United Corp.,* Del. Ch., C.A. No. 5397 (March 28, 1978). This applies to settlements as well as final adjudications. *Chrysler Corp. v. Dann,* supra; *Rosenthal v. Burry Biscuit Corp.,* Del. Ch., 209 A.2d 459 (1949).

[16] Plaintiffs concede that although the complaint contained a demand for damages, any recovery thereunder would have been slight at most, that damages would have been extremely hard to prove, and that they would probably have been offset by Shopwell's costs of defending the claim. The benefits of the action would probably have been non-pecuniary and prophylactic in any event, so that the lack of a pecuniary recovery by Shopwell under the agreement is of little significance. The agreement provides specific long-term benefits to the corporation (the prophylactic relief and the elimination of Amsellem as a vociferous and disruptive minority) as well as immediate benefits to the present stockholders (convertibility of Shopwell common into marketable debentures). Where such benefits obtain, it is not inappropriate to award counsel fees. It is also apparent that plaintiffs acted diligently in the face of considerable legal obstacles in pursuing this action and that former objectors Norte, Galdi and Barr acted in the best interests of the class for whose benefit the action was brought.

I therefore find that the agreement as amended is both reasonable from a business standpoint and fair to the holders of Shopwell common in whose interest it was brought. The agreement is therefore approved. So ordered.

II

[17, 18, 19] Objector Simkins has moved for additional time in which to conduct discovery and has asserted its position with vigor in its memorandum objecting to the settlement. While discovery is favored and is usually allowed to proceed where the party seeking it specifies material areas to be investigated, in this case I decline to grant Simkins the additional time it requests. It is apparent that Simkins has failed to use the time available to it in any way except to prepare motions for

more time. In sharp contrast are the former objectors who gained access to and reviewed voluminous files covering both the original agreement and the underlying cause of action. This time was sufficient for them not only to fully learn of the underlying facts but to formulate and negotiate specific proposals for an amendment to the settlement agreement. Simkins was invited to participate in the review undertaken by Norte, Galdi and Barr, was offered the results of that review, and could have participated in the negotiations but declined to do so. A proposed settlement of a lawsuit necessarily requires objectors to the settlement to move with the utmost promptness. It would chill the settlement of lawsuits if the approval of the settlement were to be routinely postponed for months. This Court is well aware how much discovery can take place in a short period of time if the one seeking discovery is highly motivated. In this case Simkins undertook no discovery and has not shown a single area where further discovery would be likely to lead to any information which would influence the approval of this settlement.

Simkins' use of *Girsh v. Jepson,* 521 F.2d 153, 157 (3rd Cir. 1975) is inapposite. In that case, the objector made every effort to undertake discovery, but was unable to complete it prior to the settlement hearing. The parties to the agreement argued that the plaintiff had reviewed the documents requested so that it was therefore unnecessary for the objector to do so. The Court held, however, that the parties to the agreement stood in an adversary position *vis-a-vis* the objector, so that plaintiff's review was of no benefit to the objector.

There are two fundamental differences between that situation and this one. First, objector Simkins has not undertaken discovery at all as did the objector in *Girsh.* Second, the issue here is not whether plaintiff's review of the requested documents is binding on the objector, but whether the objector who failed to review documents available to it should be allowed to delay the present proceeding. In view of my findings that Simkins has failed to undertake discovery with diligence, has failed to specify what discovery it needs, and that the amended agreement is intrinsically fair to all Shopwell stockholders, including Simkins, I deny Simkins' application to delay this proceeding in order to conduct discovery which could have been completed prior to the August 17, 1979, hearing with the exercise of reasonable diligence.

So ordered.

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## TELVEST, INC. v. OLSON

No. 5798

*Court of Chancery of the State of Delaware, Sussex*

October 5, 1979

The defendant, OSI Corporation, challenged the plaintiff Telvest Corporation's claim for legal fees after having stopped an illegal issue of

preferred stock by OSI, through a stockholders' derivative suit. The defendant, OSI, claims Telvest brought the suit for its own benefit because stopping the stock issue would enable Telvest to complete a planned takeover of OSI. The defendants seek discovery to prove Telvest had its own benefit in mind when it brought the suit. The Court of Chancery, per Vice-Chancellor Brown, held that the defendants should be entitled to reasonable discovery into the area they seek.

1. Corporations ⟸ 214

All legal fees are not fully compensable to a plaintiff in a derivative action.

2. Corporations ⟸ 214

In determining legal fees in a derivative action, effort spent on individual claims can be segregated from effort spent on achieving a benefit for all stockholders.

3. Corporations ⟸ 214

Appeal and Error ⟸ 984(5)

Costs ⟸ 172

The award of legal fees in a derivative action is a discretionary act.

4. Appeal and Error ⟸ 984(5)

Judicial discretion to be exerted properly should be based on a record which reflects all the facts.

BROWN, *Vice-Chancellor*

The current posture of this litigation is that Telvest, Inc. ("Telvest"), having sued as a stockholder of the defendant Outdoor Sports, Inc. ("OSI") and having obtained an injunction so as to prevent what this Court concluded to be a proposed illegal issue of preferred stock by the defendant management of OSI, now seeks to be awarded some $70,000 in counsel fees and more than $40,000 in expenses based on the theory that its efforts produced a substantial benefit on behalf of OSI and all its shareholders. The defendants oppose this application on the basis that Telvest, at the time, was seeking to gain control of OSI, that Telvest sued both individually as well as derivatively, that as a result of a tender offer for OSI stock made by a third party during the course of the litigation it reaped a profit of more than $1.5 million by tendering its shares to the third party, and that as a consequence Telvest has already realized a substantial individual benefit which should outweigh any right to recover counsel fees and expenses as a derivative plaintiff, especially since the result it achieved produced no fund or ascertainable monetary benefit to OSI.

Alternatively, the defendants take the position that even if Telvest is entitled to an award of counsel fees and expenses, the amount which it seeks is excessive. To this end, the defendants seek leave to engage in limited discovery with regard to the effort of Telvest's counsel actually expended on the derivative aspects of this one particular suit. Defendants feel this to be pertinent in view of the fact that at the same time that this suit was proceeding the parties were engaged in companion litigation in the federal courts in Chicago. Telvest also noticed a tender offer for OSI stock the day after the injunction was entered here, although during the course of this litigation prior to that time it had disavowed that it had any such intention in mind. Defendants would like to probe into the amount of legal time that went into this conduct on Telvest part so as to be sure it is not included in the fee Telvest is claiming on behalf of the therapeutic benefit it feels that it produced for the corporation it was attempting to take over.

The fee application further includes a request for $35,000 for an opinion as to the marketability of OSI's stock apparently rendered to Telvest by an investment banking firm during April 1979, and thus several weeks after a hearing had been held in this Court and a preliminary injunction entered. The application also includes a request for fees to compensate for the legal services rendered by one Nathan Dardick, house counsel for, and secretary and director of, Telvest.

Defendants stress that they are not disputing the total hours spent by counsel for Telvest as set forth in their respective affidavits, nor are they questioning the hourly rates charged, the competence and standing of counsel, etc. They simply want discovery to be certain as to the hours and expenses specifically attributable to the Delaware litigation, including the time spent in defense of OSI's counterclaim. Telvest opposes such discovery, viewing it as further harassment by the defendants. It presumably follows that Telvest would have the Court decide the fee application on the briefs and affidavits of record.

Having considered the situation, and as reluctant as I am to do so, I conclude that the defendants should be entitled to reasonable discovery in the limited area into which they seek to inquire before any decision is made on the fee application. I arrive at this conclusion for the following reasons.

This case came into being because of the device seized upon by the defendants in an effort to thwart what they perceived to be an on-coming take-over attempt by Telvest. The device was a proposed issue of preferred stock by resolution of OSI's board of directors which would have increased the stockholder vote necessary to approve a merger between OSI and another entity. Telvest was the other entity at which the increased voting requirement was directed. Telvest was a 20% stockholder of OSI. I think it fair to say that it was at least exploring the possibility of obtaining control of OSI at the time OSI's board proposed

the action which would have made the effort considerably more difficult. Thus I do not believe that Telvest was acting solely out of an eleemosynary concern for the rights of its fellow OSI stockholders when it instituted this individual and derivative suit to stop the proposed action of the defendants. While the result achieved by Telvest may have benefited the corporation by preventing an illegal issue of stock to public investors, it would seem just as likely that it also enhanced the private plans of Telvest. That Telvest was engaged in a planned take-over attempt all along is at least moderately indicated by its tender offer notice given one day following the entry of the injunction in its favor in its "individual and derivative" suit.

[1-4] It has been judicially recognized that not all legal effort is fully compensable to a derivative plaintiff. Effort spent on individual claims can be segregated from effort spent on achieving a derivative benefit when the time comes to hand out the fees. *Saks v. Gamble,* Del. Ch., 154 A.2d 767 (1958); and see *Dillon v. Berg,* 351 F. Supp. 584 (D. Del. 1972), *remanded,* 482 F.2d 1273 (3rd Cir. 1973). Moreover, the award of fees in a derivative action in this Court is a discretionary act, reviewable only for an abuse of discretion. *Chrysler Corporation v. Dann,* Del. Supr., 223 A.2d 384 (1966). Discretion, to be properly exercised and thus adequately reviewable, should be on a record which fairly reflects the issues for decision. In fact the remand in *Dillon v. Berg, supra,* was for the purpose of making a more adequate record.

Accordingly, I grant the defendants the right to take discovery in the limited area requested. Since this would seem to include the purpose for some of the legal work undertaken on behalf of Telvest (since under the defendants' approach time spent cannot be categorized without knowing its purpose), I think it only fair that Telvest should have a corresponding right to take such discovery as it may need from the defendants in order to bring matters into proper focus. I do not intend, however, for such discovery by either side to be extensive. And it goes without saying that any "shot gun" approach which smacks of harassment or dilatory tactics will be darkly viewed by the Court.

If counsel feel the need for any particular form of order reflecting this decision, I shall be glad to meet with them upon request.

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## SCHREIBER v. BRYAN

No. 4250

*Court of Chancery of the State of Delaware, New Castle*

October 29, 1979

The plaintiff, Leonard I. Schreiber, brought a derivative action against the defendant corporation, Pennzoil Company (Pennzoil) and Pennzoil

Offshore Gas Operators, Inc. (POGO). The plaintiff as a stockholder in POGO challenged a fee charged by Pennzoil to POGO incident to POGO investment in Pennzoil Louisiana and Texas Offshore, Inc. The Court of Chancery, per Vice-Chancellor Hartnett, held that in a derivative action the burden of producing evidence may be shifted to the defendant corporation, when the facts are peculiarly in the knowledge of the defendant.

1. Judgment ⟸ 185(2)

In considering a motion for summary judgment, the facts are construed in a light most favorable to the plaintiff.

2. Judgment ⟸ 527, 550

In a derivative suit the plaintiff is not relieved of the burden of proving his ownership of the corporation's stock by relying on a prior ruling which stated that plaintiff had purchased shares of stock in the corporation.

3. Corporation ⟸ 212

In a derivative action the burden is on the defendant to come forward and produce evidence relating to the challenged transaction, since the facts are peculiarly in the knowledge of the defendant.

4. Evidence ⟸ 90, 91

Having the burden of producing evidence of a challenged transaction is not the same as having the burden of proof in an act.

5. Corporations ⟸ 581, 583, 584

The "entire fairness" or "intrinsic fairness" test is applied in reviewing an attached merger transaction, even though a majority of the minority stockholders approved the merger.

6. Corporations ⟸ 320(11), 584

Under the intrinsic fairness test the burden of showing the entire fairness of a challenged transaction rests with the entity which controls the corporation.

7. Corporations ⟸ 320(11)

When a challenged transaction had been ratified by a majority of a corporation's stockholders, the burden of proof shifts to challenging party to show the unfairness of the transaction.

HARTNETT, *Vice-Chancellor*

At the pre-trial conference held on October 25, 1979, on the eve of trial, a number of matters were raised which should be ruled upon or clarified prior to the commencing of the trial. They are:

[1, 2] (1) Plaintiff requests he not have to personally appear at the trial and establish his ownership of stock in Pennzoil Offshore Gas Operators, Inc. ("POGO"). He relies on the fact that in my prior opinion in this matter, dated September 6, 1978, (*Schreiber v. Bryan*, Del. Ch., 396 A.2d 1144), I denied defendant's Motion For Summary Judgment and I stated that plaintiff purchased shares of stock of POGO in 1971 and 1972. He therefore believes that it is not necessary for him to appear at trial and prove these facts. In my recitation of the facts in considering defendant's Motion For Summary Judgment I had to construe the facts in the light most favorable to plaintiff. *Dineen v. City & Suburban Cab Company*, Del. Super., 175 A.2d 39 (1961). This did not relieve the plaintiff of the burden of proving his ownership of stock in POGO. Plaintiff therefore must appear at trial and prove his ownership of POGO stock although it does not seem that there is really any dispute as to his ownership.

(2) It is conceded by plaintiff and corporate defendants that this action must be dismissed as to the individual defendants since jurisdiction over them has never been obtained by this Court. Their dismissal is therefore ordered with prejudice as to plaintiff but without prejudice to any other stockholder of POGO and the caption of this case shall be changed to "Leonard I. Schreiber v. Pennzoil Company and Pennzoil Offshore Gas Operators, Inc."

(3) At the pre-trial conference plaintiff abandoned certain of his claims. The only issues remaining in this case revolve around an approximate $650,000 fee charged by Pennzoil Company ("Pennzoil") to POGO incident to POGO's investment in Pennzoil Louisiana and Texas Offshore, Inc. ("PLATO").

A former issue was whether Pennzoil, by its dominance of POGO, diverted a corporate opportunity from POGO. This has been abandoned by plaintiff. The abandoning of this issue should considerably narrow the scope of the testimony to be adduced at trial since there now should be no necessity for the defendants to show that a corporate opportunity was not diverted. Defendants, however, persist in their desire to present evidence as to the full background of the transaction. Defendants shall be expected, however, to produce only that evidence which relates to the issue of the three percent fee.

(4) Plaintiff at the pre-trial conference alleged that in addition to the three percent fee of $650,000 which has always been the subject of this litigation, plaintiffs have just learned that there are additional three percent fees which have been charged to POGO. Defendants objected to any consideration at this time of such additional fees. Upon defendants' assurance that they would advise plaintiff promptly whether these additional fees had in fact been collected, plaintiff agreed not to seek to challenge any additional fees at the present trial.

(5) Defendants again reiterated their claim that the burden of proof in this case rests with the plaintiff. In my prior September 1977 opinion I stated at 396 A.2d 521: "the burden is upon defendants, however, to come forward with the facts relating to the transaction."

[3, 4] I still hold that the defendants should come forward and produce the evidence relating to the transactions since these facts are peculiarly in the knowledge of the defendants. In so holding, however, I am only imposing upon them the burden of producing evidence. I am not, at this time, assigning to them the burden of persuasion. See *McCormick's Handbook of the Law of Evidence, 2d,* § 336; 337; *Bennett v. Andree,* Del. Super., 264 A.2d 353 (1970), *aff'd,* Del. Supr., 270 A.2d 173 (1970).

[5, 6] In my prior opinion, 396 A.2d at 519, I held that the defendants had the burden of proving the intrinsic fairness of the transaction citing *Singer v. Magnavox,* Del. Supr., 380 A.2d 969 (1977) and other prior Delaware cases. I so held, notwithstanding the non-unanimous independent stockholder approval such as may have occurred here. Although not cited, I also relied on *Tanzer v. Int'l Gen. Ind., Inc.,* Del. Supr., 379 A.2d 1121 (1977). In that case the Delaware Supreme Court mandated that the "entire fairness" or "intrinsic fairness" test be applied in reviewing an attacked merger transaction. This was so even though the majority of the minority stockholders approved the merger. Under the intrinsic fairness rule the burden of proof of showing entire fairness rests upon the entity which controls the corporation. See *Tanzer v. International General Industries, Inc.,* Del. Ch., No. 4945, — A.2d — (1979).

The Supreme Court, in its 1977 opinion in *Tanzer,* however, did not discuss the stockholder approval. *Tanzer* also involved a merger and did not involve an allegation of waste or inadequate consideration.

In my November 6, 1978, opinion on the Motion For Reargument, 396 A.2d at 520-521, I denied the defendants' Motion For Reargument and somewhat unclearly modified my holding in the original opinion.

[7] Now it appears that the entire issue of whether independent stockholder approval shifts the burden of proof to an objector who alleges breach of fiduciary duty, waste or inadequate consideration has been freshed by the recently decided case of *Michelson v. Duncan,* Del. Supr., — A.2d — (1979). In that case the Delaware Supreme Court held that non-unanimous independent shareholder ratification shifted the burden of proof to the objector to show want or inadequacy of consideration for the granting of certain stock options.

Because our present trial is due to commence this week and because there apparently now may be a factual issue as to whether the stockholders did approve the three percent fee, I decline to rule, at this time, whether plaintiff or defendants have the burden of persuasion or whether

any presumptions in favor of either exist. These issues will be reconsidered, if necessary, after all the evidence is adduced and the parties are given an opportunity to brief the points.

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## WEINBERGER v. UNITED FINANCIAL CORP.

No. 5915

*Court of Chancery of the State of Delaware, Sussex*

November 20, 1979

Plaintiff requested an order prohibiting any questioning of plaintiff to his past record in class and derivative actions or experience in class actions during discovery. Plaintiff contended that it was not an area of relevant inquiry for discovery purposes. The Court of Chancery, per Vice-Chancellor Brown, held that questioning of plaintiff as to his past experience and understanding of class and derivative actions is proper since it could possibly lead to the discovery of relevant evidence bearing on whether or not he is entitled to certification as a representative of the proposed class under the allegations contained in the complaint, and that such questions should be answered subject to any right to refuse further answers should matters reach a point of harassment.

1. Discovery ⇐ 38, 41

   Parties ⇐ 9

Inquiry into a plaintiff's past record and experience in class and derivative actions, as well as his understanding of them based thereon, could possibly lead to the discovery of relevant evidence bearing on the question of whether or not he is entitled to certification as the person to represent the class under the allegations contained in the complaint.

2. Discovery ⇐ 28

   Parties ⇐ 9

A class action applicant should not be harassed about his past record and experience as a class action representative.

3. Discovery ⇐ 28, 41

   Parties ⇐ 9

It lacks a certain grace for a plaintiff to seek certification as the representative of a large group of corporate shareholders and, at the same time, to assert a right to stand mute as to his past efforts as a representative plaintiff and his understanding of the duties and obligations expected of him as a result of his experience.

4. Discovery ⇐ 28, 41
   Parties ⇐ 9

Even if it may prolong the deposition to answer questions about plaintiff's experience and understanding of class and derivative actions, it seems only fair that such questioning be tolerated with a certain benign understanding in view of the gravity of the responsibility to the other members of the class which a class action plaintiff asks to assume.

5. Discovery ⇐ 28

The area of questioning as to plaintiff's past experience and understanding of class and derivative actions is proper and such questions should be answered, subject to any right to refuse further answers should matters reach a point of harassment.

BROWN, *Vice-Chancellor*

While the above case is assigned to Vice Chancellor Hartnett, I was called upon during his absence in August to rule upon several discovery problems which arose during the deposition of the plaintiff Weinberger. Rulings were made at the time on all but one issue. Indications were that this remaining point might have become moot. However, I am recently advised that counsel would still like a ruling prior to any resumption of the deposition of Mr. Weinberger. Accordingly, I offer this in disposition of the remaining contested point.

Specifically, at his deposition, defendants sought to question Mr. Weinberger as to his familiarity with derivative suits. Objection was made to this line of questioning on the grounds that it was not relevant, the action here being purportedly brought as a class action. In addition, counsel for Weinberger would like an order prohibiting any questioning of the plaintiff as to his past litigation record as a class or derivative plaintiff or as to his past experience as a class action representative.

[1] I have reviewed the authorities submitted and as a result I decline to uphold the objections to discovery into this area. I realize that there are authorities supporting both sides of this proposition, especially within the Federal Courts. However, I am not prepared to state as a blanket proposition that inquiry into a plaintiff's past record and experience in class and derivative actions, as well as his understanding of them based thereon, can never lead to the discovery of relevant evidence bearing on the question of whether or not he is a proper person to represent a class under the allegations contained in the complaint based upon which he seeks such class action certification. See Rule 26.

To this extent, I must disagree with the holding of *Lewis v. Black*, 22 FR Serv. 2d 132 (EDNY 1975). There it was stated that the instigation of many other securities lawsuits could not, of itself, disqualify a plaintiff from acting as a class representative in that action and that consequently it was not an area of relevant inquiry for discovery purposes.

It seems to me that this begs the question. It would support a rationale that because a plaintiff might have served as a class representative in ten previous cases without fully understanding what he was doing, further inquiry as to all future class actions should be thereby foreclosed.

Moreover, in the other decision offered by plaintiff, *Denny v. Carey*, 73 F.R.D. 654 (E.D. Pa. 1977), I note that even though it was held that the plaintiff's involvement in other securities litigation was irrelevant to the decision as to whether or not he should be certified as class representative, the decision does not hold that his past experience is not a proper area for discovery. In addition, the ruling in *Denny* is a one sentence statement based solely upon *Lewis v. Black, supra.*

[2-4] In short, while I do not feel that a class action applicant should be harassed about his past record and experience as a class action representative, I nonetheless feel that it lacks a certain grace for a plaintiff to seek certification by this Court as the representative of a large group of corporate shareholders and, at the same time, to assert a right to stand mute as to his past efforts as a representative plaintiff and his understanding of the duties and obligations expected of him as a result of his experience based on the contention that it is not relevant to the decision that the Court must make. If he has enjoyed a good record and knows what he is doing, I should think he would enjoy telling it, since in all probability it would enhance the likelihood of his eventual certification. It would surely take less time to do so than it has taken for this exercise brought about by his objections. And, even if it may prolong the deposition a bit in order to answer such questions, it seems only fair that such questioning be tolerated with a certain benign understanding in view of the gravity of the responsibility to others which a class action plaintiff asks to assume.

[5] I rule that the area of questioning as to Mr. Weinberger as to his past experience and understanding of class and derivative actions is proper and that such questions should be answered, subject to any right to refuse further answers should matters reach a point of harassment. I decline plaintiff's request that an order be entered prohibiting such questioning.

IT IS SO ORDERED.

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## JAFFE v. REGENSBERG

No. 5965

*Court of Chancery of the State of Delaware, Sussex*

November 20, 1979

Plaintiffs moved, pursuant to DEL. CT. CH. R. 37(a), to compel the production of any agreements or understandings between any named

defendants and any documents reflecting discussions between defendant Regensberg and any other person concerning the alleged illegal issue of stock without consideration in order to maintain control of the corporation. Plaintiffs further sought production of any defense or proposed defense of defendant Regensberg to this action. The Court of Chancery, per Vice-Chancellor Brown, held that: 1) any agreements or understandings between any named defendants related to the matters alleged in the complaint could lead to the discovery of admissible evidence, 2) documents between defendant and others related to keeping defendant's faction in control of the corporation to the exclusion of plaintiffs would be relevant for discovery purposes, and 3) a defendant who is presently challenging service of process made upon him, but who is not a party defendant, has no obligation to assert a defense or proposed defense. The requests for the production of documents were granted, and the request for the production of any defense or proposed defense was denied.

1. Discovery ⟸ 80, 89

In a motion for production of certain documents, any agreement between the named defendants purporting to bring about the illegal issue of stock without adequate consideration to maintain control in named defendant corporation, giving support for the action taken, or dealing in any way with the factual setting resulting therefrom could certainly lead to the discovery of admissible evidence.

2. Discovery ⟸ 80, 89

Documents between defendant and others relating in any way to keeping defendant's faction in control of the corporation to the exclusion of plaintiffs would be relevant for discovery purposes.

3. Discovery ⟸ 93, 95

A defendant who is challenging the service of process made upon him and who is not clearly a party defendant, is not obligated to assert a defense or proposed defense.

4. Discovery ⟸ 93, 95

When a defendant is before the court, his defense will presumably be asserted in the form of an answer to the complaint and at that time all will know the basis for his personal defense.

BROWN, *Vice-Chancellor*

In connection with the noticed depositions of the named defendants Regensberg and Fishman plaintiffs also moved for the production of certain documents. On behalf of Regensberg and Fishman, objections were filed as to certain of the production requests. Plaintiffs then moved to compel pursuant to Rule 37(a). Prior to presentation of the motion,

all areas of dispute were resolved, with the exception of three. I offer this as my decision on the disputed matters.

*As to Request No. 1.* This sought production of any agreements or understandings between Regensberg and the named defendant Petersen, or between any other named defendant, relating to Car-X Service Systems, Inc. including "the voting of their Car-X stock for election of directors; the selection, hiring, retention or discharge of any officer or employee of Car-X; and voting as a director or shareholder of Car-X." The objection was on the basis that the request sought irrelevant material not reasonably calculated to lead to the discovery of admissible evidence.

[1] I find this objection to be without any justifiable basis, subject to the clarification that the documents sought relate only to the matters alleged in the complaint. It will not be construed to seek any agreements relating to future actions or to the promise of future action. The complaint alleges an orchestrated directors meeting whereby stock sufficient to maintain control in Regensberg and Petersen was illegally issued without adequate consideration. Any agreement between the named defendants purporting to bring about this alleged result, giving support for the action taken, or dealing in any way with the factual setting resulting therefrom could certainly lead to the discovery of admissible evidence. The objection to Request No. 1 is overruled.

[2] *As to Request No. 8.* This sought documents reflecting any "discussions between Regensberg and any other person concerning control of Car-X." The primary objection is that the request is ambiguous since it is not certain what is meant by control. I find no substance to this objection, again subject to the clarification—an obvious one I think—that "control" is used only in the context of the allegations of the complaint. The issuance of the 534 challenged shares to Regensberg, if legally accomplished, has kept his faction in control of the corporation to the exclusion of plaintiffs. This is what the suit is all about. Documents between Regensberg and others relating to any way to this challenged development would be relevant for discovery purposes. I see no basis for concluding that any such documents would be privileged. Nor, if the intent of the word "control" is so limited, do I see where the production of any such documents would provide the plaintiffs information which would give them an unfair advantage should they be seeking to purchase Car-X stock from others. The objection to Request No. 8 is overruled.

*As to Request No. 15.* This sought production of any "defense or proposed defense of Regensberg to this action." As to this request I shall uphold the objection.

[3, 4] As stated, the request goes to any defense or proposed defense of Regensberg to the extent that the suit may seek relief against him personally, Regensberg is presently challenging the service of process

made upon him. The matter has been argued and is awaiting decision. Until it is clear that he is a party defendant, he has no obligation to assert a defense. If he is before the Court, his defense will presumably be asserted in the form of an answer to the complaint and at that time all will know the basis for his personal defense. While time is a critical element in this case since there exists some dispute as to whom is in control of the corporation, and while it might be helpful to the expeditious determination of the dispute to know in advance the defenses on which Regensberg may choose to rely, the fact remains that the production request really seeks to know what defensive position Regensberg may take for the purpose of deposing him prior to the time that he is obligated to file an answer. I am reluctant to do this. The objection to Request No. 15 is upheld.

This decision contemplates that plaintiffs will not be required to file new requests as to Requests Nos. 1 and 8. The matter should proceed along as quickly as possible in the interests of corporate stability. As to the foregoing, IT IS SO ORDERED.