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 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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A. R. DERVAES CO. v. HOUDAILLE INDUSTRIES, INC.

No. 6471

Court of Chancery of the State of Delaware, New Castle

September 29, 1981

Plaintiff, A. R. Dervaes Co., filed a motion for a preliminary injunction against defendant, Viking, to restrain Viking from terminating an alleged franchise granted to plaintiff. Plaintiff alleged that defendant's termination of the alleged franchise violated both the Delaware Franchise Security Law and common law contract principles.

The court of chancery, per Chancellor Marvel, held that the Delaware Franchise Security Law did not apply in this instance as plaintiff had not paid the $100 consideration required by DEL. CODE ANN. tit. 6, section 2551(3) (Supp. 1980) to establish a franchise. The fact that Viking required that plaintiff purchase a minimum inventory level of Viking's goods was considered to not fulfill the $100 consideration requirement. The court further held that the contractual relationship between the parties was terminable at will except that as plaintiff had expended a substantial amount of money in furtherance of the contract. The agreement should be continued for a reasonable time to allow plaintiff to recoup its investment. The court determined, however, that as distributorship had been in effect for ten (10) years, the reasonable time requirement had been fulfilled and the contract was terminable at will. The motion for a preliminary injunction was denied.

1. Franchises ⟹ 1

Customary and reasonably anticipated payments required of a particular dealer or retailer which enable him to perform and carry out the terms of an agreement with his supplier do not meet the $100 consideration requirement of DEL. CODE ANN. tit. 6, § 2551 (3) (Supp. 1980).

2. Franchises ⟹ 1

Where a franchise relationship cannot be established under DEL. CODE ANN. tit. 6, § 2551 (Supp. 1980), the franchise rights afforded by DEL. CODE ANN. tit. 6, § 2552(c), 2553(b), may not be invoked.

3. Contracts ⟹ 217

Contracts which are silent as to termination are terminable at will by either party upon reasonable notice.

4. Contracts ⟹ 217

Where an agent or distributor expends a substantial sum of money or gives something of considerable value to develop a distributorship system, this constitutes sufficient consideration to require that the arrangement continue for a reasonable time to allow the distributor to recoup expenditures incurred in reliance upon the agreement.

5. Injunctions ⟹ 151

A party seeking preliminary injunctive relief must in addition to establishing the threat of irreparable injury and that such injury outweighs any harm to the party against whom the preliminary injunction is sought were a preliminary injunction to be granted, demonstrate a reasonable probability of success on the merits.

MARVEL, *Chancellor*

Plaintiff A. R. Dervaes Company, Inc. in its complaint for injunctive relief claims that the defendant Viking, in terminating an alleged franchise granted to plaintiff, not only violated the Delaware Franchise Security Law but also common law contract principles, by unjustly terminating an established working arrangement between the parties. In addition, plaintiff alleges that in taking such action, Viking unlawfully interfered with a prospective business opportunity of plaintiff's and further conspired to restrain trade in violation of Delaware's antitrust law.

Plaintiff having filed a motion for the granting of a temporary restraining order against such alleged improper contract termination, an order to such effect was entered by the Court. The parties having thereafter engaged in expedited discovery, this is the opinion of the Court on plaintiff's motion for the granting of a preliminary injunction in conformity with the terms of the restraining order.

The A. R. Dervaes Company, Inc. has offices and facilities located in Wilmington and Dover and is primarily engaged in the business of distributing industrial equipment in Delaware, southern New Jersey and southeastern Pennsylvania. Its principal commodity is industrial pumps which are marketed by several manufacturers, one of which is Viking. Dervaes also repairs and assembles various add-on items, which consist generally of pump motors and couplings.

The parties did business on an independent basis until January 15, 1969, when, by a letter of appointment Viking commissioned Dervaes a Class 5 authorized distributor.[1] Such letter was silent as to the possibility of future termination or continuance of plaintiff's distributorship. However, the basic terms of the parties' business arrangement are comparable to those found in Viking's annual discount schedules. Thus, Viking's discount schedule, effective February 16, 1981, obligates a Class 5 distributor to maintain a $90,000 minimum inventory purchasable at 58% of the list price. In addition, Viking agreed to establish a credit line for each of its distributors. The amount of such credit line was to be dependent upon classification, quantity of sales, conformance with billing procedures, and in general reflected the length of time a distributor has been affiliated with Viking. In the same letter of January 15, 1969, Viking suggested that Dervaes focus its sales in a particular market area. This area, otherwise known as Region 3, consists of the southeastern counties of Pennsylvania, southern New Jersey, and the entire state of Delaware.

Viking's marketing strategy has been to authorize nonexclusive distributorships, an arrangement which allows Viking to be represented by several distributors which compete with one another in a given area. Thus, the loss of a single distributorship in a particular area does not significantly endanger Viking's marketing capabilities.

The first ten years of the parties' business relationship appears to have been mutually beneficial. Then, early in 1979, Dervaes began to experience financial difficulties, and, as a result, its account was constantly delinquent.[2] Moreover, pump sales were in a general decline.

Next, during the fall of 1980, Robert Dervaes was succeeded as president of plaintiff by his brother, Rene, who had not been until then, actively involved in the company's daily business affairs. In addition, other managerial positions changed hands and several sales persons were replaced. Viking, which ascribes importance to keeping in close contact with its distributors' sales personnel, felt that these and the managerial changes were detrimental to both Viking's image

1. Viking classifies its distributors according to quantity of sales and market area. Class 5 distributors are Viking's largest. They are required to maintain a substantial minimum inventory, yet are entitled to purchase at Viking's maximum discount.

2. Dervaes argues that Viking's portrayal of its accounts receivable is exaggerated. There is some discrepancy as to exactly what is Viking's policy on accounts receivable. Its stated policy is a 30 day period, while it appears to practice a 35-40 day policy before late charges are assessed. However, by its own admission, Dervaes was many times in the 40-50 day range of delinquency.

as well as Dervaes' marketing potential. These changes further weakened business relations between the parties.

Viking, which had become concerned with Dervaes' overdue accounts, its financial future, and its internal changes, decided to restrict Dervaes' credit line. Although this may have been a justifiable business decision and is apparently Viking's long-standing policy, this action in fact acerbated problems between the parties. In fact, the imposed restriction appears to have actually precipitated much of the customer complaints which Viking emphasizes.

Finally, the parties embarked on an effort to resolve their differences. As a result of such negotiations, Dervaes agreed to settle its delinquent account and Viking agreed to increase the former's credit line. However, during such negotiations plaintiff disclosed that it carried several other delinquent supply accounts. Thus, Dervaes appeared to be increasing its debt with other suppliers in order to make payments to Viking, a practice which Viking felt only postponed a show-down with plaintiff.

Accordingly, by letter dated May 5, 1981, Viking notified Dervaes that its distributorship would be terminated effective June 12, 1981, the letter providing that Viking would continue to supply Dervaes up to that date. It also offered to repurchase any remaining inventory. Dervaes declined to accept such purported termination and filed the instant lawsuit.

In order to maintain service to its customers, Dervaes sought alternate sources of supply but was unsuccessful. It alleges that its lack of success is due to interference by Viking.

The case law interpreting Delaware's Franchise Security Law makes it clear that the statute in question is not all-inclusive. See Tulowitzki v. Atlantic Richfield Company (Unreported Del. Ch. March 8, 1977), aff'd, Del. Supr. 396 A.2d 956 (1978), 33 Flavors of Greater Delaware Valley, Inc. v. Bressler's 33 Flavors, Inc., 375 F. Supp. 217 (Del. 1979), and B-F Spirits, Ltd. v. Delaware Alcoholic Beverage Control Comm'n., Del. Super., 418 A.2d 1014, aff'd on other grounds, Del. Supr. 429 A.2d 975 (1981). In order to come within the statute's purview, the business arrangement in question must fall within the definition of a protected business arrangement, 6 Del.C. § 2551. Should the arrangement fall within such definition, it is to be deemed a franchise and thus entitled to the protection of the provisions found therein.

Pursuant to this section, Dervaes alleges that Viking is a "franchisor", that Dervaes is a "franchised distributor" and that there existed between them a "franchise." A "franchise" is defined as:

> "(3)" . . . a contract or other arrangement governing the business relationship within this State between a franchised distributor and a franchisor where the franchised distributor is required to pay more than $100 to enter into such contract or other arrangement; provided, however, that a franchised distributor as defined under subdivision (1)(d) of this section shall not be required to have paid any consideration to enter into such contract or other arrangement." 6 Del. C. § 2551(3)

First of all, subdivision (1)(d) is inapplicable to the situation here presented inasmuch as it applies solely to gas service stations. Thus, in the present case, *the issue of whether or not there has been a payment of the required consideration (more than $100), must be dispositive of plaintiff's claim to protection under the statute.*

[1] Dervaes argues that although it did not admittedly pay such statutory consideration upon entering into a business relationship with Viking, that the minimum inventory requirement exacted by Viking, which at present approximates $90,000.00, serves to bring it within the protection of the statute. However, in Del-Way Petroleum Company, Inc. v. Phillips Petroleum Company, Del. Ch., March 10, 1977, in rejecting such contention, this Court stated:

> "In Delaware, the General Assembly in its infinite wisdom has seen fit to require that a payment be made by the franchise distributor as a condition to entering into an arrangement which would constitute a protected franchise, and has further seen fit to establish a minimum amount for the qualifying payment. In view of the nominal amount established as the standard, i.e., $100, it seems unrealistic to think that any and all payments required in connection with the business arrangement, including the wholesale cost of goods for resale, were contemplated as being sufficient to turn the relationship into a protected 'franchise' which could only be terminated thereafter by the supplier for good cause. Carrying Del-Way's argument to its extreme, any person who, in order to acquire a line of goods for resale, is required to purchase a minimum of $100 worth of such goods at wholesale, would qualify as having made the necessary payment for a franchise under § 2551(3). Thus, the only business arrangements potentially exempt from the application of the Franchise Security Law would be those where the retailer or distributor is under no obligation to spend $100 or more with his supplier or manufacturer . . .

"In view of this, I am of the opinion that the critical factor in the present case centers around the nature of the payments relied upon by Del-Way. And in making the determination, I feel that a distinction must be recognized between customary and reasonably anticipated payments required of a particular dealer or retailer which enable him to *perform and carry out* the terms of the agreement as opposed to a payment required by the supplier or manufacturer as the price to the dealer of *entering into* the agreement in the first place." (emphasis supplied)

In light of the above holding, I conclude that the amounts paid out by plaintiff for inventory relied upon by Dervaes to establish consideration do not meet the strict requirements of 6 Del.C. § 2551(3).

Plaintiff also argues, in the alternative, that it is nonetheless entitled to relief under the provisions of 6 Del. C. § 2552(i) and § 2553(b). These sections provide:

2552 "(i) No franchisor may unjustly refuse to deal with a franchised distributor with whom the franchisor has been dealing for at least 2 years."

*****

2553 "(b) Without limiting any other provisions of this chapter, if a franchisor unjustly refuses to deal with a franchised distributor with whom the franchisor has been dealing for at least 2 years, the franchised distributor shall be entitled to recover damages from the franchisor pursuant to subsection (a) of this section plus all other damages (including, without limitation, loss of profits) allowed under the law of this State; and, in addition, shall be entitled to secure in the Court of Chancery of this State an order directing the franchisor to deal with the franchised distributor on fair and competitive terms. Pending the issuance of such final order, the franchised distributor shall be entitled to secure such a manatory order pendente lite."

Plaintiff argues that even if the business arrangement here in issue does not fall within the strict definition of a franchise per se, it is nevertheless entitled to protection as a franchised distributor of more than two years duration. In essence, Dervaes argues that sections 2552(i) and 2553(b) are not dependent upon the existence of a statutorily defined franchise, but provide a separate and independent classification, which is also entitled to protection.

[2] First, as held in the case of Del-Way Petroleum Co., Inc. v. Phillips Petroleum Company, supra, the thrust of plaintiff's complaint is centered on an alleged unjust termination of a distributorship under the provisions of 6 Del. C. § 2551 and not an alleged unjustified refusal to deal, being based on the improper assumption that under the terms of a statute designed to insure franchise rights, there can be a franchisor and a franchised distributor even though a franchise relationship has never existed.

The answer to the basic issue raised by plaintiff's argument is that in an event its rights are protected by contract depends on whether or not the agreement between the parties was renewable from year to year, as contended by Dervaes, or, as Viking argues, such business arrangement was terminable at will. In support of its position, plaintiff points to a January 23, 1981 letter of Joseph Kozler, Viking's regional manager, directed to Dervaes' president, Rene Dervaes. This letter primarily consists of sales information and concludes in the following manner.

> "We do want to thank all of you at A. R. Dervaes for your sales effort in 1980, and we want to continue to work with you to improve your sales in 1981. Our lead times are down to (6) to (8) weeks in most cases and we have the broad product line to meet the market requirements. It is now up to all of us, in the field marketing program, to get the business.
>
> " 'Good Luck' in 1981."

Dervaes contends that this letter in effect renewed plaintiff's distributorship for the year 1981, and accordingly that Viking cannot terminate such agreement without good cause. In reply, Viking argues that the letter in question merely transmitted certain sales data and that therefore the provisions of the original letter of January 15, 1969 remains in full force and effect. Since that letter was silent as to termination or renewal, it is argued, the arrangement in issue was clearly terminable at will.

In my opinion, the January 23, 1981 letter does nothing more than transmit sales information and express an expectation and hope that the parties' business relationship will run smoothly and be profitable in the future. In short, the contractual relationship here in issue is terminable at will, the operative terms being a specified market area with annual minimum inventory requirements.

[3,4] The accepted judicial approach to the duration of distributorship contracts of the kind in issue is that expressed in 9 Williston on Contracts, § 1017A, p. 150-152 (3d Ed. 1967), wherein it is stated

that contracts which are silent as to termination are terminable at will by either party, (i.e. without the need to demonstrate good cause) upon reasonable notice. However, there is an exception to this general rule. This exception is found in a situation in which the agent or distributor expends a substantial sum of money or gives something of considerable value in furtherance of the terms of the contract. As stated in Williston supra p. 152:

> "A similar result has been reached though the dealer is a buyer-distributor rather than a technical agent, where in addition to undertaking to pay for the manufacturer's products as ordered, he promises to establish or maintain adequate sales and demonstration facilities or to provide a maintenance and repair service for handling said products. Thus, where substantial sums of money were expended 'in developing a distributorship system' throughout a certain territory, it was held that the distributor was entitled to retain his franchise 'for such a period of time as would enable it to recoup' expenditures incurred in reliance upon the agreement."

Further support of this principle can be found in the Annot., Distributorship Contract-Termination, 19 A.L.R.2d 196 (1968). Hence, in this context, Viking's minimum inventory requirement is consideration sufficient enough to require that this arrangement continue for a reasonable time. This is particularly so insofar as Dervaes appears to assume the risk of inventory destruction, is required to maintain warehouse facilities, and, must tie up a substantial amount of its capital in inventory and accounts receivable. However, in view of the fact that this distributorship has continued for more than ten years, it is clear that the reasonable time requirement has been met. During this time Dervaes has had sufficient time to recoup any initial investments, and, in addition, Viking has offered to repurchase any remaining inventory at the date of termination.

Whether or not there has been reasonable notification of termination is not presently at issue. As stated in Dervaes' Reply Brief "the purpose of Dervaes in this proceeding is to maintain its Viking distributorship, not to extend the termination period per se. p. 13. Consequently, the Court will not address this issue.

[5] The standards which govern Dervaes' application for preliminary injunctive relief are those outlined in Paradee Oil Company v. Phillips Petroleum Company, Del. Ch. 320 A.2d 769, 776 (1974). Thus, plaintiff must, in addition to establishing the threat of irreparable injury and that such injury outweighs any harm to Viking

were a preliminary injunction to be granted, demonstrate a reasonable probability of success on the merits. Since the Delaware Franchise Security Law is inapplicable and the parties' contractual relationship appears to be terminable at will, and plaintiff's other theories, which are advanced in support of the relief sought, are not persuasive, I conclude that plaintiff has failed to establish a reasonable probability of success on final hearing. Accordingly, plaintiff's application for the granting of a preliminary injunction will be denied and the outstanding restraining order will be dissolved.

On notice, an order in conformity with the above may be submitted.

CARROLL v. CM&M GROUP, INC.

No. 6351

Court of Chancery of the State of Delaware, New Castle

September 24, 1981

The plaintiff, Carroll, the owner of approximately one-third of the outstanding stock of the defendant CM&M Group, Inc., brought suit for an order granting the right to inspect corporate records, pursuant to DEL. CODE ANN. tit. 8, section 220, in order to determine the value of his stock. The defendant resisted, contending that Carroll has access to much of the requested material because of his position as one of the founders and former president of Carroll, McEntee & McGinley, Inc., now a subsidiary of the defendant.

The court granted the motion to the extent that entitled the plaintiff to such information, supplemented by that already in his possession, which would allow him a reasonable basis to value his stock.

1. Corporations ⟹ 181(8)

The burden of proving a proper purpose in a case which seeks books and records other than a stock list rests on a plaintiff stockholder, and such purpose is one reasonable related to such person's interest as a stockholder.

2. Corporations ⟹ 181(1)

Once a proper primary purpose has been demonstrated, the existence of a secondary purpose of a questionable nature becomes irrelevant.

3. Corporations ⟹ 181(1)

Every case in which a shareholder requests an inspection of corporate books and records rests on its own facts.

4. Corporations ⟹ 181(1)

The standard established in determining what records are essential for the purpose of evaluating stock is that which is sufficient and essential to furnish the information needed in order to place a value on the stock.

5. Appeal and Error ⟹ 1198

In an action by a stockholder seeking access to corporate records in order to value his stock, it is the court, not the corporation or petitioner, that determines what is essential and sufficient to determine value.

6. Corporations ⟹ 181(1)

Establishing a proper purpose does not, ipso facto, entitle a plaintiff shareholder to examine every book, paper, and record which a corporation possesses in an effort to value his stock.

7. Corporations ⟹ 181(1)

A stockholder may not enforce his right to inspect corporate books where he already has the information to which he is reasonably entitled.

MARVEL, *Chancellor*

Plaintiff, a holder of approximately one-third of the issued and outstanding stock of the defendant CM&M Group, Inc., seeks the entry of an order granting inspection by him of designated books and records of the defendant corporation pursuant to the provisions of 8 Del. C. § 220 for the avowed purpose of determining the value of his stock in order to facilitate its sale. The defendant is a subsidiary of Carroll McEntee & McGinley, Inc., a privately held corporation, its 1,946,613 shares of issued and outstanding stock being held by some

eighty shareholders, most of whom are employees of the defendant. Plaintiff has made three demands for defendant's books and records, the latest being a continuing request for information up to the time of its production and thereafter until the sale of plaintiff's stock.

CM&M Group, Inc., in defending this action, contends that plaintiff has had access to a large number of the requested documents by reason of the fact that he was one of the original founders and former president of Carroll McEntee & McGinley, Inc., now a subsidiary of defendant, and served as a director of such corporation until 1976. Defendant also contends that the pending demands exceed the scope of plaintiff's stated purpose of seeking to have a value placed on his stock as a prerequisite to selling it and is actually an attempt by plaintiff to force defendant to purchase its own stock at twice its book value. According to defendant, plaintiff has allegedly placed such a value on his shares and has no intention of accepting less than such price and thus has no genuine need for the requested data. Defendant also argues that even if plaintiff had a proper purpose for being granted the data which he seeks, his demand far exceeds what is required to establish the value of his shares, the defendant being a privately held corporation, the activities of which are not governed by the federal securities laws, Neely v. Oklahoma Publishing Company, Del. Ch., (C.A. 5293) August 15, 1977. Defendant also contends that the data to which plaintiff is actually entitled are to be found in the independently audited, consolidated statements which were furnished to plaintiff before trial and contain all the information to which he is now entitled.

The history of the defendant corporation has been marked by persistent disputes between the plaintiff and the present managers of the defendant corporation, which disputes date back to December 31, 1969 when Carroll McEntee & Co., later to become Carroll McEntee & McGinley, Incorporated, a broker in the purchase and sale of United States government securities, was formed, such corporation eventually being later merged into CM&M Group, Inc., which thus became a financial holding company. At the outset of the enterprise plaintiff became a 51% majority shareholder in the enterprise, but in 1972, when threatened by a resignation of 45% of the corporate employees because of dissatisfaction with plaintiff's actions, he was persuaded to sell one-third of his shares back to the corporation for the sum of $900,000 as well as the grant to him of a consulting contract in the gross amount of $750,000, Mr. Carroll's original investment in the enterprise having been only $10,000. However, he remained on the

board of directors, despite continuing dissension, until his resignation in 1976. Since then he has had little contact with defendant's business. Thus, Mr. Carroll, at the present time, while the largest single shareholder of the defendant is nonetheless a minority shareholder with no representation on the board of directors of what is a closely-held corporation, the operation of which is subject to a voting trust agreement made up of 49.7% of the outstanding stock of the corporation, which agreement will remain in effect until 1990. The bylaws of the defendant also grant the corporation a right of first refusal in the event of a bona fide offer of a shareholder to sell his stock.

As noted above, defendant contends that inasmuch as plaintiff has already placed a value on his shares of twice their book value, he has no genuine need for the information which he seeks. Furthermore, defendant charges that plaintiff's avowed purpose in seeking to sell his stock to a third party is actually a sham to mask his actual intention of forcing the company to purchase his shares at an inflated price. However, plaintiff denies that he has placed a precise value of twice book value on his shares and points to the inequality of the bargaining positions held by the litigants in which defendant as a potential buyer of plaintiff's shares has access to financial information withheld from him. He also argues that inasmuch as defendant has the right of first refusal to buy his shares, that it has a strong interest in making sure that a third party not offer a generous price for the shares in question.

Plaintiff further contends that the information sought by him is necessary in order for him to make anything more than a tentative offer to any outside potential buyer, and claims that his hiring of Robert P. O'Brien, a Cyrus J. Lawrence employee, who is in charge of the merger and acquisition department of such business, supports the bona fides of his intentions, Mr. O'Brien having been employed by plaintiff on a contingency basis.

[1,2] The burden of proving a proper purpose in a case which seeks books and records other than a stock list, as is the case here, rests on a plaintiff stockholder, and a proper purpose is a purpose reasonably related to such person's interest as a stockholder. Furthermore, once a proper primary purpose has been demonstrated, the existence of a secondary purpose of a questionable nature becomes irrelevant. As stated in Skouras v. Admiralty Enterprises, Inc., Del. Ch. 386 A.2d 674 (1978).

> "In addition, although the Court cannot, of course, read the thoughts of a stockholder, it must be satisfied that a plaintiff

has successfully carried the burden of proving that the purpose behind his demand is proper. Once a proper purpose is established, it becomes irrelevant that the stockholder may have a secondary and perhaps questionable ulterior purpose behind his primary purpose. Western Air Lines, Inc. v. Kerkorian, Del. Supr., 254 A.2d 240 (1969), General Time Corporation v. Talley Industries, Inc., Del. Supr. 240 A.2d 755 (1968), and Skoglund v. Ormand Industries, Inc., Del. Ch., 372 A.2d 204 (1976)."

[3] As has been often stated, every case in which a shareholder requests an inspection of corporate books and records rests on its own facts, State ex rel. Cochran v. Penn Beaver Oil Co., (Del. Super.) 143 A. 257 (1926), State v. Gulf Sulphur Corporation, Del. Super. 233 A.2d 457 (1967), and Skoglund v. Ormand Industries, Inc., Del. Ch., 372 A.2d 204 (1976).

Having considered the evidence adduced at trial, I am satisfied that Mr. Carroll has a proper purpose in asking for information concerning the value of his shares, being persuaded that he genuinely wishes to sell his stock, having hired the services of Mr. O'Brien to assist him in doing so within the available admittedly limited market existing for it (the corporation itself being the most likely purchaser) only a very special type of buyer being interested in acquiring such stock. Thus, the interest is a minority one, a voting trust will exist until 1990, no dividends have been declared since 1976, and the company has the right of first refusal of the purchase of shares of the defendant. Nonetheless, there being no doubt in my mind but that plaintiff genuinely desires to sell his stock, I find that he has met the requirements of the statute.

[4,5] Next for decision is a determination of what records are essential for the purpose of making an evaluation of stock in a closely-held corporation. The decision in the Neely case, supra, offers guidelines for such a situation, stating that the depth of inspection depends upon whether or not the plaintiff has relied on a specific circumstance or whether there is merely a desire to sell at some future time. It would seem to me that Mr. Carroll's case is much stronger here than was the case of the plaintiff in Neely, supra. Affirmative action in the hiring of Mr. O'Brien has been undertaken, and the defendant corporation is an interested and potential buyer. The standard established in prior books and record cases, where a privately-held corporation has been involved, is that which is sufficient and essential in order to place a value on its stock, State ex rel Rogers v. Sherman

Oil Co., Del. Super. 117 A. 122 (1922). This same standard was also utilized in Neely, supra. Furthermore, the Court, not the corporation or petitioner, determines what is essential and sufficient, State ex rel Brumley v. Jessup & Moore Paper Co., Del. Super., 83 A.2d 30 (1912).

I agree with defendant that plaintiff is not the ordinary run-of-the-mill minority shareholder. By virtue of having been a founder of the corporation and a former director he is obviously better able than the average shareholder to evaluate the worth of the stock. Keeping in mind the fact that this is a privately-held corporation with less duty to disclose than one which is public, and acknowledging the fact that preparations for extensive discovery can interfere with the daily business of a private corporation, it is my opinion that plaintiff deserves less than requested, yet more than received.

[6,7] Establishing a proper purpose does not, ipso facto, entitle a plaintiff to examine every book, paper and record which a corporation possesses.

> "While it is the duty of the court to protect the rights of stockholders, it is equally their duty to safeguard the rights of the corporation as such. Necessarily, every case involving the right to examine corporation books must be determined on its own facts. The extent and scope of the privilege granted must depend in a large degree upon the company's treatment of the relator's legitimate request, and the extent to which the company has furnished to its stockholders by financial statements and otherwise, information relative to the conduct and condition of its business." State v. Penn-Beaver Oil Co., supra.

Another consideration is whether or not the one seeking the discovery already has access to such material. As noted in State v. Gulf Sulphur Corporation, supra:

> "A stockholder may not enforce his right to inspect corporate books where he already has the information to which he is reasonably entitled." 233 A.2d 210

Further guidance toward the permitted degree of discovery is found in State ex rel. Brumley v. Jessup & Moore Paper Co., Del. Super., 83 A. 30 (1912):

> "What books and papers, and what books and papers only, are required to furnish the information whereby the relator may determine the value of the deceased's stock in said com-

> pany, cannot perhaps be ascertained with perfect exactness, but it is our opinion, based upon the most reliable information we have been able to obtain, that the minutes of the directors are not so required. There may be very much in the minutes that would not be pertinent to the inquiry, and which need not be disclosed."

And finally, even though Mr. Carroll's case is stronger than that of the plaintiff in Neely, the facts of the two cases are similar, each being a shareholder in a privately-held corporation, seeking to place a value on such shares for future sale. One point which the Court made in Neely, and which has been stressed in the present action, is that the selling price for the private sale of an untraded stock is normally one negotiated by the parties. Thus, it will partly depend on the current purposes and needs of the buyer.

> "If the standard is limited to that which is sufficient and essential, then obviously it stops short of including all books and records of a corporation and its subsidiaries, or, stated another way, it stops short of all books and records which the petitioning stockholder, in his or her personal opinion, deems to be essential. The one thing that the opposing experts (both ably qualified in their field) agree upon is that there is no such thing as a precise market value of stock in a company whose stock is not publicly traded. Even so, to attempt to reach the ultimate of near-precision, it can be assumed that one can never get enough information unless he is given access to everything. When this is measured against plaintiff's position that she would like to sell if the right deal comes along even though she has nothing definite in mind now, her demand becomes one to be advised of all internal affairs of the corporation and to be kept current on a monthly basis hereafter just in case. To honor the extent of her demand under these circumstances would virtually transform her into an ex officio member of the board of directors simply because she has decided to rid herself of her stock." Neely v. Oklahoma Publishing Company, supra.

Plaintiff appears to be in possession of the following data:

1) Complete annual financial statements audited by Price, Waterhouse for the defendant corporation and its predecessor on a consolidated basis for the years 1970-80, which audited financial statements consist of balance sheets, statements of income and re-

tained earnings, statements of changes in financial position, and notes of the accountant preparing such statements.

2) All quarterly, unaudited statements for the defendant prepared from 1970 through the first two quarters of 1980 and before that all unaudited financial statements of the defendant on a monthly basis since the defendant's organization.

3) Texts of the certificates of incorporation for both the defendant corporation and its principal subsidiary, Carroll McEntee & McGinley;

4) The complete bylaws of the defendant corporation and those of its subsidiary, Carroll McEntee & McGinley, including the full text of the defendant's right of first refusal in the event of the sale of any of its shares by any of its shareholders;

5) A full disclosure of the plan referred to in the defendant's 1980 audited financial statement to the effect that the defendant has reserved 500,000 shares of its common stock for the development of a long-term incentive compensation program for its employees;

6) Defendant's 1980 audited financial statement disclosing that the defendant had 1,946,613 shares of common stock issued and outstanding as of December 31, 1980 and that none of its authorized preferred shares is issued;

7) Information as to the existence of a voting trust containing 49.7% of the outstanding common stock of the defendant, the term of the agreement being for ten years beginning March 19, 1980;

8) A letter from the defendant dated June 12, 1980, describing a recent sale of approximately 145,000 shares of the defendant's common stock to the defendant by a group, including a corporate director, and the price of that sale;

9) Records disclosing that the defendant has paid no cash dividends since 1976; and

10) Information that plaintiff's shares are restricted under the provisions of the Securities Act of 1933.

The parties appear to be in agreement on the fact that in order for plaintiff to negotiate a fair sale of his stock, he and through him any potential buyer must have adequate data. However, to furnish plaintiff with all of the documents which he has requested would, in effect, place him in a position tantamount to being a corporate director without having been so elected, and I believe that in seeking docu-

ments which have little or nothing to do with the value of his stock, plaintiff is attempting to force the defendant into purchasing his stock.

Additional books and records, as follows, will be ordered opened to plaintiff's inspection.

1) The complete audited and financial statements of CM&M for the years 1977-81, which are not already in plaintiff's possession.
2) A disclosure of the current total remuneration of all officers and directors of CM&M and the percentage thereof of the gross income of CM&M.
3) A description of outstanding current stock options of CM&M.
4) A description of any transactions with CM&M involving any of its current officers and directors.
5) Current agreements relating to any material acquisition or disposition of corporate assets and letters of intent relating to any such transaction.
6) Current major investment advisory agreements of CM&M.
7) Current major software and hardward contracts of CM&M.
8) Any other current major contracts, including employment contracts between CM&M and its directors or officers.
9) Current stock option or other plans designed to benefit management.
10) Current shareholders' agreements and any other voting agreements other than the voting trust agreement which plaintiff already has.
11) Current instruments creating any long or short term indebtedness, including extension agreements.
12) An account of any increases or decreases in the amount of outstanding common stock of CM&M.
13) A description of any current legal proceedings other than ordinary litigation incident to its business to which CM&M has become a party or in which any of its property has become involved.
14) A description of any indebtedness of each CM&M director or officer, or of any associate of any such officer or director, to CM&M.

15) A description of the current trading and investment inventory of CM&M.

Finally, I am not persuaded that Mr. Carroll is entitled to day-to-day information concerning defendant's business records for the purpose of placing a value on his shares, and the information which will be ordered to be produced need not be updated from time to time pending the conclusion of this case, Neely v. Oklahoma Publishing Company, supra.

The above information, which must be current as of the date of its production, in addition to that which Mr. Carroll has already in his possession will, in my opinion, permit him to place a value on his shares and thus facilitate their sale.

On notice, an order in conformity with the above directing the production of the above designated documents within thirty days from the date hereof is to be submitted.

FLORIDA GLASS INDUSTRIES, INC. v. KENTON

No. 649

Court of Chancery of the State of Delaware, Kent

September 22, 1981

Petitioner, Florida Glass, in a review *de novo* from a determination of the Secretary of State, sought a reduction in the computation of its corporate franchise taxes for the years 1971 and 1972 pursuant to DEL. CODE ANN. tit. 8, section 505(d) (1974). The Secretary asserted that subsection (b), a 1976 amendment to section 505, was intended to control, rather than subsection (a), in circumstances such as those present, when Florida Glass petitioned for a reduction. Florida Glass had its corporate charter voided in 1973 and had applied for a renewal prior to instituting these proceedings. As subsection (b) authorized filing for a reduction before filing for a charter renewal, the Secretary argued that it was the legislative intent that subsection (b) control here. The Secretary noted that under subsection (b) the petitioner's application for a reduction was untimely as it occurred subsequent to its filing for a renewal.

The court of chancery, per Vice-Chancellor Brown, held that subsection (b) was permissive in nature and did not mandate that its procedure be followed by all voided corporations. Subsection (a) was deemed to still be available to voided corporations as subsection (b) was neither repugnant to nor inconsistent with the preexisting right available under subsection (a). The court thus granted petitioner's motion for summary judgment.

1. Statutes ⟹ 184

In the absence of a clearly expressed intention to do so, it is not appropriate to construe a statute in such a manner as to alter previously existing statutory policy.

2. Statutes ⟹ 223.1

Where two statutes speak to the same subject matter, they must be construed, if possible, so as to reconcile them and remove any inconsistency or repugnancy.

3. Statutes ⟹ 158, 159

Repeal by implication is not favored and only occurs when two statutes are so inconsistent that reconciliation is impossible.

4. Statutes ⟹ 219(1)

While the position taken by an administrative agency is normally entitled to some weight, it is not necessarily controlling on the question of legislative intent.

BROWN, *Vice-Chancellor*

This matter involves an interpretation of 8 *Del.C.* § 505, as amended in 1976 by the addition of a new Subsection (b). Pursuant to § 505 (d) the case is before this Court on a review *de novo* from a determination by the Secretary of State concerning the application of the petitioner, Florida Glass Industries, Inc. ("Florida Glass") for a reduction in the computation of its corporate franchise taxes for the years 1971 and 1972. The Secretary of State has moved to dismiss pursuant to Rule 12(b)(6) for failure to state a claim. Florida Glass, in return, has moved for summary judgment, there being no dispute as to any material fact.

Florida Glass was incorporated in Delaware in 1971. Through an alleged failure of communication with its registered agent, it filed

no annual reports with the Secretary of State for the years 1971 and 1972. As a result, the Secretary assessed the corporation's franchise tax pursuant to 8 *Del. C.* § 502(c) based on the number of shares of stock authorized by the certificate of incorporation. In 1973, the charter of Florida Glass was proclaimed void under 8 *Del. C.* § 510 due to its failure to file annual reports and to pay its franchise tax.

On March 7, 1979 Florida Glass filed a certificate of renewal so as to reinstate its corporate charter. In so doing, it paid its delinquent franchise taxes and penalties as previously computed by the Secretary. On July 10, 1979, claiming the right to do so under § 505(a), Florida Glass petitioned the Secretary for a reduction and refund of the franchise taxes and penalties paid for the years 1971 and 1972, seeking thereby to have its franchise taxes for those years assessed on the basis of its gross assets rather than on its number of shares of stock. The difference between the two methods of assessment is said to represent an amount in excess of $7,000.

On July 11, 1979, the Secretary, through Marie C. Shultie, Corporation Administrative Officer, rejected the petition as being untimely. The basis for this decision was that under § 505(b) such an application was required to be made *prior* to the filing of the certificate of renewal of the corporate charter which, in this case, had not been done. From this decision, Florida Glass brought the present petition for a review *de novo*.

At 8 *Del. C.* § 505(a), the provision on which Florida Glass relies, it is stated as follows:

> "Any corporation may, within the period of 60 days after the Secretary of State has notified the taxpayer of the fixing or determination of the tax, pursuant to §§ 502(c) and 504(a) of this chapter, or after the payment of taxes imposed by this chapter, petition the Secretary of State for a reduction or refund of taxes, penalties or interest claimed to have been erroneously or illegally fixed or paid. The petition shall set forth the facts upon which the petitioner relies."

In 1976, an amendment was made to § 505 which realigned other portions of the statute and which inserted a new Subsection (b) to read as follows:

> "Prior to the filing of a certificate required by subsection (c) of § 312 of this title [the statute dealing with renewals], a corporation may petition the Secretary of State for a reduction of taxes, penalties or interest which the State claims are due it pursuant to subsection (g) of § 312 of this title and

which the corporation claims have been erroneously or illegally fixed."

On behalf of the Secretary of State it is argued that the addition of Subsection (b) must have had some purpose. It is conceded that prior to the addition of Subsection (b) the provisions of Subsection (a) provided the only path for relief for any corporation seeking such a reassessment. Thus, it is necessarily conceded by the Secretary of State that prior to the amendment a corporation in the situation of Florida Glass would have been compelled to pay the delinquent taxes in order to have its charter renewed, and to thereafter have petitioned under § 505(a) for a reduction and refund. But, the argument continues, since § 505(b) must have been added for some purpose, and since it deals specifically with a situation wherein a voided corporation is seeking reinstatement, it must have been the intent of the General Assembly to make Subsection (b) the exclusive means for a voided corporation to obtain a redetermination of its franchise tax obligation, and to thereby require it to do so *prior* to filing an application for renewal pursuant to 8 *Del. C.* § 312.

In short, it is argued on behalf of the Secretary that § 505(b) created a new right and established a new procedure, and that where a new law directs a thing to be done in a certain manner, it may not be done in any other manner and have legal effect. *State ex rel. Green v. Foote*, Del.Supr., 168 A.245 (1933); 2A *Sutherland, Statutory Construction* § 57.10.

However, since the argument of the Secretary concedes that prior to the addition of Subsection (b) a corporation in the position of Florida Glass would have been entitled to proceed under Subsection (a), the argument reduces itself to the proposition that the addition of Subsection (b) wiped out the preexisting right of a voided corporation to pay the delinquency, renew its charter and then seek a redetermination of its franchise tax liability and a refund. I do not find that this result is mandated by the language of Subsection (b).

It must be noted that the amendatory provision is permissive in nature. It provides that one in the position of Florida Glass "may," prior to filing a certificate of renewal, petition the Secretary for a reduction in taxes, penalties and interest which the State claims to be due. Thus, the statute does not mandate that this procedure be followed by all corporations suffering from a voided charter. Rather, it can be said to clearly provide an alternative which did not exist previously, namely, the option to seek a redetermination of the amount in advance of filing for renewal as opposed to first paying the delinquent amount and then attempting to recover a portion of it by means of a

refund. Thus, the alternative right given by Subsection (b) does not conflict with the preexisting right made available under Subsection (a).

[1,2,3] In this regard it is a general rule of statutory interpretation that in the absence of a clearly expressed intention to do so, it is not appropriate to construe a statute in such a manner as to alter previously existing statutory policy. *Nationwide Mutual Insurance Co. v. Krongold*, Del.Supr., 318 A.2d 606 (1974). Where two statutes speak to the same subject matter, they must be construed, if possible, so as to reconcile them and remove any inconsistency or repugnancy. *In re Diane*, Del.Ch., 318 A.2d 629 (1974); *Wright v. Husbands*, Del.Supr., 131 A.2d 322 (1957). Repeal by implication is not favored and only occurs when two statutes are so inconsistent that reconciliation is impossible. *In re Diane, supra*; *Hodson v. Hodson Corp.*, Del.Ch., 80 A.2d 180 (1951).

Here there is nothing in the language of Subsection (b) that makes it repugnant or inconsistent with anything contained in Subsection (a). The two can stand independently of each other. The 1976 amendment can be read to merely provide a corporation with a voided charter an alternative way in which to proceed in seeking a reassessment of its franchise tax, the nonpayment of which brought about the loss of its corporate standing.

[4] It may be that the purpose of the amendment was to bring about the result argued for on behalf of the Secretary of State. But there is nothing in the amendatory language itself to warrant such a construction. It may also be true that this is the construction which has been given to Subsection (b) by the Secretary of State since its enactment. But while the position taken by an administrative agency is normally entitled to some weight, it is not necessarily controlling on the question of legislative intent. *Nationwide Mutual Insurance Co. v. Krongold, supra.*

Accordingly, I conclude that the petition of Florida Glass was not untimely for the reason given by the Secretary's Administrative Officer. The motion of the Secretary of State to dismiss is denied, and the motion of Florida Glass for summary judgment is granted. The matter is hereby remanded to the Secretary of State for such further consideration on the merits as may be deemed necessary. IT IS SO ORDERED.

LUSTGARTEN v. PHILIPS, INC.

No. 4055

Court of Chancery of the State of Delaware, New Castle

October 21, 1981

Plaintiff makes a motion to amend his complaint which was originally filed in 1972. The proposed amendment would result in a change in the original cause of action from an action for an accounting in equity, to a tort claim in conversion in law. The defendant, the only remaining party from the original six defendants opposes this motion contending that an amendment should not be permitted to alter a legal theory used as a basis for recovery. Additionally, he asserts that to allow that would cause him serious prejudice. Finally, the defendant claims that if plaintiff's cause of action could be shifted from equity to law, the court would be stripped of subject matter jurisdiction in accordance with DEL. CODE ANN. tit. 10, section 342.

The court of chancery, per Vice-Chancellor Hartnett, held that the record clearly indicates that to allow the plaintiff to amend his complaint would be prejudicial to the defendant in that it would require him to prepare a new defense. The facts indicate that plaintiff would have great difficulty in doing that due to the nine year time lapse from the date of original filing, as well as the missing defendants and missing relevant records. Accordingly, plaintiff's motion to amend was dismissed.

1. Pleading ⟹ 229

Amendments to pleadings are favored and should be liberally allowed in furtherance of justice in order that every case may so far as possible be determined on its real facts.

2. Pleading ⟹ 236(2)

While laches and unexcused delay may bar a proposed amendment, the mere fact that an amendment is offered late in the case is not enough to bar it if the other party is not prejudiced.

3. Pleading ⟹ 233

A proposed amendment should be allowed unless prejudice to other party would result.

4. Pleading ⟹ 236(7)

Lack of notice can be the cause of prejudice to an opposing party.

5. Pleading ⟹ 248(9)

Where relevant records and parties are unavailable, due in part to a nine (9) year lapse from the date of the original filing of a complaint, an amendment to such a complaint by the original plaintiff will not be permitted due to the fact that it is prejudicial to the original defendant.

HARTNETT, *Vice Chancellor*

Plaintiff seeks to amend the complaint as filed nine years ago on November 15, 1972, by his former attorney. The original complaint was styled: "Complaint For an Accounting and For Other Equitable Relief". The proposed amendment would alter § 11 of the complaint and § 3 of the prayer for relief. They presently read:

> "11. Further, respondent Philips, Inc., and/or Leonard Bronstein, on information and belief has without right or authority taken possession of and sold drugs and related merchandise from the stock of supplies owned by petitioner.
>
> WHEREFORE Petitioner prays: . . .
>
> 3. That respondent Philips, Inc. and Leonard Bronstein be ordered to pay to petitioner such sums as shall be found due upon the accounting."

The proposed amendments state:

> "11. Further, Philips, Inc., and Leonard Bronstein, without right or authority, took possession of and sold pharmaceutical supplies and merchandise owned by Petitioner at his pharmacy. Specifically, Philips, Inc., and Leonard Bronstein willfully and intentionally interfered with an inventory of pharmaceutical supplies sold by The Drug House to Petitioner, valued at between $7,000 and $8,000 as of June, 1971, without justification, and deprived Petitioner of the possession of this inventory. As a result, Philips, Inc., and Leonard Bronstein converted this pharmaceutical inventory in June, 1971, to their own uses.
>
> WHEREFORE PETITIONER PRAYS: . . .

3. That respondent Philips, Inc., and Leonard Bronstein be ordered to pay to Petitioner such sums as shall be found due upon the accounting and that the Court enter a money judgment for damages for conversion of Petitioner's pharmaceutical supplies."

Defendant-Bronstein opposes the Motion to Amend on grounds that the amendment changes the cause of action from an action seeking an accounting to an action for the tort of conversion and an amendment should not substantially change a cause of action or defense or introduce a different claim or defense; that serious prejudice would result to him because more than eight years have lapsed since the complaint was filed and because all the business records of the defendant corporation (now bankrupt) have disappeared; and finally, that a claim of conversion is an action at law—not equity—and therefore, if the complaint is permitted to be amended, the case should be dismissed for lack of subject matter jurisdiction in accordance with 10 *Del. C.* § 342. Plaintiff's motion must be granted.

I

The underlying facts are: between February 1, 1971, and June 26, 1971, Philip Goldstein, as manager of Philip's Discount Drug Store and an officer of Philip's, Inc., leased the pharmacy section of the store to plaintiff under the terms of a written contract. Plaintiff became ill and was unable to man the pharmacy fulltime, but apparently did arrange for substitute pharmacists to replace him, at least for parttime [sic]. His contract had specified the exact number of hours the pharmacy was to be kept open. During the course of his illness, hard feelings developed between plaintiff and Goldstein, resulting in many accusations and counter-accusations and culminating on June 22, 1971, when plaintiff was prevented from entering the store by Mr. Goldstein. Subsequently, this suit was commenced by plaintiff against Philips, Inc., Philip Goldstein, Arlene Goldstein, Henry Goldstein, Marsha Goldstein and Leonard Bronstein.

Leonard Bronstein is the only defendant remaining active in the case. Depositions were taken in 1974 of three of the Goldstein defendants, as well as of Bronstein, during the course of which both parties, the Goldsteins and plaintiff, charged each other with possession of the essential records and documents, but, as defendant concedes, "no one has ever contended that Len Bronstein possessed any of the records of the plaintiff."

The case has been delayed for various reasons, but suffice it to say the fault cannot all be laid at any one person's doorstep. Finally, on

July 18, 1980, all the defendants but Bronstein were held in default for failure to appear, and any documents within their possession are apparently unreachable. Thus, the Court is faced with a situation where that which once was or could have been is no more. Philip's, Inc., has gone bankrupt; and the Goldstein defendants are among the missing, with or without the records and business documents. All that remains is the original plaintiff and one of the six original defendants—both of whom are now represented by new attorneys.

It may be helpful to relate why Bronstein is a defendant in this action. After plaintiff and Philip's, Inc., terminated their relationship in June of 1971 and for whatever reason, defendant-Bronstein replaced plaintiff as the registered pharmacist lessee at Philip's Discount Store. There was apparently an agreement between Philip's and Bronstein whereby Bronstein paid as rental 5% of the weekly gross sales in the prescription department. Bronstein was not required to make any outlay of cash prior to, or at the time of, commencing his business on June 26, 1971; but he admits that there did exist an inventory on hand in the store of pharmaceutical supplies valued at approximately $7,000 to $8,000. He also admits that he notified the State Board of Pharmacy "that he was the pharmacist responsible for the aforesaid inventory, which included narcotic drugs," but states that he believes that Philip's, Inc., was responsible for payment of the note given to secure payment for the supplies. Bronstein agrees that he "assumed responsibility for the inventory and exercised sole dominion and control over it as owner thereof," but says that he does not possess sufficient knowledge to determine whether or not plaintiff or Philip's, Inc., was indebted to the supplier for these supplies. Bronstein does agree that as of June 26, 1971, the supplier had not been paid by plaintiff for the inventory and that he agreed to pay them, although he signed no promissory note. Bronstein also admits that he was warned by plaintiff that there would be problems if he commenced his business by exercising control over the inventory, but believes such conversation took place shortly after June 26, 1971.

At the time of the filing of the complaint, plaintiff requested an accounting. Now he seeks to charge defendant-Bronstein with *willful* and *intentional* interference with the pharmaceutical inventory resulting in a conversion, an intentional tort.

II

[1, 2] "Amendments to pleadings are favored and should be liberally allowed in furtherance of justice in order that every case may so

far as possible be determined on its real facts . . . " 61A AM. JUR.2d, *Pleading, Liberal Policy As to 'Allowance'*, § 311, p. 298.

> "[U]nder the Federal Rules of Civil Procedure it has been held that the merits of the claim are irrelevant in determining whether a motion to amend should be granted. As long as the amendment is not a frivolous or dilatory measure, and is made in good faith, it should be granted. The critical element in determining whether to grant leave to file an amended complaint is prejudice to the opposing party."

3 MOORE'S *Federal Practice* 2d, § 15.09 [2], pp. 15-61 to 62 states that:

> "[R]ecognizing that the entire spirit of the rules is to the effect that controversies shall be decided on the merits, the courts have not been hesitant to allow amendments for the purpose of presenting the real issues of the case, where the moving party has not been guilty of bad faith and is not acting for the purpose of delay, the opposing party will not be unduly prejudiced, and the trial of the issues will not be unduly delayed."

Furthermore, "[I]t should be particularly noted, however, that while laches and unexcused delay may bar a proposed amendment, the mere fact that an amendment is offered late in the case is not enough to bar it if the other party is not prejudiced." *Id.* at § 15.08 [4], p. 15-102. 6 WRIGHT & MILLER, *Federal Practice & Procedure*, § 1497, pp. 500-01 states:

> "[T]he fact that an amendment changes the legal theory which the action initially was brought is of no consequence if the factual situation upon which the action depends remains the same and has been brought to defendant's attention by the original pleading. Thus, an amendment may set forth a different statute as the basis of the claim, or change a common law claim to a statutory claim or vice-versa, or shift from a contract theory to a tort theory, or delete a negligence count and add or substitute a claim based on warranty, or change an allegation of negligence in manufacture to continuing negligence in advertising."

III

[3, 4] Applying the above guidelines, it is clear that the proposed amendment should be allowed unless prejudice to Bronstein would result. Lack of notice, however, can be the cause of prejudice and

Bronstein opposes the amendment on grounds of undue delay and prejudice, relying on *Brunswick Corporation v. Bowl-Mor Company, Inc.*, Del. Ch., 297 A.2d 61 (1972). In that case the motion to amend was denied because it would have permitted new factual allegations and substantial legal questions involving interstate commerce to the prejudice of the defendant.

[5] In the present case, although defendant Bronstein has not attempted to show what specific prejudice he will suffer if the amendment is allowed, the record itself makes it clear that he will suffer some prejudice if the amendment to the Complaint is now allowed—almost nine years after the suit was filed. The records of defendant Philip's, Inc., are now no longer available and defendant Philip Goldstein, who was the principal officer and stockholder of Philip's, Inc., and is the one witness who knows where the inventory came from and whether it was paid for, is no longer available for questioning.

It would therefore be prejudicial to defendant Bronstein to require him to now prepare a defense to plaintiff's new theory of claim which has now been asserted over eight years after suit was filed and long after the records and testimony which might preclude recovery were available.

Plaintiff's motion to amend his complaint is therefore denied. IT IS SO ORDERED.

MENDICH v. HUNT INTERNATIONAL RESOURCES, INC.

No. 5912

Court of Chancery of the State of Delaware, New Castle

October 21, 1981

Several proof of claims for payment pursuant to a court approved stipulation of settlement stemming from a contested merger between Hunt International Investment Corporation ("HIRCO") and New Subsidiary, Inc. ("NewCo") were rejected by HIRCO for failing to meet the filing deadline and/or not conforming with the proper proof of claim format. This class action was subsequently instituted

against HIRCO by claimants, all former stockholders of HIRCO. Plaintiffs claimed that proof of claims procedure should be liberally construed, and noted that a strict construction benefitted the defendants (HIRCO) who had a reversionary interest in the settlement fund.

The court of chancery, per Vice-Chancellor Hartnett, held that the defendants were to re-evaluate the contested claims utilizing this opinion as their guidance. The defendants were given ten (10) days to submit a revised list of any claims still contested. Additionally, defendants were ordered to notify, within thirty (30) days, all claimants that this opinion had granted an opportunity to correct their claims. Finally, the defendants were ordered to pay, within ten (10) days, all claims which they had previously conceded to be uncontested or which are now rendered uncontested by this opinion.

1. Federal Civil Procedure ⟹ 1699

A claims procedure approved by a court should be followed.

2. Federal Civil Procedure ⟹ 1699

A settlement agreement is an equitable action, and where the equities lie with the stockholders, substantial compliance with the claims procedure is adequate to protect shareholders and their claims.

3. Federal Civil Procedure ⟹ 1699

Claimants to a settlement fund should be given reasonable opportunity to file and receive what is due to them.

4. Federal Civil Procedure ⟹ 1699

A filing deadline in a claims procedure is not inflexible, and must yield, if necessary, to the demands of equity.

5. Federal Civil Procedure ⟹ 1699

The missing of the postmark deadline, even without excuse, is substantial compliance with the procedures for the filing of claims, when all the equities are considered, if the postmark shows mailing within a few days of the deadline.

6. Federal Civil Procedure ⟹ 1699

Fairness requires that where stockholders receive correction forms to modify their initial proof of claim application, they should receive an extra time extension in which to supplement their original claims.

7. Federal Civil Procedure ⟹ 1699

Thirty (30) days from the date of receiving notice is considered a reasonable extension of time for claimants to refile their claims.

8. Federal Civil Procedure ⟹ 1699

Stockholders whose claims were rejected for failing to provide adequate substantiation of their stock ownership must be given reasonable time to substantiate their claim. Thirty (30) days from the date of receiving notice is deemed to be reasonable.

9. Federal Civil Procedure ⟹ 1699

The rejection of claims for failing to be notarized is a "hypertechnicality" and such rejection on that ground will not be permitted.

10. Federal Civil Procedure ⟹ 1699

Equity permits claims rejected for failure to submit proof of ownership under another name to be reinstated, if those stockholders can furnish proper proof of ownership within thirty (30) days of being advised to do so by defendant.

11. Federal Civil Procedure ⟹ 1699

Claims mistakenly asserted by debenture owners who were not part of the settlement class were properly rejected by defendant corporation.

HARTNETT, *Vice-Chancellor*

This class action was initially commenced on behalf of certain former stockholders of Hunt International Investment Corporation

("HIRCO"), a Delaware corporation, who attacked a merger between HIRCO and New Subsidiary, Inc. ("NewCo"), also a Delaware corporation.

After prolonged negotiations a settlement was reached and a Stipulation of Settlement executed which was approved by the Court on January 30, 1981, as being fair, reasonable and adequate. By that Order a settlement class was certified, consisting of all persons other than the individual defendants in this action who owned HIRCO common stock as of October 2, 1979—the date of the merger. The Court also reserved jurisdiction to effectuate the judgment and to resolve disputes as to the validity of claims to the settlement fund.

A dispute has now arisen as to the payment of some claims. The grounds for the refusal to pay are considered seriatim.

I

According to the terms of the agreement the Hunt defendants agreed to pay, in full settlement of all claims in this action, up to approximately $1,228,000. as follows:

"A. To each member of the Settlement Class as defined in paragraph 4(a) of this Stipulation of Settlement who, either by proxy or in person, voted against the merger of New Subsidiary, Inc. ("NEWCO") and HIRCO at the Special Meeting of HIRCO shareholders held on October 2, 1979 (approximately 651,000 shares were voted against the merger) *and* who files a valid Proof of Claim, $1.00 per share of common stock so owned and voted.

B. To each member of the Settlement Class as defined in paragraph 4(a) of this Stipulation of Settlement who, either by proxy or in person, voted in favor of the merger of NEWCO and HIRCO at the Special Meeting of HIRCO shareholders held on October 2, 1979 (approximately 711,000 shares were voted in favor of the merger) *and* who files a valid Proof of Claim, $0.55 per share of common stock so owned and voted.

C. To each member of the Settlement Class as defined in paragraph 4(a) of this Stipulation of Settlement who did not vote on the merger of NEWCO and HIRCO at the Special Meeting of HIRCO shareholders held on October 2, 1979, (approximately 338,000 shares were not voted on the merger) *and* who files a valid Proof of Claim, $0.55 per share so owned and not voted."

On December 26, 1980, a Notice of Proposed Settlement was sent to each class member along with a Proof of Claim. A notice was also published on two separate occasions in the national edition of the *Wall Street Journal.* The notice briefly described the lawsuit and summarized the details of the settlement agreement. It instructed class members that if any wished to exclude themselves from the settlement, they could do so by mailing such request, postmarked on or before January 20, 1981. Similarly, the notice instructed class members to file objections to the settlement by January 23, 1981, and notified them of a January 30, 1981, hearing to approve the settlement. The notice further stated that any stockholder wishing to participate in the settlement fund was required to fill out an accompanying Proof of Claim and mail it to HIRCO postmarked on or before March 30, 1981.

The following instructions were set forth on the cover page of the Proof of Claim:

> "PURSUANT TO COURT ORDER, THIS PROOF OF CLAIM MUST BE PROPERLY FILLED OUT IN ORDER TO TAKE PART IN THE SETTLEMENT ON BEHALF OF ALL PERSONS OTHER THAN THOSE NAMED AS A DEFENDANT TO THIS ACTION WHO OWNED SHARES OF THE PUBLIC COMMON STOCK OF HUNT INTERNATIONAL RESOURCES CORPORATION ("HIRCO") ON OCTOBER 2, 1979.
>
> BOTH THIS PROOF OF CLAIM AND THE PROOF OF CLAIM VERIFICATION MUST BE COMPLETELY AND ACCURATELY FILLED OUT IN ORDER FOR YOU TO BE ENTITLED TO SHARE IN THE SETTLEMENT PROCEEDS.
>
> THIS PROOF OF CLAIM, TOGETHER WITH THE REQUESTED SUPPORTING DOCUMENTS, MUST BE MAILED ON OR BEFORE MARCH 30, 1981. IF YOU WISH TO FILE THIS PROOF OF CLAIM, YOU ARE URGED TO DO SO PROMPTLY. PLEASE MAIL TO:"

It concluded by providing the appropriate address to which the claims were to be mailed. No class member chose not to participate in the settlement.

After the March 30, 1981, deadline for the mailing of claims, HIRCO notified plaintiff's counsel that it had accepted the greater majority of the claims.

Prior to the March 30th deadline, however, several Proofs of Claim were deemed defective by HIRCO. HIRCO concedes that many of these claims could have been corrected against its own records, but claims it was not permitted to do so since counsel for plaintiff insisted that such corrections be made by the individual claimants. As a result, HIRCO sent a correction of Proof of Claim to those claimants indicating the supplementation required. This correction form specified that the revised Proof of Claim must be received prior to the original deadline of March 30, 1981. Many claimants who received the notification of the need for additional information had sufficient time in which to respond—others did not. Nevertheless, HIRCO strictly adhered to the deadline and rejected all late claims. Similarly, HIRCO rejected all claims which did not strictly comply with the Proof of Claim form. HIRCO's stance is obviously motivated by its reversionary interest in the settlement fund.

The plaintiff, on the other hand, maintains that the Proof of Claim procedure should be liberally construed in keeping with the tradition of equitable administration of settlements.

II

[1,2,3] It it clear that although a claims procedure approved by the Court should be followed, otherwise settlements would become an administrative nightmare, substantial compliance should be adequate. In approving the settlement, the Court was bound to exercise its own business judgment as to the fairness of the settlement to all concerned. *Neponsit Inv. Co. v. Abramson*, Del. Supr., 405 A.2d 97 (1979). A corollary to that duty must be the duty of this Court to insure that the stockholders who are entitled to participate in the settlement are given a reasonable opportunity to file for and receive what is due to them. This Court is a Court of Equity and as such it must always balance the equities between the parties. The ancient maxim that he who seeks equity must do equity is still valid. 2 *POMEROY*, Eq. Jur., 5th ed. § 363. Here defendants, who were alleged wrongdoers (although they deny any wrongdoing), agreed to a settlement whereby they agreed to pay all of the stockholders of HIRCO (except defendants) a sum of money greater than what was originally offered pursuant to the merger. Now defendants seek to avoid paying what they agreed to pay in the settlement because some of the stockholders failed to file their claims within the deadline or failed to fully com-

plete the claim forms. It is clear that the equities lie with the stockholders. The purpose of the settlement was to compensate the shareholders for relinguishing their claims against the defendants, and they should therefore be given a fair and reasonable opportunity to obtain what they are due. When the defendants agreed to settle with the plaintiff they must have assumed that the entire settlement fund would be paid out and their failure to pay all claimants would amount to a windfall to them. And because of the relatively few contested claims (less than 4%), the defendants will not be significantly burdened if all of the claims are allowed.

III

HIRCO has rejected six categories of claims:

(1) claims postmarked after March 31, 1981, even though most were postmarked within a few days of the deadline,

(2) claims which when filed were defective and in which supplements were not filed prior to March 31, 1981,

(3) claims which failed to provide adequate substantiation of stock ownership,

(4) claims which were otherwise correct but which were not notarized,

(5) claims where the claimants did not own shares of HIRCO common stock in their own name and who failed to submit proof of ownership under another name, and

(6) claims based on the ownership of debentures.

These objections will be discussed seriatim.

IV

[4,5] In Category One, HIRCO rejected all claims that were untimely filed. While it is true that "the function of the filing deadline is to put a time limit on the claims procedure", *Valente v. Pepsico, Inc.*, D. Del., 89 F.R.D. 352, 363 (1981), and it is clear that fair warning was given to the potential claimants concerning the deadline, nevertheless the filing deadline is not inflexible and must yield, if necessary, to the demands of equity. In *Zients v. LaMorte*, 2nd Cir., 459 F.2d 628 (1972), the Court stated:

> "Until the fund created by the settlement is actually distributed, the Court retains its traditional equity powers. It

> is not novel law to announce that a Court supervising the distribution of a trust fund has the inherent power and duty to protect unnamed, but interested persons. In the words of Professor Chafee, the dean of equity law, these individuals are akin to 'wards of the Court'. Z. CHAFEE, *Some Problems of Equity*, 292 (1950)." 459 F.2d at 630.

See also *Shanghai Power Company v. Delaware Trust Company*, Del. Ch., C.A. No. 3888, N.C. (May 28, 1981).

Many claimants here have legitimate excuses to which the filing deadline must yield. To illustrate, there are claimants who were away from home (Hopsicker, Schlager) or ill (Travis, Paulsen), thus preventing them from filing a timely claim. And there are claimants who did not receive the notice (Beckwith). As noted above, this Court is duty bound to protect these claimants and it must balance the equities between the claimants from whom the fund was created and the alleged wrongdoers who agreed to pay a settlement.

The missing of the postmark deadline, even without excuse, is substantial compliance with the procedures for the filing of claims, when all the equities are considered, if the postmark shows mailing within a few days of the deadline.

V

[6,7] In Category Two, HIRCO maintains that the claim should be rejected because the original filing was defective and the supplemental filings were not filed prior to the March 31, 1981, deadline. Many of these claims were originally timely filed, however, and after the claimants were informed of a deficiency they sought to correct it with proper proofs of ownership. Some of these claimants received notification of the rejection of their claims but were not given sufficient time in which to respond and their corrected claim arrived beyond the filing deadline.

HIRCO seeks to deny the Category Two claimants' participation in the settlement because they failed to supplement their claims within the original deadline. It contends that this is proper because HIRCO was not obligated to even send correction forms. HIRCO also represents that mistakes are inexcusable considering the clear and simple instructions on the Proof of Claim. HIRCO's contention that mistakes are inexcusable is unfounded because even HIRCO itself was guilty of several mistakes while processing the claims. The shareholders of HIRCO, many of whom are unsophisticated, cannot be held to a higher standard of conduct than HIRCO itself.

The fact that HIRCO voluntarily sent the correction forms does not preclude further supplementation because many claimants were given insufficient time in which to respond. Fairness requires that these claimants be allowed an extension of time in which to supplement their original claims. They shall now be given an additional 30 days to do so after being given notice by HIRCO.

VI

[8] In Category Three HIRCO claims that the stockholders failed to provide adequate substantiation of their stock ownership. Of course the stockholders must show that they were owners of HIRCO stock on October 2, 1979, and are entitled to participate in the settlement. They must be given a reasonable time, however, to substantiate their claim. They shall now be given an additional 30 days to submit other documentation to HIRCO after being given notice to do so by HIRCO.

VII

[9] In Category Four HIRCO rejected claims because the filings were not notarized as required by the instructions. These claims were submitted within the required time and HIRCO's records show that they were proper in all respects except for the failure to be notarized. To penalize these few shareholders for such an insignificant oversight would be unfair. This is particularly so in view of HIRCO's own admitted oversights while processing claims. The defendants' rejection on this ground is a "hypertechnicality" and must not be permitted.

VIII

[10] HIRCO's rejection of claims in Category Five is proper since these stockholders did not own shares of HIRCO in their own name on October 2, 1979, and they have failed to submit proof of ownership under another name. However, if they now can submit proper proof of ownership within 30 days of being advised to do so by HIRCO their claims should, in equity, be allowed.

IX

[11] The claims in Category Six were properly rejected because these claims were mistakenly asserted by debenture owners who are not part of the settlement class.

X

Defendants are directed to reevaluate their contested claims pursuant to this opinion and to submit to the Court within ten days a revised list of any claims which are still contested after the ruling herein. They shall also, within thirty days, notify those claimants who have now been given an opportunity to correct their claims, of the existence of that opportunity.

Defendants are also directed to pay within ten days all the claims which they have previously conceded to be uncontested or which are now rendered uncontested by this opinion. Plaintiff may submit a proposed order.

MILLS v. FRUIT AUCTION SALES CO.

No. 6468

Court of Chancery of the State of Delaware, New Castle

October 1, 1981

Walter B. Mills, plaintiff and a stockholder of record of defendant corporation, Fruit Auction Sales Co., applied for an order to compel defendant to allow him to inspect and copy certain of defendant's books and records pursuant to DEL. CODE ANN. tit. 8, section 220 (1974). Plaintiff asserted that he sought the aforementioned materials in order to determine the value of his stock as well as to seek evidence of misapplication of corporate assets and of improper management of defendant. Defendant contended that plaintiff's true purpose for seeking the materials was to harass defendant into purchasing his stock and that such purpose was an improper one for invoking the remedies of DEL. CODE ANN. tit. 8, section 220 (1974). Alternatively, the defendant argued that even if the plaintiff's purpose was a proper one, he had received sufficient information in the form of balance sheets and income statements to discharge the corporation's duty under DEL. CODE. ANN. tit. 8, section 220 (1974).

The court of chancery, per Chancellor Marvel, held that the purpose for which the plaintiff requested the information was a proper one and ordered the defendant to produce the materials sought for in-

spection. The existence of an ulterior or improper motive was deemed to be irrelevant so long as a proper purpose was proven. The court also held that the financial statements previously provided the plaintiff were insufficient to fulfill his informational needs and thus did not fulfill the defendant's obligations under DEL. CODE ANN. tit. 8, section 220 (1974).

1. Corporations ⟹ 181(1)

As long as a proper purpose is proven for the request of information pursuant to DEL. CODE ANN. tit. 8, § 220, it is irrelevant that an ulterior motive may exist as well.

MARVEL, *Chancellor*

Plaintiff Walter B. Mills, a stockholder of record of Fruit Auction Sales Company, a corporation engaged in the business of auctioning fresh fruits and vegetables, seeks the entry of an order enforcing his claimed right to inspect and copy designated books and records of the defendant pursuant to the provisions of 8 Del. C. § 220. Plaintiff's stated purposes for seeking such inspection were to determine (1) the value of his stock in the defendant corporation, (2) whether or not improper transfers or payments of cash or other assets of the defendant had taken place, and (3) whether or not there had been general mismanagement of the defendant.

Defendant has refused to accede to plaintiff's demand for production on the ground that the latter's avowed purposes, as set forth in his demand letter, were not bona fide and that plaintiff's actual purpose in seeking to inspect and copy the books and records of Fruit Auction was to harass such corporation into purchasing his stock. This is the decision of the Court following trial.

Plaintiff Mills has been a shareholder of Fruit Auction for thirty-five years. He was a director of the company from 1946 through 1975 when he was ousted from the board. He controls approximately 20.4% of the 30,308 issued and outstanding shares of class A stock of the defendant, which is nonvoting. He owns no shares of the class B voting stock, all of which is owned by the corporation's six directors and is subject to a voting trust agreement. Class B shares are non-transferable, and the right to vote them is contingent on the owner thereof remaining on the board of directors. The class A shareholders have historically received no financial information concerning their corporation.

Petitioner contends that he was ousted from defendant's board of directors in 1975 merely because he had purchased additional Class A

stock. Thus, Mr. Denniston testified that Mr. Mills had told him in 1971 that his intent was to accumulate a large block of shares and then request the corporation to buy them back at a price in excess of what he had paid for such shares. He also allegedly told Denniston that he believed Fruit Auction was engaged in a declining business and that if the company refused to buy back his shares, he would bring a lawsuit to coerce the liquidation of the company.

Subsequently, plaintiff did approach the company to inquire whether it would be interested in buying back his shares for $12.00 per share in 1975 and 1976. He had paid $6.50 and $7.00 per share for such stock. However, the company declined to purchase the shares. Accordingly, in 1979, plaintiff had his lawyer, Paul Rodden, approach the firm as a shareholder requesting information without disclosing that he was acting as Mr. Mill's agent. According to defendant, plaintiff had actually provided the funds for Rodden to purchase Fruit Auction stock. In response to Rodden's request for information, the corporation sent him a balance sheet and a profit and loss statement for the year 1978.

It was apparently not until 1979, when Rodden and plaintiff jointly requested information, that the defendant corporation became aware of Rodden's connection with Mr. Mills. At this time, although not all of the requested materials were sent, a balance sheet and profit and loss statement for the year 1979 were provided.

The next sequence of events took place in 1980 when petitioner retained Frank R. Reynolds, a Chicago attorney, to approach Fruit Auction and to offer plaintiff's shares once again at $12.00 per share, threatening a lawsuit if the company did not buy. The demand letter followed, after which the board of directors of Fruit Auction unanimously determined not to respond to plaintiff's demand.

Defendant contends that even if it were to be assumed that plaintiff has demonstrated a proper purpose for the requested inspection, that he has in fact received sufficient information to place a value on his shares, such information being contained in the balance sheets and profit and loss statements furnished to plaintiff. However, I am satisfied that the information, which has been furnished to plaintiff, is entirely inadequate for evaluation purposes, even if, as in Neely v. Oklahoma Publishing Co., C.A. No. 5293 (Del. Ch. August 15, 1977), the plaintiff has no specific potential buyer in mind but rather has a desire to sell at some future time. Furthermore, in the cited case, the plaintiff had already received a great deal of information, and the Court simply refused to give her more. The issue was the extent of the information which should be provided one who generally wishes to

sell. The Court stated that the standard of limiting books and records to that "*** which is sufficient and essential . . . . stops short of including all books and records of a corporation and its subsidiaries but did not address the question as to what the minimum would be if the plaintiff had previously received little or no information. Defendant would have the Court decide that a long standing desire to sell one's shares back to the corporation which issued them ipso facto constitutes an improper purpose under section 220, citing Skouras v. Admiralty Enterprises, Inc., Del. Ch., 386 A.2d 674, 680 (1978). Defendant quotes a section from the opinion in the cited case to illustrate its contention that the present litigation is a mere pretext. However, counsel has omitted the following crucial portion of such opinion.

> *However, plaintiff further testified that he has contemplated bringing the present suit for over a period of ten years, and* a distinction must be drawn between a demand for inspection of books and records as a pretext for coercing a corporation into purchasing stock, and a statement that a possible basis for settlement of threatened litigation might lie in the purchase of such stock. In other words, I am satisfied that plaintiff's demand for inspection was not to compel a buy-out of his holdings but was to the effect that such a sale was a possible alternative to litigation. (emphasis supplied)

Plaintiff admittedly wants Fruit Auction to buy back his shares and has had such a transaction in mind for nine or ten years. He also testified that he has been concerned about the management of the company and the possibility of, *inter alia*, the payment of excessive salaries for fifteen years, dating back to the time when he was a director of Fruit Auction. In seeking to substantiate such charges, plaintiff may reasonably seek this Court's assistance in examining corporate records pursuant to 8 Del. C. § 220, and on the basis of such records file a suit for the appointment of a liquidation receiver. As long as there is just cause for such a suit and I believe there may be it is irrelevant that plaintiff may have some other ulterior purpose. As stated in the case of Skouras v. Admiralty Enterprises, Inc., supra.

> "[i]n addition, although the Court cannot, of course, read the thoughts of a stockholder, it must be satisfied that a plaintiff has successfully carried the burden of proving that the purpose behind his demand is proper. Once a proper purpose is established, it becomes irrelevant that the stockholder may have a secondary and perhaps questionable ulterior purpose behind his primary purposes. Western Air Lines, Inc. V.

Kekorian, Del. Supr., 254 A.2d 240 (1969), General Time Corporation v. Talley Industries, Inc., Del. Supr., 240 A.2d 755 (1968), and Skoglund v. Ormand Industries, Inc., Del. Ch., 372 A.2d 204 (1976)."

Plaintiff received profit and loss statements for the year 1978 and 1979 which I believe reasonably gave him cause for concern about the management of the corporation. In 1978 gross sales of $5,808,953, gross income of $456,060, and general administrative expenses of $453,115 were reported, leaving net income in the amount of $2,353. It is a similar story for the year 1979 although the information supplied was even more alarming, the corporation having reported a net loss of $14,331 on gross sales of $5,174,128.

I am of the opinion that in light of these bare bones profit and loss statements, plaintiff is entitled to allay or confirm his suspicions as to corporate mismanagement and the like through the furnishing of additional and more explicit information, Agency Rent-a-Car v. Gateway Industries, Inc., Del. Ch. C.A. No. 6109, July 21, 1980, Skouras v. Admiralty Enterprises, Inc., supra, Skogland v. Ormand Industries, Inc., supra and Nodana Petroleum Corporation v. State ex rel v. Brannen, Del. Supr., 123 A.2d 243 (1956).

Plaintiff has listed sixteen categories of documents which he wishes to inspect in order to determine the value of his shares and whether or not there have been improper transfers of assets of the corporate defendant or other mismanagement of such corporation. The documents requested include all minutes of meetings of the stockholders of Fruit Auction as well as minutes of meetings of such corporation's directors, and of any committee or subcommittee thereof, including all documents presented or considered at any such meeting. Also sought are all financial statements issued by the corporation, including all documents which record wages, bonuses, reimbursement for expenses, dividends or other distributions of any type or description made to any officer, director, agent or employee of the defendant corporation, including all documents reflecting expenses incurred by the defendant. In addition, all books and records pertaining to the business of Fruit Auction, including all contracts to which such corporation is a party or is expected to be a party, as well as all employment contracts and plans for the compensation of directors, officers and employees of Fruit Auction are also sought. I do not think that the production of the documents requested, which will not be recited in toto, would prove to be an onerous task for defendant.

Plaintiff, as noted above, has been a shareholder of Fruit Auction for 35 years, has served on the board of directors of the corporation,

and is at present owner of 20.4% of the outstanding class A stock of the corporation. He has reached an age at which he is anxious to liquidate his investment in Fruit Auction. And while Mr. Mills has in the past been devious and dilatory in his efforts to find out what, if any, mismanagement has been going on in the affairs of the defendant corporation and what his stock is worth, it must be borne in mind that statutes such as the one here in issue are designed primarily to protect the interests of stockholders and to keep them informed as to corporate activity which may affect their interests, 1970 Duke Law Journal, 393, 410, and the right to inspect is not to be denied merely because the stockholder plaintiff is on unfriendly terms with corporate management, Fletcher Cyclopedia on Corporations, § 2223 p. 728. Furthermore, plaintiff has not, in my opinion, waited too long to seek such inspection.

On notice, a form of order may be presented directing defendant to produce the books and records set forth in plaintiff's letter of demand dated April 20, 1981, such production to be made within 30 days from the date hereof.

ROIZEN v. MULTIVEST, INC.

No. 6535

Court of Chancery of the State of Delaware, New Castle

September 25, 1981

Plaintiff brought an action on behalf of himself and all other shareholders, other than the defendants, seeking an injunction to enjoin the consumation of a going-private merger. Plaintiff charges that the defendants have no proper purpose for the merger and that the merger price offered to the plaintiffs had not been properly or fairly determined.

The court of chancery, per Vice-Chancellor Brown, issued the preliminary injunction, holding that the directors of the corporation, who are one and the same as the majority shareholders, have the burden of proving the transaction to be fair to the minority. Furthermore, there was no evidence that the cash-out price was in any way ne-

gotiated or established through efforts of anyone representing the minority interests.

1. Corporations ⟹ 585

In an action seeking to enjoin a corporate merger, where there is no indication that the cash-out price was in any way negotiated or established through the efforts of anyone representing the interests of the minority shareholders, the individual defendants, as controlling shareholders have the burden of proving that the transaction is fair to the minority.

2. Corporations ⟹ 585

Injunctions ⟹ 151

In determining whether an applicant for a preliminary injunction will suffer irreparable injury if the preliminary injunction is denied, the court must also consider potential hardship to the parties enjoined.

BROWN, *Vice-Chancellor*

This case is presently before the Court on an application for a preliminary injunction which seeks to enjoin the consummation of a going-private merger. Plaintiff is the owner of 7,400 shares of the corporate defendant, Multivest, Inc. ("Multivest") and he purports to bring this action on behalf of himself and the class comprised of all shareholders in Multivest other than the four named individual defendants. Based upon the arguments and matters of record at this stage of the proceedings, I conclude that the preliminary injunction should be granted.

The individual defendants are Erwin I. Gold, James J. Groberg, James Grosfeld and Peter Kimmelman. Together, Gold, Groberg and Grosfeld own 63.2 per cent of the outstanding stock of Multivest, with Grosfeld himself owning 54.1 per cent. Kimmelman has subscribed for post-merger shares which would give him and his family a 15 per cent interest in the resulting corporate entity in the event the merger is not enjoined. On the other side of the coin, there are approximately 625 minority shareholders of Multivest who own a total of some 220,000 shares. Under the terms of the proposed merger, these minority shareholders are to be removed from the corporate enterprise in return for a cash payment to them of $6.50 per share.

Plaintiff charges that the merger price has not been fairly or properly determined, that there is no proper purpose for the merger

under current Delaware law, and that the individual defendants, who constitute the board of directors of Multivest in addition to being its combined majority shareholders, have breached their duty of candor by misrepresenting and omitting germane facts in the proxy statement disseminated to the minority shareholders in connection with the merger. I find it necessary to treat only the first two of these contentions in reaching my decision. The applicable facts are set forth hereafter.

There are two major areas of concern which enter into the proposed transaction. First, Multivest is the general partner in a series of limited partnership which own substantial real estate interests. Some of these partnerships are apparently in the process of being liquidated. Multivest's interests in these partnerships are said by plaintiff to carry the potential for $9 million to $12 million in management and brokerage fees, particularly in the event of the eventual liquidation of the several partnerships. At this point, the defendants do not necessarily agree with these figures.

Secondly, Multivest is engaged in ongoing litigation on several fronts. There is a purported class action suit against it in Michigan seeking damages in the sum of $20 million which is apparently scheduled for trial in October. Multivest is also engaged in precious metals activities, which business has spawned numerous smaller lawsuits against it. In addition, the Commodity Futures Trading Commission is said to be considering regulations which could conceivably wipe out Multivest's substantial current business dealings with leverage contracts in the field of precious metals.

Against this backdrop must be weighed the following series of events. To begin with, it seems clear that the defendant Grosfeld has favored the return of Multivest to the status of a private company for some time. (Apparently, Multivest was originally a privately owned corporation and picked up its public shareholder status by merging with a company having public shareholders.) However, as recently as March 11, 1981, Multivest's board—then composed of only two directors, namely, the defendant Gold and a Mr. Phillips—determined that it would not be in the best interests of Multivest to go private at that time because of the uncertainties of the various litigation matters in which the company was then involved.

Some ten days thereafter, the defendant Grosfeld obtained proxies from two other shareholders which, together with his ownership interests at the time, enabled him to exercise majority shareholder voting control. He then adopted consent resolutions to increase the board of directors to four and named himself and the defendant Kim-

melman as the additional directors. Several days later, the board was increased to five, and the defendant Groberg was named a director as well as being named chairman of the board. Eight days later, on April 21, 1981, Phillips resigned, leaving the four individual defendants in control of the company. Six days later, the newly constituted board met and determined to take the company private. On May 20, 1981, the board unanimously approved a form merger agreement which would accomplish this purpose.

While these developments may hardly seem onerous standing alone, they take on significance when weighed against that which came thereafter. Specifically, according to the present status of the record, the decision that $6.50 per share would be "fair" to the minority was reached by the individual defendants in their capacity as Multivest's board of directors. Under the merger plan, the funds to pay off the minority shares are to come from the corporation itself. In this regard, it is to be remembered that once the merger is concluded, the four individual defendants will end up owning the corporation. Thus it is simple logic that each dollar saved in paying off the minority shareholders will ultimately inure to the benefit of those who have made the determination as to what is a "fair" price for the minority to receive.

This circumstance becomes significant by virtue of the fact that in arriving at the $6.50 price the defendant board members relied primarily on recent private sales and purchases of Multivest stock which had been in the area of $6.00 per share. There is no active market for Multivest shares and no recent trading history to evaluate other than the handful of private transactions. And although the defendants view these transactions to be the result of arm-length bargaining, plaintiff contends that one or more of them involved the corporation's purchase of stock from former employees who were terminating their relationship with the company, thus indicating that there were other possible factors which could have had a bearing on the price paid for the stock. It is to be noted that Multivest's book value exceeds $11.00 per share.

Also, in arriving at the $6.50 figure, the defendants took the position that the potential income to Multivest from the real estate partnerships and the potential litigation liability, as well as the status of certain long-term debt obligations, were "unquantifiable" and no range of values was assigned to any of the three, even though heavy reliance was placed on the litigation and partnership elements in the proxy statement in the process of urging the fairness of the $6.50 merger price.

In addition, defendants obtained the opinion of Drexel Burnham Lambert Incorporated that the $6.50 price was fair. However, Drexel Burnham did not make an independent analysis of Multivest to determine on its own what a fair price would be. Rather, it was content on the limited information available to approve the price determined by the board which, in so doing, had simply concluded that the various unquantifiable factors were probably sufficient to push the adjusted book value of Multivest down below $6.00 per share. At least the present status of the record would appear to so indicate.

As to the purposes for the merger as set forth in the proxy statement, they are unusual, albeit candid in nature. For one thing, it is suggested that the public shareholders "have not achieved the benefits which normally derive from public ownership of a corporation," thus suggesting that the minority is being eliminated for its own good. It is further stated that "continued public ownership of the Company is detrimental to the Company's best interests." For example, it is said that the company needs to diversify and in so doing will require additional funding from its principal investors "which might not be forthcoming if the Company remains publicly held." The "principal investors" are conceded to be the defendants Grosfeld and Kimmelman. Moreover, discovery has revealed that Multivest has no present plan to diversify and thus no current funding needs for that purpose.

It is also stated that private ownership of Multivest will enhance its ability to attract and retain experienced management and eliminate the $65,000 per year expense (or over $100 per shareholder) that is required to maintain public ownership. It is also stated that Multivest's principal competitors are privately held, thus placing Multivest, as a publicly held company, at a competitive disadvantage. Arguably, all of these reasons can be said to boil down to the proposition that for general business purposes it will be in the best interests of the individuals who comprise the board of directors—and who look to own the company entirely after the merger—to remove the minority shareholders from the corporation.

In structuring the terms of the merger, no independent person was designated to negotiate on behalf of the minority and no investment banker was retained to determine what a fair price for the minority would be. The transaction was not structured so as to require the vote of a majority of the minority interest. While none of these machinations are mandatory, their absence lends a certain amount of color to the overall picture. In addition, of the some 220,000 minority shares outstanding, only about 97,000 voted on the merger. Of these, approximately 85,000 voted in favor, thus meaning that less

than 40 per cent of the outstanding minority shares actually voted to approve the terms of the merger.

Finally, plaintiff argues that there has been no showing by the defendants of any needs for rushing the merger through on such an expedited basis. Rather, he suggests that the defendants are attempting to do so now so as to take advantage of the so-called "unquantifiable" factors, and thus, for example, before it becomes unarguably evident that Multivest is about to receive millions in income as a result of the partnership liquidations and before it is established that the greatly feared liability exposure in the Michigan class litigation is far less than the $20 million in damages being sought. Why else, he suggests, would the defendants attempt to effectuate the cash-out merger within a month of the very trial that could well help to clarify the whole situation.

[1] Considering the overall picture, I am convinced that the preliminary injunction should issue. This is not just a situation where the board of directors agreeing to the terms of a cash-out merger is controlled or dominated by a majority shareholder. Here, the board and the majority shareholders are one and the same. Under this situation, and particularly where there is no indication that the cash-out price was in any way negotiated or established through the efforts of anyone representing the interests of the minority shareholders, the individual defendants, as controlling shareholders, have the burden of proving that the transaction is fair to the minority. *Sterling v. Mayflower Hotel Corp.*, Del. Supr., 93 A.2d 107 (1952).

Given the conflicting position in which the individual defendants necessarily find themselves, the manner in which the cash-out price is said to have been established, and the reasons given to justify the removal of Multivest's public shareholders, I am persuaded on the present record and arguments that plaintiff has demonstrated a likelihood that he will prevail at final hearing and that the defendants will be unable to show the entire fairness of the transaction to the minority shareholders under the principles established in *Sterling v. Mayflower Hotel Corp.*, *supra*; *Singer v. The Magnavox Co.*, Del. Supr., 380 A.2d 909 (1977); and *Tanzer v. International General Industries, Inc.*, Del. Supr., 379 A.2d 1121 (1977).

[2] Furthermore, under the guidelines set forth in *Gimbel v. Signal Companies, Inc.*, Del. Ch., 316 A.2d 599, *aff'd*, Del. Supr., 316 A.2d 619 (1974) I am also persuaded that the likely harm to the interests of the minority shareholders if the merger is permitted to go through is such that it warrants the imposition of injunctive relief at

this point against the consummation of the merger. This is balanced against the fact that the defendants have shown no pressing need to have the merger consummated with regard to any time deadline or any specific business purpose or activity.

Accordingly, a preliminary injunction will issue enjoining the consummation of the merger pending further order of the Court. The matter of a bond was not touched upon during oral argument. Therefore, for present purposes the amount of the bond is fixed at $10,000, with corporate surety required. If counsel wish to be heard further as to the amount of the bond, they may make the necessary application. Counsel for plaintiff may submit a form of order.

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CORPORATE CONFIDENTIALITY: PROBLEMS AND DILEMMAS OF CORPORATE COUNSEL

BY ROBERT J. WILCZEK *

The public outcry for more responsible corporate governance has left both the corporate director and corporate counsel in unenviable positions. Directors have been charged with increasing responsibilities to shareholders, consumers, and the investing public—responsibilities which demand competent legal advice. Yet they may be deterred from seeking needed legal counsel by developments which have obscured the traditional protections of the attorney-client privilege. Similarly, increasingly high standards of professional responsibility have been asserted to apply to corporate counsel, creating confusion over just what those responsibilities are and to whom the corporate attorney owes his loyalty. The Supreme Court's celebrated decision in *Upjohn Co. v. United States* [1] made major strides in clarifying the scope of the privilege in the corporate context. Nonetheless, it left important questions unanswered, and did not address other basic questions involving the relationship of an attorney to the corporation he represents. It is the purpose of this article to explore these problems in light of the legislative, judicial, and regulatory trends which have expanded directors' responsibilities and confused the duties and loyalties of corporate counsel.

I. DIRECTORS' DUTIES AND LIABILITIES

Conceptually, directors' duties can be divided into two spheres—those which have their genesis in the common law and those which find their roots in federal, state, or local regulatory schemes.

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1. 449 U.S. 383 (1981).